

Valuation Insights

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Did you know?

The number of SBA backed 7A loans dropped 30% in 2008 from 99,606 in 2007 to 69,434 in 2008. However, the loan dollar amounts only dropped 11%, from \$14.29bln to \$12.67bln during this same period.



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SBA To Provide Further Guidance on Goodwill in Lending Practices

The SBA recently enacted new updates to the SOP known as SOP 50 10 5(A) which were effective March 1, 2009. The section of the SOP relating to financing of business acquisitions was modified as follows regarding guidance on the amount of goodwill that may be financed:

“Goodwill:

If the purchase price of the business includes goodwill (or “blue sky”), the lender should explore seller-financing with a subordinate lien to the SBA-guaranteed loan.

The lender may finance a limited amount of goodwill. In no event may the amount of goodwill financed by an SBA guaranteed loan exceed 50% of the loan amount up to a maximum of \$250,000.

If any of the loan proceeds will be used to finance goodwill, the amount must be specifically identified in the Use of Proceeds section of the Authorization.”

Needless to say, the SBA was inundated with comments from SBA lenders, business brokers and business appraisers who were concerned that this new guidance would have a negative impact on their businesses. Most agreed that, based on historical data, approximately 60% to 80% of the loans previously granted would not have qualified under the new goodwill restrictions. Non-asset intensive businesses (e.g. service businesses, professional practices, etc.) and other high profit, low hard asset type businesses appear to be penalized by this restriction. Thus, lenders, brokers and appraisers were very concerned that this would put a halt to business acquisitions at the exact same time that the Federal government was trying to stimulate lending.

In response to the multitude of concerns voiced, the SBA issued an “11th hour” statement in late February that they have decided to begin collecting information specific to the financing of goodwill in business acquisitions to determine how the current guideline will impact business acquisitions. The SBA also stated that until August 31, 2009, all SBA loans where goodwill exceeds the above guidelines will be submitted for review and analyzed on a case-by-case basis. The SBA has stated that they will gather information on the types of business and transaction structures submitted and will then provide further guidance on the “goodwill” issue.

So, stay tuned...we’ll keep you updated as to how the “goodwill dilemma” unfolds.



Estate of Erma V. Jorgensen, Deceased, Jerry Lou Davis, Executrix, and Jerry Lou Davis and Gerald R. Jorgensen, Co-Trustees, Petitioner vs. Commissioner of Internal Revenue, Respondent, T. C. Memo 2009-66, March 26, 2009.

The Facts: Colonel Gerald Jorgensen passed away on November 12, 1996. He was survived by his wife Erma Jorgensen and his children Jerry Lou Davis and Gerald Jorgensen. Mr. and Mrs. Jorgensen were frugal and thrifty having been raised during the Great Depression. Prior to his death in November of 1996, Colonel Jorgensen made all financial decisions related to the family, their revocable trusts, signed in 1994, and of the family limited partnership named the Jorgensen Management Association (JMA-I), which was formed on May 19, 1995. JMA-I was funded by both Colonel and Mrs. Jorgensen who each contributed \$227,644 of marketable securities to the family limited partnership in exchange for a 50% limited partnership interest. The couple's children, Gerald and Jerry Lou, along with Colonel Jorgensen were the general partners. In addition, Gerald, Jerry Lou and their combined six children were all listed as limited partners and received their initial interests by gifts although no gift tax return was ever filed for these gifts.

After Colonel Jorgensen's death, the couple's estate planning attorney wrote to Ms. Jorgensen and recommended that the estate claim a 35% discount on Colonel Jorgensen's interest in JMA-I. The estate's interest in JMA-I passed into Colonel Jorgensen's family trust - which was funded with \$600,000 of assets including JMA-I interests valued using minority and marketability discounts. All amounts over \$600,000 were transferred to Ms. Jorgensen. In subsequent letters, the couple's estate planning attorney recommended that Ms. Jorgensen transfer her brokerage accounts into JMA-I and explained reasons for doing so including reducing the chance of an IRS audit on the 35% discounts previously taken by the estate and potential audit and tax savings on Ms. Jorgensen's own estate. No formal valuation of the estate's assets was completed.

Ms. Jorgensen never met personally with their estate planning attorney to discuss these issues. Instead, all financial decisions were made by the attorney, Gerald, Jerry Lou and Jerry Lou's husband. On July 1, 1997, JMA-II was formed to primarily hold high basis assets with the original JMA-I to hold basically low basis assets. On July 28, 1997, Ms. Jorgensen funded the partnership with \$1,861,116 in marketable securities. In addition, Ms. Jorgensen personally contributed another \$22,019 of marketable securities, money market funds and cash to JMA-II in August of 1997 and acting, as executrix of Colonel Jorgensen's estate, transferred \$718,350 from his brokerage account that also consisted of marketable securities, money market funds and cash. Once all contributions were made, Ms. Jorgensen held a 79.6947% interest in JMA-II and Colonel Jorgensen's estate held a 20.3053% interest. Gerald and Jerry Lou were the general partners and Gerald, Jerry Lou and their children were listed as the limited partners. The children and grandchildren again received their interests in the partnership as gifts from Ms. Jorgensen. The value of the interests was determined using the value of the securities held by JMA-II on November 12, 1997 (although the interests were transferred in the summer of 1997). On the basis of their values in the summer of 1997, all gifts exceeded the \$10,000 gift tax exclusion so gift tax returns were therefore required, but none were filed.

Mrs. Jorgensen passed away on April 25, 2002, and Gerald and Jerry Lou filed her Form 706 Estate Tax Return and claimed discounts for both JMA-I and JMA-II.

The Arguments: The IRS claimed that the discounts should be disallowed for several reasons including the following:

1. No Partnership books and records other than a checkbook were maintained for either Partnership;
2. Checkbooks were never reconciled;
3. The Partnership never held formal meetings or kept meeting minutes;

4. The Partnership and Ms. Jorgensen's funds were co-mingled and used interchangeably by Ms. Jorgensen at her discretion;
5. Partnership funds were used to pay Ms. Jorgensen's personal expenses; and
6. Partnership funds were used for Ms. Jorgensen's personal gifts to her children and grandchildren.

In addition, the IRS argued that neither Partnership had a valid non-tax purpose despite several arguments including, but not limited to; management of partnership assets, financial education of family members and promotion of family unity, and perpetuation of the Jorgensen's investment philosophy and motivating participation in the Partnerships presented by the petitioner.

The Findings: The Court determined that inclusion under Sec. 2036(a) of the code is applicable when (i) there is a transfer of property, (ii) there is not a bona fide sale for full and adequate consideration and (iii) the decedent retains an interest in the gifted property as described under Sec. 2036(a). The Court determined that there were transfers of property; however since Ms. Jorgensen stood on "both sides of the transaction" there was no bona fide sale for full and adequate consideration. In addition, the Court felt Ms. Jorgensen retained an interest in the gifted property as she continued to use Partnership assets to meet her needs.

Accordingly, the Court disallowed all discounts and assessed a deficiency of \$796,954 on the estate. However, because the children had received assets and paid income tax in the years 2003-2006 on sales of assets later included in the estate of Ms. Jorgensen, the Court determined that the estate was entitled to an offset for the income taxes paid by the children (as the basis in these assets was higher once valuation discounts were disallowed in this instance).

Parting Thoughts: Colonel Jorgensen, who did most of the investing, adhered strongly to a buy and hold policy so there was never a significant amount of active trading and portfolio management. I found it interesting that in analyzing the business purpose of these Partnerships, the Court stated that "the mere holding of an untraded portfolio of marketable securities weighs against the finding of a nontax benefit for a transfer of that portfolio to a family entity". The Court also stated that "the General Partners management of JMA-I's and JMA-II's portfolios of marketable securities was not active, therefore management succession was not a legitimate reason for Ms. Jorgensen's transferring the bulk of her assets to the partnerships."



Estate Tax Legislative Update

There are several pieces of proposed legislation regarding estate tax reform being "kicked around" with the most publicized being HR 436 - aka the Pomeroy bill. What changes will be made to the estate exemption and estate tax rate(s)? Will there be any reform/elimination of valuation discounts for FLPs and LLCs? Don't worry, we'll keep you informed of the latest developments in this area throughout the year.



Cubs Corner: There's nothing like the start of a new baseball season. Every fan has high expectations for their team. Even fans of the bad teams last year have hopes that their team will do a 180 degree turnaround like the Tampa Bay Rays were able to accomplish last year. For Cubs fans like myself, expectations are very high this year. Barring major injuries, most expect the Cubs to win the NL Central again and get into the playoffs. However, we are all hoping they will fare much better than they have over the last two years (being swept in the first round of the playoffs in each of the last two years). They have opened the season with an 8-4 record and are currently tied with those dreaded Cardinals for first place. Piniella has the team playing very well. They are definitely are a more balanced team this year as they have added a few left handed bats into the mix. I'll keep you posted on my team thoughts as the season progresses. Go Cubs!!!



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About Mack Business Appraisals, LLC

Mack Business Appraisals, LLC is an experienced valuation firm that provides expert business valuation services to businesses across the United States for various purposes including, but not limited to: gift and/or estate tax, merger and acquisition, ESOP's, FASB 141/142, buy-sell agreements, S-corporation election, SBA funding, stock option granting and management planning purposes. Mack Business Appraisals, LLC also has extensive experience in valuing family limited partnerships (FLP's) and limited liability companies (LLC's) for gift and estate tax purposes.

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