

BUSINESS VALUATION UPDATE

TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

Current Observations on the Valuation Impact of the TCJA

At the AICPA Forensic & Valuation Services (FVS) Conference this past November in Atlanta, there were a number of sessions on the Tax Cuts and Jobs Act (TCJA). *BVU* attended all of these sessions and also talked with practitioners outside of the sessions, collecting some thought-provoking observations on how the new tax law is impacting valuations. Practitioners are still grappling with understanding the new law's many provisions, so this list is certainly not exhaustive, and the thinking will continue to evolve.

Known or knowable issue. In a litigation setting, there may be disputes over what was "known or knowable" if you have a valuation date between the dates President Trump was elected and when the new tax law was passed. Some practitioners will factor in a pre-enactment expectation into their valuations. What to do? Take a position and stick to it.

Plans for increased cash flow. It is now necessary to have more consultative conversations with management over its plans in light of the new law changes that overall will increase a company's cash flow. But not all of this extra cash will go to the bottom line. The company may increase wages, accelerate capital expenditures, invest in R&D, and the like. Are these plans reflected in the projections you get from management? Will the company change its capital structure? For fair value purposes, do these plans translate into what market participants might do? These are just some of the questions to think about.

Cost of capital. There will be minor effects on the cost of equity and larger effects on the cost of debt due to interest expense limitations, so the impact to WACC will depend on the level of debt.

Guideline transaction method. This method will be more difficult to apply because of the different tax regimes, but there is a model¹ that converts older transactions and adjusts the multiples.

The five-year DCF. Although the tax effects of certain provisions extend more than five years out, you can still do a standard five-year DCF and use separate analysis modules for the cash flow effects of those provisions, such as bonus depreciation or the interest expense limitation. You would add the main DCF to the separate DCF analyses to get the overall valuation.

Use of PTE models. Existing PTE valuation models can be used if you adjust for the new tax rates (and, for some, their temporary nature) and QBI deduction. The article and webinar in Footnote 1 explain how the Van Vleet SEAM model is adjusted.

¹ See Daniel R. Van Vleet, ASA, and William P. McInerney, "Valuing C Corps and Pass-Through Entities Under the New Tax Law," *American Society of Appraisers Business Valuation Review*, ASA, Spring 2018, Volume 37, Issue 1; also see Daniel R. Van Vleet, ASA, 2018 Tax Cuts and Jobs Act: Impact on Valuations of C Corps and Pass-Through Entities, BVR Webinar, Feb. 8, 2018. Both available from BVR's BVRresearch Pro at bvresources.com/products/bvresearch.

BUSINESS VALUATION UPDATE

Publisher: Sarah Andersen
Managing Editor: Monique Nijhout-Rowe
Senior Copy Editor: David Solomon
Desktop Editor: Warren Simons
Customer Service: Melissa Snow

Executive Editor: Andrew Dzamba
Executive Legal Editor: Sylvia Golden, Esq.
Chief Revenue Officer: Lisa McInturff
President: Lucretia Lyons
CEO: David Foster

EDITORIAL ADVISORY BOARD

R. JAMES ALERDING, CPA/ABV, ASA ALERDING CONSULTING LLC INDIANAPOLIS, IN	JARED KAPLAN, ESQ. DELAWARE PLACE ADVISORY SERVICES, LLC CHICAGO, IL
CHRISTINE BAKER, CPA/ABV/CFP ADVANCED ARCHITECTURAL PRODUCTS LLC ALLEGAN, MI	HAROLD G. MARTIN JR. CPA/ABV/CFP, ASA, CFE KEITER GLEN ALLEN, VA
NEIL J. BEATON, CPA/ABV, CFA, ASA ALVAREZ & MARSAL VALUATION SERVICES SEATTLE, WA	GILBERT E. MATTHEWS, CFA SUTTER SECURITIES INC. SAN FRANCISCO, CA
JOHN A. BOGDANSKI, ESQ. LEWIS & CLARK LAW SCHOOL PORTLAND, OR	Z. CHRISTOPHER MERCER, ASA, CFA MERCER CAPITAL MEMPHIS, TN
ROD BURKERT, CPA/ABV, CVA BURKERT VALUATION ADVISORS LLC MADISON, SD	JOHN W. PORTER, ESQ. BAKER & BOTTS HOUSTON, TX
DR. MICHAEL A. CRAIN, CPA/ABV, CFA, CFP FLORIDA ATLANTIC UNIVERSITY BOCA RATON, FL	RONALD L. SEIGNEUR, MBA, ASA, CPA/ABV, CVA, CFP SEIGNEUR GUSTAFSON LAKEWOOD, CO
MARK O. DIETRICH, CPA/ABV FRAMINGHAM, MA	ANDREW STRICKLAND, FCA SCRUTTON BLAND UNITED KINGDOM
JOHN-HENRY EVERSGERD, ASA, CFA, MBA FTI CONSULTING SYDNEY, AUSTRALIA	EDWINA TAM, ASA, CBV DELOITTE HONG KONG
NANCY J. FANNON, ASA, CPA, MCBA MARCUM LLP PORTLAND, ME	JEFFREY S. TARBELL, ASA, CFA HOULIHAN LOKEY SAN FRANCISCO, CA
JAY E. FISHMAN, FASA, FRICS FINANCIAL RESEARCH ASSOCIATES BALA CYNWYD, PA	GARY R. TRUGMAN, ASA, CPA/ABV, MCBA, MVS TRUGMAN VALUATION ASSOCIATES PLANTATION, FL
LYNNE Z. GOLD-BIKIN, ESQ. WEBER GALLAGHER NORRISTOWN, PA	KEVIN R. YEANOPILOS, CPA/ABV/CFP, ASA BRUEGGEMAN & JOHNSON YEANOPILOS PC TUCSON, AZ
LANCE S. HALL, ASA STOUT RISIUS ROSS IRVINE, CA	
THEODORE D. ISRAEL, CPA/ABV/CFP, CVA ISRAEL FREY GROUP LLP SAN RAFAEL, CA	

Business Valuation Update™ (ISSN 2472-3657, print; ISSN 2472-3665, online) is published monthly by Business Valuation Resources, LLC, 111 SW Columbia Street, Suite 750, Portland, OR 97201-5814. Periodicals Postage Paid at Portland, OR, and at additional mailing offices. Postmaster: Send address changes to *Business Valuation Update* (BVU), Business Valuation Resources, LLC, 111 SW Columbia Street, Suite 750, Portland, OR 97201-5814.

The annual subscription price for the BVU is \$459. Low-cost site licenses are available for those who wish to distribute the BVU to their colleagues at the same firm. Contact our sales department for details. Please contact us via email at customerservice@bvresources.com, phone at 503-479-8200, fax at 503-291-7955 or visit our website at bvresources.com. Editorial and subscription requests may be made via email, mail, fax or phone.

Please note that, by submitting material to BVU, you grant permission for BVR to republish your material in this newsletter and in all media of expression now known or later developed.

Although the information in this newsletter has been obtained from sources that BVR believes to be reliable, we do not guarantee its accuracy, and such information may be condensed or incomplete. This newsletter is intended for information purposes only, and it is not intended as financial, investment, legal, or consulting advice.

Copyright 2019, Business Valuation Resources, LLC (BVR). All rights reserved. No part of this newsletter may be reproduced without express written consent from BVR. Please direct reprint requests to permissions@bvresources.com.

Reasonable compensation. The QBID has changed the compensation game for PTEs, which may want to boost W-2 compensation to trigger the new 20% deduction.

Alimony deduction. Valuation experts and attorneys feel that the IRS will follow a strict interpretation of the rule that eliminates the deduction for alimony payments that became effective Dec. 31, 2018. That is, a marital settlement agreement must be approved by the court or signed—not just agreed to by the parties—before that date for the alimony to be deductible.

Divorce settlements. In addition to the alimony deduction, dependency exemptions and the deductibility for divorce-related professional fees have been eliminated. But practitioners should not assume that effective tax planning is no longer a critical element to marital settlements.

Marginal vs. effective tax rates. Before the TCJA, most C corps were not paying the 35% effective tax rate—and post-TCJA they will not pay at the 21% effective rate.

State income taxes. Not all states have adopted all of the TCJA provisions, so make sure you research what constitutes taxable income in the subject company's state.

Special industry breaks. A number of industries get special tax breaks under the new law. For PTEs, service firms get different treatment than nonservice firms. Also, there are special provisions for REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income.

Risk in sunset provisions. Some provisions will sunset, so, once those dates approach and it's unclear whether or not they will be renewed, how do you handle this? Does this add a higher element of risk? Should you reflect this in the terminal value in a DCF? Congress usually extends provisions that are set to sunset, but will it do that this time?

Consider the use of EBITDA. Under this new tax environment, consider using an EBITDA single-period income capitalization.²

Role of the tax professional. Speakers went through a great deal of the mechanics of the new tax law's provisions. While you should have an understanding of the details, consult with a tax professional over how the new law applies to your subject company. For example, is the company a "service" business with respect to the new QBI deduction for pass-through entities? Service and nonservice PTEs have different tax pictures under the new tax law.

Valuation reports. Analysts may need to include more material in their valuation reports that explains the tax issues involved and supports the conclusions of the effect on the valuation.

Big picture. Don't lose sight of the notion that, overall, companies are more valuable than before the new tax law was passed. It appears that C corps have had a greater boost in value than

PTEs in general. PTEs that are service businesses no longer enjoy as much of a value advantage while nonservice PTEs continue to have a material tax-related benefit—for now, anyway.

The primary sessions at the AICPA conference that covered the new tax law were:

- Valuation Tax Panel; Robert F. Reilly (Willamette Management Associates), James R. Hitchner (Financial Valuation Advisors), and Z. Christopher Mercer (Mercer Capital);
- How Tax Reform Is Impacting Divorce Litigation; Hubert Klein (EisnerAmper) and Randall Kessler (KS Family Law);
- Dissecting Section 199A; Anthony Nitti (WithumSmith+Brown); and
- Impact of Tax Reform on 805/350 Analyses; Mark L. Zyla (Acuitas Inc.).

Recordings of these sessions and all of the sessions from the conference are available on the AICPA website.³ ♦

² See Z. Christopher Mercer, ASA, CFA, "EBITDA Single-Period Income Capitalization for Business Valuation," *Business Valuation Review*, American Society of Appraisers, Fall 2016, Volume 35, Issue 3. Available from BVR's BVRResearch Pro at bvresources.com/products/bvresearch.

³ aicpaconferences.com/aicpa/conferences/951/view/1?aicpa/conferences/951/view.