# Business Valuation

Revenue Ruling 59-60, 1959-1 CB 237 sets forth the factors to be considered in valuing a closely held business for death tax purposes. They are as follows:

- The history and nature of the business, i.e., the risk and the stability of the business.
- The economic outlook in general, as well as for this industry.
- The book value of the company.
- The company's earning capacity.
- The capacity to pay dividends (not its dividend paying history).
- The goodwill of the company.
- Any recent sales of company stock.
- The value of similar businesses which are publicly traded.

## A Formula for Valuing Goodwill

| | | |
|---|---|---|
| 1. | Value of tangible assets | $_____________ |
| 2. | - Liabilities | (_____________) |
| 3. | = **Net value of tangible assets** | _____________ |
| 4. | x Industry percentage return [1] | x _____%[1] |
| 5. | = **Annual earnings attributable to assets** (line 3 x line 4) | _____________ |
| 6. | Average annual earnings of company[2] | _____________[2] |
| 7. | **Earnings from goodwill** (line 6 minus 5) | _____________ |
| 8. | ÷ Capitalization rate[3] | ______%[3] |
| 9. | = **Goodwill** (line 7 ÷ line 8) | _____________ |
| 10. | **Goodwill plus net value of assets** (line 9 + line 3) | $_____________ |

[1] Industry percentage return: 8% should be used with stable, low-risk businesses and 10% with more hazardous, high-risk businesses.

[2] The average annual net earnings amount is computed on all the years of operation up to five. This should be before taxes and personal compensation to the owners.

[3] Revenue Ruling 68-609 recommends a capitalization rate of 15% for low-risk, stable businesses and 20% for hazardous, high-risk businesses.

## Projected Future Growth

| | | | | | | |
|---|---|---|---|---|---|---|
| ____Years | _____% Growth | $_________ | x | $_________ | = | _________ |
| | | Current Business Value | | Compound Interest Factor | | Projected Business Value |

**Note:** This is not intended to replace a qualified appraisal.