The AICPA Business Valuation Standard SSVS 1

Advice for Tax Preparers

By Thomas A. Hutson

The AICPA Statement on Standards for Valuation Services 1 (SSVS 1), *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*, went into effect January 1, 2008, and tax practitioners frequently ask how the statement may affect them in particular tax practice circumstances. Are valuation calculations or reports provided by a client or others for use in preparing a tax return subject to SSVS 1? Does SSVS 1 require a written report to be attached to a tax return when a value is determined by a CPA for tax reporting purposes? Is the work in tax planning or estate planning engagements—where the value of an interest in a privately held business or a block of publicly traded stock is one of many issues—subject to SSVS 1? Are engagements to allocate purchase price among various assets or to allocate value among various partnership assets subject to SSVS 1? Is a cost segregation study to compute depreciation properly subject to SSVS 1? Does SSVS 1 apply when determining the value of a block of publicly traded stock in connection with the filing of an estate tax return? Does SSVS 1 apply to the determination of the value of a small percentage interest in a privately held real estate holding company?

Answering these and other questions must begin with an analysis of SSVS 1 itself, focusing particularly on references to tax practice. The next step is to take a look at Interpretation 1-01, "Scope of Applicable Services," which addresses the issue of which services SSVS 1 applies to.

Background

SSVS 1 was issued in June 2007 and applies to business valuation engagements accepted on or after January 1, 2008. The litigation exemption from the reporting provisions of SSVS 1, which applies to expert witness services and other litigation services engagements, is not available for tax work. Accordingly, all tax work that involves valuation services is generally covered by all provisions of the standard. The nature and extent of a tax team's workpapers and reports documenting their compliance with SSVS 1 is a matter of professional judgment given the circumstances applicable to a specific engagement, including an overall assessment of the size or materiality of the valuation procedures in general and their impact on the specific issue or subject assignment.

In general, SSVS 1 was issued to improve the consistency and quality of business valuation work. It provides a listing of procedures to consider when performing a business valuation services engagement. SSVS 1 includes two principal sections, namely Development Standards (paragraphs 21 through 46) and Reporting Standards (paragraphs 47 through 78).

The Development Standards define two types of engagements to estimate value: a valuation engagement and a calculation engagement. A valuation engagement requires more procedures than a calculation engagement and results in a conclusion of value. A calculation engagement provides what is referred to as a "calculated value." A valuation engagement is a higher level of service than a calculation engagement. A key differentiator between the two types of engagements is that, in a valuation engagement, the CPA is free to apply the valuation approaches and methods deemed appropriate for the circumstances, whereas in a calculation engagement, the CPA reaches an agreement with the client as to the nature and limited scope of procedures employed.

In a tax-related engagement where the judgment and opinion of a CPA are sought by a client and will be used as the basis of a representation made to a third party, including tax authorities, a valuation engagement is appropriate. As discussed in paragraph 6 of SSVS 1, however, it is important to note that when information regarding value is provided by others (e.g., the client or a third party) to a tax practitioner, the information is not subject to SSVS 1. This is because the CPA is not performing any valuation services, and the CPA can use the information to prepare a tax return or provide other tax-related services. Such information is specifically excluded from the scope of SSVS 1, as noted in Interpretation 1-01. The interpretation is included at the end of the statement and is considered an integral part of it.

The SSVS 1 Development Standards can be segregated into four primary categories: 1) analysis of the subject interest, 2) consideration and application of appropriate valuation approaches and methods, 3) consideration of subsequent events, and 4) preparation and maintenance of appropriate documentation. Paragraphs 44 and 45 of SSVS 1 are most pertinent in answering the compliance questions that many tax practitioners have raised.

SSVS 1's provisions define documentation as the principal record of the information obtained and analyzed, the procedures performed, the valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are considered matters of the CPA's professional judgment. Engagement documentation may include: information and financial records gathered and analyzed, assumptions and limiting conditions, any restrictions or limitations on the scope of work or data available for analysis, valuation approaches and methods considered and used, information related to pertinent subsequent events, or other documentation a CPA considers relevant.

The Reporting Standards can be segregated into three primary categories: 1) detailed report, 2) summary report, and 3) calculation report. The communication reporting the results of a calculation or valuation engagement can be oral or written. Experienced practitioners agree that a written report avoids the confusion caused by lapses in memory after an important number or process is described in an oral report.

For a valuation engagement, SSVS 1 allows either a detailed report or summary report. The decision as to whether a detailed report or summary report is best suited to a particular engagement is a matter of professional judgment. That decision is based on the level of reporting detail agreed to by the CPA and the client. Detailed and summary reports are used only to communicate the results of a valuation engagement and express a conclusion of value. Neither a detailed report nor a summary report may be used to communicate the results of a calculation engagement. A calculation report should be used only for calculation engagements. In any of the three types of reports provided for in SSVS 1, it is important to state any restrictions on the users and use of the report.

SSVS 1 provides a list of items that each level of report should include. These items should be considered by the CPA during the report preparation process. A detailed report should provide sufficient detail to enable intended users to understand the data, reasoning, and analyses underlying the CPA's conclusion of value. A summary report presents an abridged version of the information required in a detailed report. Summary report disclosures, to the extent they are applicable in any given situation, are listed in SSVS 1.

A calculation report should clearly describe the scope of work performed, the assumptions and limiting conditions applicable to the engagement, and a general description of a calculation engagement. It should include, at minimum, a statement that a calculation engagement does not include all the procedures required for a valuation engagement and that, had a valuation engagement been performed, the results may have been different.

Interpretation 1-01

A number of relevant concerns for tax practitioners are addressed by the AICPA in Interpretation 1-01. Sixteen of the 21 illustrations included in Interpretation 1-01 relate to tax engagements. The conclusions from several illustrations are summarized below. Interested readers are encouraged to review SSVS 1 and Interpretation 1-01 in their entirety.

Interpretation 1-01, illustration 7, paragraphs 18 and 19, points out that although preparation of an oral or written valuation report is required under the reporting provisions of SSVS 1, the standard does not require that any form of written report be attached to the tax return or mandate any other tax-specific disclosures. This provision does not relieve a CPA from the use of due care in the preparation of tax filings, however. There are a number of situations where attaching a written report is the prudent course of action or may be considered necessary to properly support a position taken on a tax return.

Interpretation 1-01, illustration 11, paragraphs 28 and 29, notes that providing technical advice without reference to specific values for various assets is not subject to SSVS 1. Nevertheless, if a CPA calculates a value for a business ownership interest, security, or intangible asset, then the provisions of SSVS 1 apply. As noted above, the use of values provided by a client or third party is specifically exempted from the standard. Hypothetical or assumed values may also be used under the provisions of SSVS 1. The standard would not apply in this case, because the CPA would not be applying valuation approaches and methods or using professional judgment.

Interpretation 1-01, illustration 12c, paragraphs 35 and 36, makes it clear that SSVS 1 applies when one or more of the assets to which value is to be allocated—in a tax engagement performed for purposes of allocating value among various business assets under IRC provisions—is a subject interest (business, business ownership interest, security, or intangible asset). There are exceptions to this rule, however. SSVS 1 does not apply in an IRC section 1060 purchase price allocation, for example, if after allocations are made to cash, receivables, inventory, depreciable tangible assets, and other relatively objective items, the residual amount is simply assigned to goodwill. If, however, the residual amount is allocated to specific intangible assets (customer lists, franchises, trademarks, copyrights, contractual rights or privileges, secret processes) based on their relative values, then SSVS 1 does apply. This is because the CPA applies valuation approaches and methods and uses professional judgment to determine the value of these specific intangible assets.

Interpretation 1-01, illustration 12g, paragraphs 43 and 44, notes that a cost segregation study performed to allocate the costs of building a structure to real estate and personal property components is not subject to SSVS 1. This is because none of the assets constitute a subject interest.

Valuation can be a complex and multifaceted process requiring the use of professional judgment that is best performed by experienced individuals.

Interpretation 1-01, illustration 13a and 13b, paragraphs 48, 49, 50, and 51, point out that the determination of the value of a block of publicly traded stock in connection with the filing of an estate tax return may or may not be subject to SSVS 1. That determination is based upon the particular circumstances of the analysis and the role assumed by the CPA tax preparer in the determination of value. The fair market value of a large block of publicly traded stock may or may not be the same as the quoted share price for any given day's trading activity. This is because of the relationship between the size of the block of stock owned by the estate and the daily trading volume for the particular stock.

Where the subject shares represent a relatively small percentage of daily trading volume and the stock's price is readily ascertainable from published quotes, the calculation of value is simply mechanical (share price times number of shares) and accordingly, SSVS 1 does not apply. In a situation where the subject shares represent a large percentage of daily trading volume, an attempt to quickly liquidate the shares could decrease the value of the block of stock below the published market quoted price. In this situation, SSVS 1 would apply, because a CPA would need to apply valuation approaches and methods and exercise professional judgment to determine an appropriate value for the block of stock held by the estate.

Interpretation 1-01, illustration 13e, paragraphs 56 and 57, makes it clear that the determination of the value of a small percentage interest in a privately held real estate holding company is generally subject to SSVS 1, because professional judgment should be exercised to determine the fair market value of a fractional interest in a privately owned company. For example, in the case of a real estate limited partnership, where the general partner does not provide the limited partner with the information necessary to determine the interest's value and the due date for filing an estate tax return is near, and where the ownership interest in question is a relatively small value both in absolute terms and as a percentage of the estate, the CPA may use the executor's estimate of value if he determines it is reasonable given the facts and circumstances known at the time. In this situation, SSVS 1 does not apply since it is not practical or reasonable to obtain and use relevant information, and therefore a CPA would be unable to apply valuation approaches and methods and exercise professional judgment.

A Matter of Professional Judgment

In summary, there are numerous services that do not rise to the level of an engagement to estimate value and, therefore, are not subject to SSVS 1. Examples of these services include the following:

- Determining the value of relatively small holdings or blocks of publicly traded stock, where the per-share price is readily ascertainable;
- Preparing a tax return using a valuation report that was provided by a third-party appraiser or by the client;
- Purely mechanical computations of value, such as using actuarial tables to compute a remainder interest for a grantor-retained annuity trust;
- Services specifically excluded from the scope of SSVS 1, as listed in Interpretation 1-01, paragraph 3, or SSVS 1, paragraphs 5 through 10; and
- Other engagements that do not involve a subject interest, or where the application of valuation approaches and methods or the use of professional judgment is not required.

Examples of services that do rise to the level of an engagement to estimate value and therefore are subject to SSVS 1 include the following:

- Valuing a large block of publicly traded stock, where consideration of a discount for blockage or other market restrictions is a relevant factor;
- Valuing shares of stock or another form of ownership interest in a privately held business enterprise;
- Engagements requiring the CPA to consider and apply valuation discounts, premiums, or other adjustments; and
- Other engagements that involve a subject interest, or where the application of valuation approaches and methods and the use of professional judgment are required.

It should also be noted that the AICPA's Statements on Standards for Tax Services (SSTS) apply to all aspects of tax engagements, including SSTS 3, *Certain Procedural Aspects of Preparing Returns*, which includes a discussion of appropriate due diligence relative to values provided to a CPA by his client, and SSTS 1, *Tax Return Positions*.

Valuation can be a complex and multifaceted process requiring the use of professional judgment that is best performed by experienced individuals. It is recommended that tax practitioners consult with a CPA accredited in business valuation, should they require valuation services or have a question about the applicability of SSVS 1 in a particular circumstance. ❑

Thomas A. Hutson, CPA/ABV, CFP, CFF, *is an advisor with Bollam Sheedy Torani & Co. LLP, in Albany, N.Y., and is a member of the NYSSCPA's Business Valuation and Litigation Services committees.*