Knowing a Company’s Value is Crucial to Estate Planning

By Joseph M. Donegan on April 4th, 2012

Business valuations are an important component of operating a company, especially for owners who plan to sell or merge with another business in the future. However, some small business owners who do not plan on making significant changes to their company may forgo valuations, which can have heavy implications for their estate planning.

Currently, only 43 percent of business owners who hire a valuation expert do so for estate planning purposes, according to a survey from TEC Worldwide. In addition, many who do value their companies may rely on professionals who are unqualified to conduct these valuations, such as certified public accountants, because they do not take into account all the factors that weigh on a company’s worth. Experts say the percentage of owners who conduct valuations is too low, which may lead to issues for the owner’s beneficiaries down the road for several reasons.

First, when a business owner dies, the IRS usually conducts an audit of the company’s tax returns and records to ensure taxes are collected on the fair market value of the business, and that the terms of the final will and testament comply with federal estate law.

Company owners who choose to transfer businesses to heirs so they can enter into retirement may also experience problems if they fail to value their business first, according to valuation firm AIW.

For example, transfers of ownership that are valued below fair market value may prompt the IRS to determine that taxes are owed. In addition, the tax agency may also enforce a penalty of up to 40 percent of the unpaid taxes, AIW reports.

For these reasons, small business owners who plan on keeping the company in the family may put their heirs – and their company – in a better financial position by having the enterprise valued by a valuation professional to avoid potential tax issues in the future.

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