A Valuation Practitioner's Perspective of the *Discount for Lack of Marketability Job Aid for IRS Valuation Professionals*

by Kevin M. Zanni, ASA

Author's Note: If you are a business appraiser, by now you should be aware of the Discount for Lack of Marketability Job Aid for IRS Valuation Professionals ("Job Aid"). As a professional it is important to keep abreast of evolving professional guidance.

The Job Aid represents evolving professional guidance related to gift and estate tax valuations from the standpoint that (1) it is a recently released (to the public) reference tool with respect to business investment marketability and (2) it provides new insights from the Internal Revenue Service (the "Service") related to investment marketability. As the Service is the primary intended audience for valuation work performed for estate and gift tax purposes, its perspective is important.

Much of my professional valuation practice involves estimating the value of business interests, specifically for tax-related purposes. More specially, my valuation reports are often filed as an attachment to federal estate tax and gift tax returns. In the normal course of the valuation analysis, I often have to apply a lack of marketability adjustment.

In this article, I discuss the Job Aid. I provide (1) a summary of the Job Aid along with my interpretation of certain of the Job Aid positions and (2) discuss the general reaction from the valuation profession with respect to the Job Aid.

Background and Introduction of the Job Aid

In June 2008, the Internal Revenue Service (the "Service") formed a team to research and analyze the most current approaches used by taxpayers to estimate the Discount for Lack of Marketability (DLOM). The intended purpose of the project was to explore and develop information to assist its internal valuators in the Large and Mid Size Business Engineering program to deal with the DLOM used in valuation reports. Based on that stated purpose the team produced the Job Aid, dated September 25, 2009.

The Job Aid (1) is not intended to be an official position and (2) is meant to be a reference document only. The Service clearly states that the Job Aid is not to be used or cited as an authority for setting any legal position.

The Job Aid is a 112 page document, with seven sections—arranged in sections A through G—an appendix that contains two analysis table sections, and three exhibits. In Section A, the Job Aid provides an executive summary. In Section B, it provides the document introduction.

In Section C, the Job Aid provides general information about the marketability discount including a definitions section. In this section, the Job Aid makes a distinction between the DLOM and the discount for the lack of liquidity (DLOL). The Job Aid defines the DLOM as: an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.* It defines the DLOL as: an amount or percentage deducted from the value of an ownership interest to reflect the relative inability to quickly convert property to cash. These definitions are consistent with definitions used by business valuation standards setting organizations.

Section C also provides a topical discussion of:

1. Influential factors on marketability,
2. Willing seller consideration and its impact on marketability,
3. Minority interest versus controlling interest as related to marketability, and
4. Sample initial information and document request items.

With regard to the influential factors the Job Aid highlights the *Mandelbaum v. Commissioner*, TC Memo 1995-255 (1995) opinion. To that end, the Job Aid provides a lengthy list of 25 subject company factors and eight subject interest factors, which were modeled after *Mandelbaum*.

According to the Job Aid, many appraisers only consider the perspective of the willing buyer and not the willing seller. When it comes to analyzing the relevant market for a subject interest in which a hypothetical willing buyer may be found, the Job Aid suggests that appraisers should be more specific than considering the entire general public. When it comes to the willing seller perspective, the Job Aid points out that the seller's perspective has been given the emphasis it deserves seven recent Tax Court decisions.

The Job Aid also provides a discussion related to the application of a discount for controlling interest positions in nonpublic companies. In many situations, a controlling interest position may not be fully marketable. In these situations, the Service suggests that the DLOL for a controlling interest is typically less than the DLOM for a noncontrolling interest.

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The Service lists sample initial information and document request items for appraisal review purposes. The list appears to be relatively standard information that appraisers would normally request. In total the Service lists 17 items. It is relatively common for an appraiser to request all of these items and perhaps more in the course of normal due diligence.

The Job Aid recommends to the Service valuation analysts—its intended audience—that Section D and E should always be read in conjunction with each other. Through the Job Aid the Service provides its unofficial opinions related to common DLOM approaches in Section D. Section E provides the Service valuation analysts with suggestions related to approaching the marketability discount from the perspective of a reviewer.

Section D identifies 18 approaches—although the Job Aid does contain information on a total of 23 approaches—that appraisers commonly use, or cite, to estimate the DLOM. In Section D, the main DLOM approaches are separated into four categories: (1) benchmark approaches, (2) securities-based approaches, (3) analytical approaches, and (4) other approaches. The progression of DLOM approaches, as presented in this section, begins with the most commonly relied on approaches and continues through to the least commonly relied on approaches.

Section E includes suggestions for Service valuation analysts, such as (1) approaching the marketability discount as a reviewer, (2) approaching the marketability discount as a valuator, (3) dealing with specific situations related to commonly used DLOM approaches, and (4) sources available to Service valuation analysts.

Section F provides a summary and conclusion. And, Section G provides the bibliography.

Job Aid Section D

This is the primary section of the Job Aid, at least in terms of page count and content. Section D discusses the most common DLOM approaches. In this section the Service identifies common approaches and provides opinions—although not in an official capacity—related to each identified approach, including (1) strengths of the approach, (2) weakness of the approach, (3) the view of the valuation community concerning the approach and (4) the Tax Court's view of the approach.

TABLE A. JOB AID — BENCHMARK APPROACHES SUMMARY

Approach Name	Vetted in Tax Court	Commonly Relied On	Positive Factors	Negative Factors
Restricted Stock Studies	Yes, but the use of averages have been rejected.	Yes	Identifiable Discount due to Restriction Market Evidence Historically Most Often Accepted by the Courts	Not Current Expected Holding Period Differences Unusually High Returns for Small Companies Courts have Rejected the Use of Study Averages
Pre-Initial Public Offering Studies	Yes, but	Yes, but not as common	Market Evidence Broad Time Period	Time period gaps-suggests factors other than marketability Companies are typically in early development stage Impacted by Economic Conditions Only Inclusive of Successful IPOs Pre-IPO transactions tend to be underpriced
Restricted Stock Equivalent Analysis	No	Not as common	NA	Does Not Explain DLOM in the Restricted Stock Transactions Data is Not Explainable from Multi-Variant Regression Analysis Critical with Regard to using Block Size as a Proxy
Cost of Flotation	NA	NA	Easily Applied Easy to Find Data	Not Applicable to Minority Interests Does Not Reflect Uncertain Holding Period Risks
Mandelbaum Factors	Yes	Yes	Raises Importance of Skilled Application of Comparison to Benchmark Studies Similar to R.R. 59-60 Precepts	Might be Difficult to Cover Insufficient Information to Analyze to Provide Opinion on All Factors

All of the DLOM approaches identified in Section D are discussed in four analysis groups:

1. Benchmark study approaches;
2. Security-based approaches;
3. Analytical approaches; and
4. Other approaches.

Benchmark Study Approaches

Table A includes a summary of the benchmark study approaches.

The two most common benchmark study approaches are (1) restricted stock based studies and (2) Initial Public Offering (IPO) pricing based studies. Within this benchmark study grouping the Job Aid also provides a discussion related to restricted stock equivalent analysis, cost of floatation, and the Mandelbaum factors.

In general, the restricted stock study approaches are commonly cited and have been vetted in Tax Court. These studies provide a measure of marketability by quantifying the difference between freely traded stock and restricted stock. The discount derived by the two types of stock is estimated using stock that is issued by the same company and is identical, but for, the trading restriction.

The Job Aid provides a listing of 14 restricted stock studies. The majority of the studies analyze market data prior to the Rule 144 holding period change in 1997. The studies indicate a discount range from a low of 13 percent—based on the Columbia Financial Advisors study from May 1997 to December 1998, after the Rule 144 change—to a high of 45 percent.

The Job Aid lists the general criticisms of restricted stock studies including the small sample size composition and the lack of current data. The Job Aid is critical of appraisers simply relying on restricted stock study averages without providing a supporting argument.

The restricted stock studies exhibit average discount and median discount indications of 31.4 percent and 33.0 percent, respectively. The Service contends that appraisers need to have an understanding of the underlying restricted stock study data in order to avoid a mischaracterization of the subject interest discount.

Therefore, it is important for a user of restricted stock studies to understand the studies. It is even more critical for the study user to understand the relationship between studies and the subject interest to be valued. The Job Aid recognizes that, that within the valuation community there is trend toward a deeper analysis of the restricted stock studies.

Courts generally support the use of restricted stock studies, although it is not likely that the courts will accept a marketability discount based solely on study averages.

As a means to implement a more rigorous analysis analysts will often consider using the FMV Restricted Stock Database ("FMV Data"). As of 2009, the database contained 475 restricted stock transactions. Using a regression analysis the Service tested the FMV Data to arrive at the following conclusions:

1. The FMV Data model is flawed in that it does not adequately explain the DLOM on the restricted stock transactions in its database;
2. Valuators cannot rely the FMV Data model when estimating the DLOM; and
3. Neither FMV's model nor multivariate regression analysis can be applied to estimate the DLOM on private equity.

Exhibit A of the Job Aid (in the appendix), provides a discussion of the FMV Data.

Pre-IPO studies are commonly cited—although not as commonly cited as the use of restricted stock studies within the valuation community. In contrast to the restricted stock studies, the Pre-IPO studies are not commonly relied on. Perhaps this is partially due to some well publicized Tax Court losses. The most well-known was the *McCord v. Commissioner* 120 T.C. No. 13 (2003) decision in which the court rejected the use of Pre-IPO studies. Nonetheless, the Job Aid devotes several pages to Pre-IPO studies.

It is well documented in the Job Aid that the Pre-IPO studies indicate discounts that are greater than the discounts demonstrated in the restricted stock studies. If a taxpayer appraiser relies on the Pre-IPO studies, it is likely that the Service, upon review, will ask the some of the following questions.

1. Has consideration been given to separate the lack of marketability from other effects that might contribute to the observed Pre-IPO discounts?
2. Has the variance and/or range of discounts observed in the Pre-IPO studies been addressed?
3. How does the subject company compare to the companies used in the Pre-IPO studies?
4. If an adjusted average is used to estimate the marketability discount, what specific factors were considered to arrive at this conclusion?

The Service is critical of the restricted stock equivalent analysis, presumably because it relies on FMV Data to estimate marketability. The Service notes that the restricted stock equivalent analysis is an attempt to refine traditional restricted stock data. The approach is performed in a two-step procedure. This approach is also discussed in more detail in the Job Aid appendix Exhibit A.

The cost of flotation approach is not as commonly used as other benchmark approaches. One reason is that it only applies to controlling interest positions. Another reason is that it does not adequately incorporate holding period risk. Thus, the Job Aid

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does not analyze this approach in the same level of detail as the restricted stock study approach and the Pre-IPO approach.

As stated in the Job Aid, one of the most relied on and cited marketability approaches to estimate the DLOM was derived from a U.S. Tax Court decision. The Mandelbaum Factor analysis, as set forth in the *Mandelbaum v. Commissioner*, T.C. Memo 1995-255 (1995) decision, is a widely followed qualitative marketability approach commonly used to adjust benchmark studies.

The Job Aid refers to the *Mandelbaum* decision as a landmark case for marketability. In this decision, Judge Laro decision outlined various factors to be considered in determining the DLOM. A non-exhaustive list of these factors includes:

1. The value of the subject corporation's privately traded securities vis-à-vis its publicly traded securities (or, if the subject corporation does not have stock that is traded both publicly and privately, the cost of a similar corporation's public and private stock);
2. An analysis of the subject corporation's financial statements;
3. The corporation's dividend-paying capacity, its history of paying dividends, and the amount of its prior dividends;
4. The nature of the corporation, its history, its position in the industry, and its economic outlook;
5. The corporation's management;
6. The degree of control transferred with the block of stock to be valued;
7. Any restriction on the transferability of the corporation's stock;
8. The period of time for which an investor must hold the subject stock to realize a sufficient profit;
9. The corporation's redemption policy; and
10. The cost of effectuating a public offering of the stock to be valued, e.g., legal, accounting, and underwriting fees.

Security-Based Approaches

Table B includes a summary of the security-based approaches.

These approaches estimate the DLOM through either (1) option pricing indications or (2) observed market liquidity

TABLE B. JOB AID — SECURITIES-BASED APPROACHES SUMMARY

Approach Name	Vetted in Tax Court	Commonly Relied On	Positive Factors	Negative Factors
Long-Term Equity Anticipation Securities ("LEAPS")	No	Not Often	Studies Contain Large Sample Size of Transactions LEAPS can be found at Specific Dates Data Can Be Segmented by Industry Data Can Be Segmented by Guideline Company	Does Not Capture Qualitative Factors Private Company Owner Does Not Have the Ability to Hedge
The Longstaff Study	No	Not Often	Easily Implemented in Excel Provides a Benchmark Maximum Estimate for the DLOM	Assumes Investor Has Perfect Market Timing Assumes Investor Has Trading Restrictions Preventing an Optimal Sale It Yields High DLOM Estimates with Low Volatility Proxy for the Maximum Estimate, Should Not be Used Blindly
The Chaffee Study	No	Not Often	Easily Implemented in Excel	Should Only Be Used as A Proxy Qualitative Factors Must Be Considered Results are Downward Biased — Minimum DLOM Indication Private Company Owner Does Not Have the Ability to Hedge
Bid-Ask Spread Method	No	Not Often	Large Sample of Trading Firms	Provides an Illiquidity Discount Only Other Factors Need to Be Considered Bid-Ask Spreads Must Be Related to Private Business Variables Considerably Subjective, Judgment is Required

evidence. The Job Aid discusses the following security-based approaches:

1. Long-Term Equity Anticipation Securities (LEAPS) studies;
2. The Longstaff Study;
3. The Chaffee Study; and
4. Bid-ask spread method.

In general, these approaches are not commonly used to estimate marketability as compared to the benchmark studies approaches. The Service is generally critical of the security-based approaches, primarily because these approaches are strictly quantitative in nature and do not address qualitative factors.

LEAPS studies—conducted by Robert Trout and then updated by Ronald Seamen—are based on an analysis of long-term put options with 1.5 to 2.0 year terms. These studies measure the protection that investors can buy to mitigate stock price declines. Study authors view the derived discounts as minimum price indications. The Job Aid points out that an area of criticism has been the fact that cost of the long-term put options could be offset by selling covered call positions—specifically a "collar" options strategy.

The Longstaff Study approach, based on the price of look back options, and assumes perfect market timing. Using the Longstaff options-based model to address a subject interest marketability discount is said to provide an upper bound of the discount. The Job Aid claims that the model produces a

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Table C. Job Aid — Analytical Approaches Summary

Approach Name	Vetted in Tax Court	Commonly Relied On	Positive Factors	Negative Factors
Karen Hopper Wruck Study	No	Not Often Relied on But Often Cited	Clearly Defined Hypothesis and Use of Analytical Tools Discount is Logically Supported by the Analysis Approach Isolates the DLOM by Comparing Registered and Unregistered Private Placements	Data Chosen Based on Availability and Not Logical Selection Classification of Public Placements (Registered or Unregistered) was Subjective in Nature Measurement Point One Day After Announcement, May Exacerbate Discount
Hetzel and Smith Study	No	Not Often Relied on But Often Cited	Isolates the DLOM Using a Multivariate Regression Analysis Primarily Comprised of Small Companies Similar to Most Appraisal Assignments	Suffers from Sample Selection, only 106 Private Placement Issues Classification of Public Placements (Registered or Unregistered) was Subjective in Nature, Only Able to Determine for 63 of 106 Private Placements Measurement Point Issues, Used 10 days After Announcement, Gives Time for any Bounce to Dissipate Prior to Measurement
Bajaj, Denis, Ferris and Sarin Study	Yes, in Part	No, but Often Discussed and Cited	Focused on Over-the-Counter Private Placements Better Process of Determining Status of Private Placements — Registered or Unregistered Primarily Comprised of Small Companies Similar to Most Appraisal Assignments Employed Five Different Parameters to Isolate the Affects of Marketability	Certain Writers have pointed to Data Errors, and Failure to Consider Other Relevant Transactions Questions Related to the 7.23 Percent Discount Estimate and Questions Related to the Inconsistency of How Bajaj Applies his Estimate Does not Consider the Length of the Required Holding Period For An Unregistered Security as a Determinate Factor Just Because a Private Placement involves Registered Securities Does not Mean the Securities are Freely Tradable
Ashok B. Abbott Study	No	No, Sometimes Cited	Recognizes Differences between Public and Private Market and Block Size as DLOM Considerations Recognizes the Innovations in the Securities Market to Reduce the Required Non-Liquid Investor Discounts Conceptually Based Strengths Rather than Actual	Has Not Been Vetted by Practitioners or the Courts It is Not Meant to Serve as a Primary Approach

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high DLOM estimate using low volatility figures. It is true that as the volatility measure increases so does the model's output related to the marketability discount. In other words, a high volatility estimate equals a high DLOM estimate.

The Chaffee Study is based on the measurement of the cost to purchase European put options. The Job Aid states that this method should only be used a proxy.

The bid-ask spread method is based on a measurement of the percentage difference between the bid-ask spread for public companies. The Service suggests that this approach only estimates an illiquidity discount.

Table D. Job Aid — Other Approaches Summary

Approach Name	Vetted in Tax Court	Commonly Relied On	Positive Factors	Negative Factors
QMDM	It has been Criticized by the Court	Minimal Use, but Presented More Often as Addition Support	Quantitative in Nature, Not as Subjective on the Surface Allows Appraiser to Estimate Certain Identifiable Factors (e.g. Growth Rate, Holding Period, and Required Return)	Estimation of Certain Identifiable Factors Can Be Subjective Increases the Scope of an Appraisers Opinion About Future Events Alternatively, if the Appraiser Relies on Management the Appraiser May Lack Independence
NICE	No	No Commonly Cited, Related Methods-Income Based-are Used in Part as Sanity Checks	Avoids Subjective Estimation of DLOC and DLOM More Straight Forward, Income Based Approach Viewed as a Better Alternative to the QMDM, as it Addresses both the DLOC and DLOM	Assumption that a Buyer Can Demand a Greater Rate of Return Control and Marketability Issues The Basis for the Buyer to Receive a Higher Rate of Return Can be Subjective Method Assumes a Lengthy Holding Period, in Excess of 10-Years Holding Period Estimation is Speculative in Nature
NERA	No	No, However Related Methods-CAPM Based-are Used in Part as Sanity Checks	Quantitative in Nature, Uses the CAPM to Employ Treats the Lack of Marketability as an Additional Risk Factor to Increase the Equity Risk Premium	Estimated From Market Comparable, Therefore Can be Subjective Holding Period Estimates are Also Subjective Model is Theoretical in Nature, No Sound Way to Calibrate Against the Market
Partnership Profiles - Real Estate Limited Partnership Data	Yes, but Questioned as the Data is Indicative of Both Elements of Control and Marketability	Yes, Primarily Used to Estimate Lack of Control Discounts, and is Often Combined with Other Methods That Estimate the Lack of Marketability	Avoids over-discounting Provides a Combined Estimate for DLOC and DLOM The Partnership Profiles Database Provides Descriptive Factors for Comparison Purposes that are Helpful to Find Guideline Companies	Questions Regarding Specific Comparability of RELP to Subject Interests Some of Data May be Reflective of Tax Law Changes in That it May Reflect Out of Favor Investments Sold Under Distressed Conditions The Data Pool is Diminishing, Creates Statistical Significance Problems The Net Asset Values Reported May Not Reflect True Underlying Value The Method is Limited to Entities With Substantial Real Property Assets
Public Vs. Private P/E Ratios in Acquisitions	No	Not Commonly Relied On, But Cited as General Support - Citied More for Lack of Control Evidence	Objective Source Data - Market Based Illustrates Discounts In Arm's Length Transactions	Excludes Upper and Lower Bound Figures in Each Year Variance in Data Could Reflect Other than Marketability Analysis of Transactions to Analyze the Variance in the Data Could be Time Consuming Might Not be Reflective of DLOM Levels in Private Transactions Based on Control Transactions, Does it Apply to Smaller Traded Interests

Analytical Approaches

Table C includes a summary of the analytical approaches.

These approaches generally compare sale prices of private placements for publicly traded stocks to the primary market where the stock is listed. The Job Aid provides a background and summary for the following analytical approaches described by these authors:

1. Karen Hopper Wruck;
2. Hetzel and Smith;
3. Bajaj, Denis, Ferris, and Sarin (Bajaj study); and
4. Ashok B. Abbot.

In general, the analytical approaches are not commonly relied on, but are commonly cited. The Service suggests through the Job Aid that these approaches—specifically the Bajaj study—are used by judges as ammunition to hold all practitioners accountable for reliance on the benchmark studies. According to the Job Aid, the analytical studies tend to show that benchmark studies can lead to unreasonably high DLOM estimation. General criticisms of the analytical approaches include sample data selection issues, uncertainty regarding registration status (i.e., registered or unregistered stock), and price measurement points.

Of the analytical approaches, the Bajaj study is discussed the most. The Job Aid noted the criticisms made by the professional valuation community—including limited sample size and measurement date issues.

In a section that discusses strengths of the Bajaj approach, the Job Aid points out that the Bajaj study uses registration status as an explanatory variable to isolate the DLOM. However, it also provides that the 7.23 percent isolated discount seems too low.

Other Approaches

Table D includes a summary of the other approaches.

The Job Aid provides a background and summary for the following other approaches:

1. Quantitative Marketability Discount Model (QMDM);
2. Non-Marketable Investment Company Analysis (NICE);
3. National Economic Research Associates (NERA);
4. Partnership Profiles (Partnership Spectrum); and
5. Public vs. Private P/E/ Ratios in Acquisitions (MergerStat).

The Job Aid provides relatively standard criticisms of each of the approaches. Because the other approaches are all different, there are no common themes provided in this section.

The QMDM is not quite as commonly used as other marketability approaches, such as the benchmark study approaches. The Service suggests that the QMDM has seen minimal adoption, other than by the firm that introduced the method. This method is generally considered to be controversial because it requires several subjective adjustments.

Of the other approaches, the Partnership Profiles approach is most commonly used and cited. However, a criticism of the data resulting from Partnership Profiles is that the discount indications derived by the approach are more akin to lack of control discounts than lack of marketability.

Job Aid Section E

In Section E, the Job Aid provides a discussion related to appraisal evaluation and review. The section progresses from a discussion of the marketability discount from the reviewer's perspective to the valuator's perspective. From there, the focus of the discussion shifts to dealing with the DLOM under certain specific situations.

To approach the DLOM as a reviewer the Service valuation analyst is advised to base judgment of the marketability approach on general reasonableness. The report in question should contain arguments of why an approach was relied on. Based on the prevailing facts of a subject interest, the reviewer should consider whether an approach is reasonable—even if a report provides just a number without a corresponding discussion. If the review leads to the conclusion that the DLOM estimate is unreasonable, the reviewer may need to change their perspective and become a valuator.

As a valuator, a Service valuation analyst should be mindful of prevailing valuation precepts. More specifically, if a subject interest is a position in a non-publicly traded company with (1) little or no history of stock transactions and (2) a restrictive shareholder's agreement in place, the DLOM could be substantial. Conversely, if the subject interest (1) is a position in a company with robust trading activity and/or (2) the holder enjoys a put right providing for fair market value of the subject interest if put back to the company, the discount should be much less.

The Job Aid provides suggestions related to approaches in which reviewers view as the most common approaches performed incorrectly.

The Service suggests that reviewers consider the following specific situations:

1. Use of Pre-IPO studies to support DLOM;
2. Use of simple average or median from Restricted Stock Studies;
3. Use of analytical study results without getting behind the data;
4. Use of study results not supported by market data; and
5. Reliance solely on court decisions.

It is clear that the Pre-IPO studies are not well received by the Service. If an appraiser cites and relies on Pre-IPO studies to estimate the DLOM then it would stand to reason that

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the appraiser will have to provide a detailed explanation. In general, the Services position regarding the Pre-IPO studies appears to be that these studies provide unreasonably high marketability discounts.

It is also clear that the Service does not support an analysis that suggests using a simple mean or median from restricted stock studies. The Service contends that the analysis of restricted stock as compared to publicly traded stock in the same business is not totally explained by lack of marketability. In other words, the Service contends that there is "noise" in the discounts derived by restricted stock analysis.

The Service suggests that business valuators need to understand the data behind analytical studies. The reason for this suggestion is that results of the studies are (1) due to the specific data chosen by the researcher and (2) pertinent to a specific time period. To cite and rely on analytical studies the appraiser should understand the data and understand how the data compares to the specific subject company and specific subject interest.

As a general rule, when a quantitative model is used the analyst needs to consider how the quantitative model marketability discount estimate relates to actual market data.

Job Aid Appendix

The Job Aid appendix includes two tables and three exhibits. Table 1 presents an analysis of the SEC Institutional Investors Restricted Stock Study. Table 2 presents an analysis of the MPI Restricted Stock Study. In Exhibit A, the Job Aid presents the Services review of the FMV Restricted Stock Model. In Exhibit B, the Job Aid presents an analysis of the Pre-IPO studies. In Exhibit C, the Job Aid revisits analytical approaches.

General Reaction from the Valuation Community

By now, several articles discussing the Job Aid have been published. Most business appraisers have probably read the Job Aid. While attending a recent estate and gift tax institute, several business valuation firms were using the Job Aid as marketing material. These firms provided printed and bound copies of the Job Aid to pass out to the attending trust and estate tax lawyers.

Certain appraisers who were specifically identified in the Job Aid have proffered their response to the criticisms put forth in the Job Aid. Lance Hall of FMV Opinions, Inc. (FMV) presented his response—*Responding to the IRS DLOM Job Aid*—in an October 12, 2011 presentation for Business Valuation Resources. Most of the criticisms levied at the FMV Data are based on statistical regression analysis.

Through the Job Aid the Service contends that regression analysis cannot explain FMV Data marketability discounts, and FMV agreed with this point. FMV also suggested that it was conceptually incorrect to apply a regression model and that the FMV data approach is more of a comparative analysis.

Summary

The Job Aid is a 112 page document, with seven sections—arranged in sections A through G—an appendix that contains two analysis table sections, and three exhibits.

After a review of the Job Aid we are left with the following takeaway points:

1. In general, a more robust DLOM analysis using multiple approaches is preferable to an analysis that relies on only one approach.
2. Approaches used to support a DLOM conclusion must convey market expectations and relate to the specific subject interest.
3. Related to the benchmark approaches, the Job Aid emphasized that both the Mandelbaum Factor analysis and the restricted stock study analysis were commonly relied on and commonly cited.
4. Related to the restricted stock studies, analysts are discouraged from the blind use of restricted stock study averages.
5. The Job Aid states that analytical studies are sometimes used by Tax Court judges as ammunition to hold all practitioners accountable for reliance on the benchmark studies.
6. The Job Aid is particularly critical of FMV database and including the restricted stock equivalent analysis approach.
7. An analyst should not exclusively rely on Tax Court decisions regarding marketability.

A competent analysis of business investment marketability should consider the criticisms put forth in the Job Aid. While, the criticisms are not new, they should be addressed in the appraisal report DLOM section. In general, the Job Aid provides good explanations of business investment marketability approaches and thoroughly explains strengths and weakness of those approaches. ◆

Kevin M. Zanni, ASA, is a manager in the Chicago office of Willamette Management Associates, a valuation consulting, economic analysis, and financial advisory services firm, www.willamette.com. *He may be reached by e-mail at* kmzanni@willamette.com *or (773) 399-4333.*

Endnotes

* *International Glossary of Business Valuation Terms*, as adopted in 2001 by American Institute of Certified Public Accountants, Canadian Institute of Chartered Business Valuators, National Association of Certified Valuation Analysts, and The Institute of Business Appraisers.