



**Pharr Valuation and
Business Services, LLC**

Business Valuation

Succession Planning

Gift and Estate Tax Considerations

Given the impact of recent and continuing economic conditions on the jewelry industry as a whole and the decrease in value of many companies related to the industry, now is the time to consider a valuation of your company in conjunction with your succession, gift and estate tax planning.

Many companies within the jewelry industry are closely held, family owned businesses. As the owners approach retirement age and older, there becomes a need for succession planning to insure an orderly transition and to minimize gift and estate taxes. Gift tax laws will be changing in the next year and a half, if not sooner, and probably not for the better. You need to involve an attorney knowledgeable in gift and estate tax planning, your accountant and an accredited valuation analyst in this process.

Gifts of an interest in a closely held, family owned business to the next generation accomplishes two goals. First you can use the annual exclusion and lifetime exclusion to transfer business interest to your heirs with no gift or estate tax consequences. Second, by transferring the interest in the business, you take future appreciation in the gifted interest out of your estate.

The economy, the stock market and business conditions have not been kind to our industry. Sales and profits are as low as they have been in recent history. This translates into lower overall company values. When values are low, a larger interest in the business can be gifted than when values are higher, before having to pay gift taxes. Reviewing or beginning your gift and estate tax planning now may reduce those taxes in the future.

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When valuing an interest in a closely held, or family owned business for gift and estate tax purposes, IRS regulations require an independent valuation of the company by a business valuation analyst to determine the value of the interest being gifted. The valuation analyst must be credentialed by the American Institute of Certified Public Accountants, the National Association of Certified Valuation Analyst or other qualified organization. The valuation report will be attached to the gift or estate tax return that is filed with the IRS.

In performing the valuation of a business, the valuation analyst will consider the following valuation approaches:

- The **market approach** compares the subject company to publically owned companies. This approach is often rejected. Finding truly comparable companies is can be difficult.
- The **asset approach** adjusts the assets and liabilities to actual market values. The valuation analyst is valuing the company as a whole. He does not appraise assets such as inventory and equipment. While these assets could be valued by the business owner, an appraisal performed by a qualified appraiser gives an independent appraisal and therefore increases the reliance the valuation analyst can put on those values.
- The **income approach** analyzes income and cash flows over several years and applies capitalization or discount rates to determine the company's value based on the cash flows.

Once the valuation method has been selected, premiums and/or discounts will generally be applied to the estimate of value. For gift and estate tax purposes, fair market value must be used as the standard of value. If a minority interest is being gifted, a minority interest discount would be applied. A hypothetical purchaser would not pay full value for an interest in which he had no say or control over what business decisions were made and would discount the amount he was willing to pay for the interest. A discount for lack of marketability is taken when valuing closely held businesses. When an individual owns shares in a publically traded company, he can sell the shares and generally have the money in three days. Selling an interest in a closely held business can take many months or longer. A hypothetical buyer wants to be compensated for the additional time and risk he will incur. These discounts also apply to valuing companies for gift and estate tax purposes.

Determining the business value is both art and science. Selecting a valuation analyst who has knowledge of the industry is an important factor.

Having your jewelry business valued by an accredited valuation analyst when doing your succession, gift and estate tax planning is an important piece of the process. Proper gift and estate tax planning done with your attorney in conjunction with a professional business valuation can save substantial amounts of gift and estate taxes. It is in your best interest to review or begin the planning process now.

Daniel Pharr is the President of Pharr Valuation and Business Services, LLC. He is a CPA and Accredited in Business Valuation (ABV) by the American Institute of Certified Public Accountants. He is a Certified Valuation Analyst (CVA), a certification awarded by the National Association of Certified Valuation Analyst (NACVA). Dan has 30 years of jewelry industry experience as an auditor, EVP and CFO of a manufacturing company, and business valuation analyst. His practice focuses business valuation of family owned and closely held companies within the jewelry industry. He may be contacted at Dan@PharrValuation.com or 804-332-5458.