

## Overview of Business Valuation Discounts and Premiums and the Bases to Which They Are Applied

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This chapter calls attention to the high degree of significance of the topic of discounts and premiums in business valuation and provides an overview of various discounts and premiums and the bases of value to which they may be applied.

In general, I will refer to stock when talking about any type of equity interest unless I am talking specifically about partnerships or some other specific ownership form. However, the same concepts as applied to stock, are usually applicable to partnership interests as well as other forms of ownership.

## DISCOUNTS AND PREMIUMS REFLECT RELATIVE RISK AND RELATIVE GROWTH

The purpose of a discount or premium is to make an adjustment from some base value. The adjustment should reflect the differences between the characteristics of the subject interest (the interest being valued) and those of the base group on which indications of value are based. These differences in characteristics create differences in risk, either to the entity or to its owners, whether the differences arise from contingent liabilities, lack of control, lack of marketability, or some other factor.

Since discounts decrease value, they have the effect of increasing the expected percentage rate of return over what it would otherwise be if the discount were not applicable. If discounts and premiums are applied correctly, the resulting differential in value should reflect the differential in expected rate of return that an investor would require to compensate for the difference in investment characteristics (risk), given the expected rate of growth of the company.

For example, assume that a publicly traded stock was selling at \$10 per share and the market expects the total return on that stock (dividends plus capital appreciation) to be on average 10% per year of which 6% is expected to be from growth and 4% from dividends. Thus, the dividend yield on the stock should be 4% as well. If an investor in an otherwise similar but nonmarketable stock were to require a 12% expected total return to compensate for the lack of marketability, that would mean that the investor would require a  $33\frac{1}{3}\%$  discount for lack of marketability from the price at which the stock would sell if it were publicly traded. This would mean that the investor would pay only \$6.67 per share for the subject closely held stock in order for the same dollar of return to yield 15% instead of 10% on the price paid. That is, the dividend yield at a 10% required return would be 4% (10% – 6% growth) while the yield at a 12% required return would be 6% (12% – 6% growth). The percentage differential in the yields  $(1 - \frac{4\%}{6\%})$  is 33% which would also be the percentage differential in the price.

Therefore, when estimating the magnitude of a given discount, differences in both risk and expected growth between the subject and the companies used to estimate the base value should also be reflected.

After all discounts and premiums have been applied, it is often a very good idea as a reasonableness or sanity check, to compute the implied expected rate of return on the final concluded value to see if it appears reasonable.

## DISCOUNTS AND PREMIUMS ARE BIG-MONEY ISSUES

Often there is more money at stake in determining what discounts or premiums are applicable to some business valuations than there is in arriving at the base value (prediscount valuation) itself. A thorough understanding of (1) the types of discounts and premiums, (2) situations in which each may or may not be applicable, and (3) how to quantify them is a major and indispensable part of the tool kit of any business appraiser or reviewer of business appraisals.

**Exhibit 1.1** *Estate of Weinberg v. Commissioner* Experts' and Court's Discounts from Net Asset Value**Minority & Marketability Discounts**

	<b>Taxpayer's Expert</b>	<b>IRS Expert</b>	<b>Tax Court</b>
Minority Interest Discount	43%	20%	37%
Marketability Discount	35%	15%	20%
Combined Discount	63%	32%	50%

Source: Robert M. Siwicki of Fleet M&A Advisors. "Tax Court Rejects QMDM and Use of Single Comparable," *Shannon Pratt's Business Valuation Update* (April 2000): 10.

In the dissenting stockholder action of *Swope v. Siegel-Robert, Inc.*, for example, one appraiser testified to a value of \$98.40 per share and another testified to a value of \$30.90 per share, a difference of well over three to one between the two appraisers' values. However, their base level values were \$72.90 and \$46.20 per share, respectively. The rest of the difference came from the fact that the first appraiser applied a 35% control premium, which the second did not, and the second appraiser applied a 35% discount for lack of marketability, which the first did not.<sup>1</sup>

There have been many cases in which the parties reached agreement on base values, and the only disputes remaining involved premiums and/or discounts.

In *Estate of Weinberg v. Commissioner*,<sup>2</sup> the parties agreed that the fair market value of an apartment building, the sole asset of a limited partnership, was \$10,050,000. The points of disagreement centered on the magnitudes of lack of control and marketability discounts for a 25.32% limited partnership interest. The differences in the experts' positions on the discounts and the court's conclusion are shown in Exhibit 1.1. If the court had accepted the taxpayer's expert's discounts, the concluded value would have been \$971,838. If the court had accepted the Internal Revenue Service (IRS) expert's discounts, the concluded value would have been \$1,770,103. This magnitude of difference based on combined discounts for lack of control and lack of marketability is not uncommon.

The most famous case dealing solely with the issue of discounts is *Mandelbaum v. Commissioner*.<sup>3</sup> The parties stipulated to freely traded minority interest values, so the only issue was the discount for lack of marketability. After hearing testimony from experts for both the IRS and the taxpayer, the court concluded a discount of 30% for lack of marketability. Some of the court's criteria for reaching its decision are still controversial in the financial community. This case is discussed more fully in Chapter 11.

## **"ENTITY-LEVEL" VERSUS "SHAREHOLDER-LEVEL" DISCOUNTS AND PREMIUMS**

Some categories of discounts apply to the entity as a whole, such as a key person or environmental liability discount; others reflect the characteristics of ownership, such as control versus minority and lack of marketability. These are often

distinguished as “entity-level discounts” or “company-level discounts,” because they apply to the company as a whole, versus “shareholder-level discounts,” which apply to a specific block of stock.

## Entity-Level Discounts

Certain discounts apply to the entity as a whole or to all shareholders, individually or as a group, regardless of any individual shareholder’s characteristics or attributes. These include, for example:

- Discount for trapped-in capital gains
- Key person discount
- Discount for known or potential environmental liability
- Discount for pending litigation
- “Portfolio,” “conglomerate,” or “nonhomogeneous assets” discount (for an unattractive assemblage of assets)
- Concentration of customer or supplier base (risk of loss/nonrenewal of significant customers or vendors normally is factored into the multiples in the market approach or the discount rates in the income approach)

These “entity discounts” usually are applied *before* “shareholder discounts,” that is, discounts affecting the entity as a whole as opposed to those characteristics affecting the particular share ownership. These entity-level discounts normally are applied to a control-level value. However, in some cases, such as the guideline public company method and sometimes in an income approach, the analysis may lead directly to a minority-level value without ever estimating a control value. In these cases, the entity-level discounts can be applied to those minority values before any shareholder-level adjustments. (The percentage would be the same since entity-level adjustments apply equally to all shareholders.)

Also, in some instances, these “discounts” can be factored into discount or capitalization rates in the income approach or valuation multiples in the market approach to reflect the additional risk that they imply. If this procedure is used, the adjustments to the discount or capitalization rates or market multiples should be clearly explained.

*Estate of Mitchell v. Commissioner*<sup>4</sup> is a good example of an entity-level discount. The Tax Court first applied a 10% key person discount (for the death of Paul Mitchell) to the \$150,000,000 control value for the entity that the court had determined. The court then took the percentage owned by the estate times the remaining \$135,000,000 value and applied discounts for lack of control and lack of marketability.

These entity-level discounts usually are applied as a percentage to some measure of value, as in the above example. In some cases, for example, the application of a trapped-in capital gains adjustment, the discount may be quantified as a dollar amount rather than a percentage.

## Discounts and Premiums Reflecting Shareholder Characteristics of Ownership

The starting point for any discount or premium has to be a well-defined base to which it is applied. This is especially true of shareholder-level discounts or premiums.

The starting point for discounts relating to characteristics of ownership could be one of the levels defined on the traditional levels-of-value chart (see Exhibit 1.2), such as:

1. Control value, or
2. Minority marketable value (also sometimes called “publicly traded equivalent value” or “stock market value”)

If, on the other hand, the analyst believes that publicly traded equivalent value is equal to control value, in accordance with the alternative levels-of-value chart shown in Exhibit 1.3, discounts for both lack of control and for the relative degree of lack of marketability between a control position and a private minority position may be appropriate to derive a private minority value. Further explanation of the concepts embodied in Exhibits 1.2 and 1.3 is included in Chapter 2.

The premiums or discounts reflecting characteristics of ownership fall broadly into two major categories:

1. Degree of control or lack of control. The issue of voting versus nonvoting stock may be regarded as a subcategory of control or as a separate issue.
2. Degree of lack of marketability.

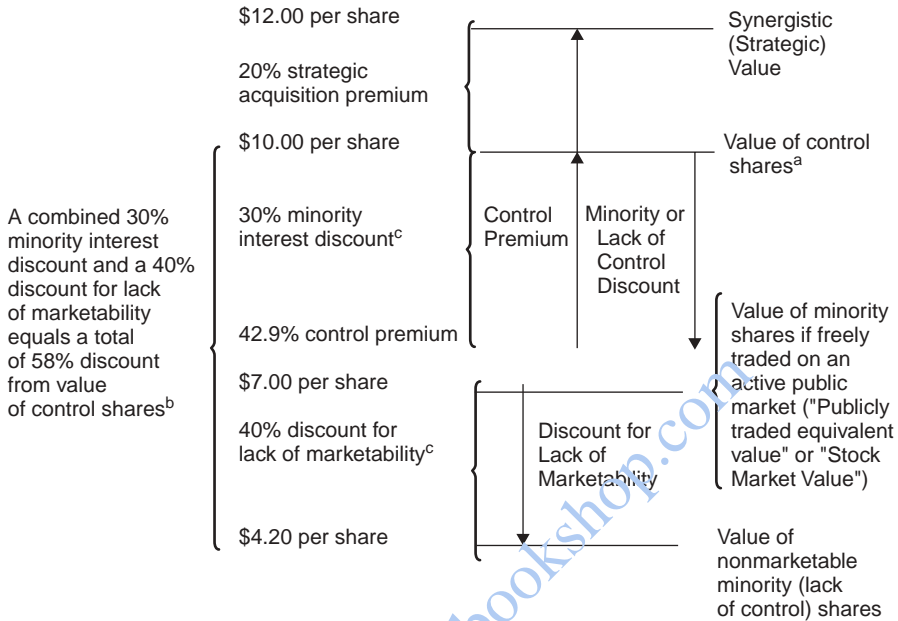
Each of the above has economic bases that must be analyzed in each individual situation.

In a valuation analysis, the degree of control usually is considered before the degree of marketability. This is because, although control and marketability are separate issues, the degree of control or lack of it has a bearing on both the size of the discount for lack of marketability and the procedures that are appropriate to quantify the discount for lack of marketability.

It generally is not practical to use the minority nonmarketable level of value as a starting point because there is no database of arm’s length transactions of minority nonmarketable interests and no other empirical data to lead directly to that level of value.

Note that the issue of marketability is usually distinguished from nonmarketability at the minority interest level but not at the controlling interest level. On the minority interest level, “marketable,” or “liquid,” reflects a stock with an active public trading market that can be sold instantly, with cash proceeds received within three days.<sup>5</sup> Controlling interests are far less liquid than an actively traded security, although in most cases they are more liquid than a private minority position. Therefore, at this point we have no benchmark against which to classify a controlling interest as marketable or nonmarketable. Also, this concept does *not* apply to other types of property, such as real property, where no such liquid market for fractional interests exists.

**Exhibit 1.2** “Levels of Value” in Terms of Characteristics of Ownership



Notes:

<sup>a</sup> Control shares in a privately held company also may be subject to some discount for lack of marketability, but usually not nearly as much as minority shares.

<sup>b</sup> Minority and marketability discounts normally are multiplicative rather than additive. That is, they are taken in sequence:

\$10.00	Control Value
- 3.00	Less: Minority interest discount (.30 x \$10.00)
<u>\$ 7.00</u>	Marketable minority value
- 2.80	Less lack of Marketability discount (.40 x \$7.00)
<u>\$ 4.20</u>	Per share value of non-marketable minority shares

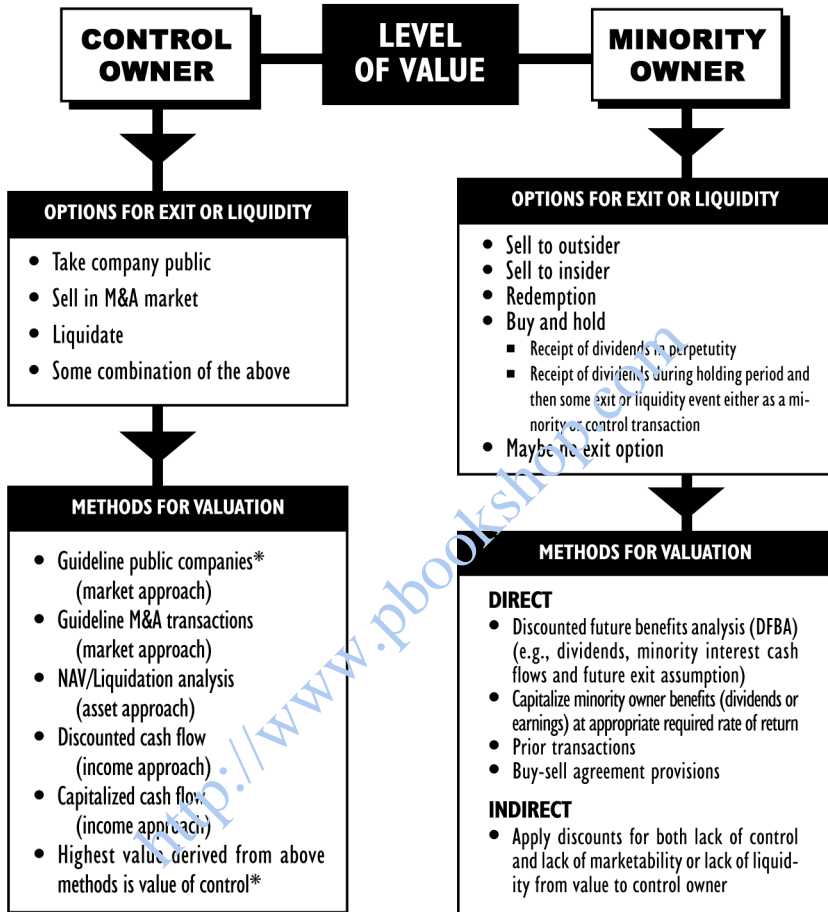
<sup>c</sup> Note that neither the minority/control nor the marketability issue are all-or-nothing matters. Each covers a spectrum of degrees.

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Since we have no such benchmark at the control level, some consider it wise to avoid trying to classify controlling interests as “marketable” or “nonmarketable.” (This will be discussed in greater detail in Chapter 9.)

The American Society of Appraisers courses use the term “basis of value” rather than “level of value.” They use a chart configured somewhat differently (see Exhibit 1.4). It

**Exhibit 1.3** “Levels of Value” in Private Companies Based on Owners’ Options for Exit or Liquidity

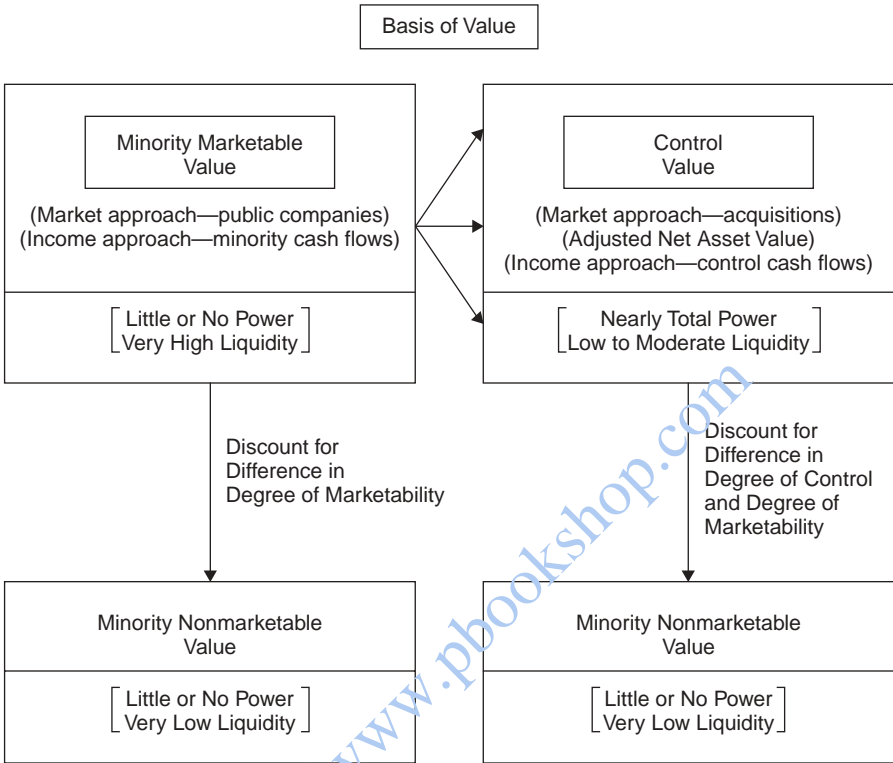


\*Guideline public company method—Determine if company could go public. If so, where would it likely trade assuming it was seasoned in the market? If not, is this method applicable? If company could do an IPO, control owners usually cannot cash out, but end up with restricted stock. May need to determine the cash-equivalent value of this restricted stock if public market indicates significantly higher value than the other approaches.

Source: Chart designed by Eric W. Nath.

differs from the levels-of-value chart in that “levels of value” implies a linear process, control being highest, marketable minority next, and unmarketable minority lowest. The American Society of Appraisers chart, developed by Michael Bolotsky, implies a non-linear, multivariate process; it implies that at certain times and for certain companies, marketable minority value can be higher than control value.

**Exhibit 1.4** Basis of Value Chart



Source: American Society of Appraisers, adapted from chart created by Michael J. Bolotsky.

The American Society of Appraisers Business Valuation Standard VII, shown as Exhibit 1.5, summarizes business valuation discounts and premiums and their application quite succinctly. Appraisers should note Section III, the steps in the application of discounts and premiums.

**Degree of Control or Minority**

The degree of ownership control covers a wide spectrum, from 100% control ownership to a tiny minority with no control attributes at all. Therefore, discounts for lack of control vary in degree depending on how many and what types of control attributes are present.

It is *vital* to recognize that ownership of stock or a partnership interest does not entail any direct claim on the underlying assets. This is a fundamental concept that those not familiar with business appraisal may not at first grasp. It is the foundation

**Exhibit 1.5** American Society of Appraisers Business Valuation Standard VII,  
Valuation Discounts and Premiums

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**BVS-VII Valuation Discounts and Premiums<sup>®</sup>**

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I. Preamble

- A. This standard is required to be followed in all valuations of businesses, business ownership interests, and securities by all members of the American Society of Appraisers, be they Candidates, Accredited Members (AM), Accredited Senior Appraisers (ASA), or Fellows (FASA).
- B. The purpose of this standard is to define and describe the requirements for use of discounts and premiums in the valuation of businesses, business ownership interests, or securities whenever they are applied.
- C. This standard incorporates the general preamble to the Business Valuation Standards of the American Society of Appraisers.
- D. This standard is applicable to appraisals and may not necessarily be applicable to limited appraisals and calculations as defined in BVS-I, Section II.B.
- E. This standard applies at any time in the valuation process whether within a method, to the value indicated by a valuation method, or to the result of weighing or correlating methods.

II. The Concept of Discounts and Premiums

- A. A discount has no meaning until the conceptual basis underlying the value to which it is applied is defined.
- B. A premium has no meaning until the conceptual basis underlying the value to which it is applied is defined.
- C. A discount or premium is warranted when characteristics affecting the value of the subject interest differ sufficiently from those inherent in the base value to which it is applied.
- D. A premium or discount quantifies an adjustment to account for differences in characteristics affecting the value of the subject interest relative to the base value to which it is being compared.

III. The Application of Discounts and Premiums

- A. The purpose, applicable standard of value, or other circumstances of an appraisal may indicate the need to account for differences between the base value and the value of the subject interest. If so, appropriate discounts or premiums should be applied.
- B. The base value to which the discount or premium is applied must be specified and defined.
- C. Each discount or premium to be applied to the base value must be defined.
- D. The primary reasons why each discount or premium selected applies to the appraised interest must be stated.
- E. The evidence considered in deriving the discount or premium must be specified.
- F. The appraiser's reasoning in arriving at a conclusion regarding the size of any discount or premium applied must be explained.

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Source: American Society of Appraisers *Business Valuation Standards*.

of the discount for lack of control. For example, the other day I tried again to back my van up to the local brewery loading dock and swap my stock in the brewery for an equivalent value of beer. I even offered to discount the value of my stock for minority interest and lack of marketability, but still no deal. They said that the stock was not exchangeable for the underlying assets.

I think that the liquidation value of my brewery's assets is a lot greater than what the stock trades for, but I cannot force liquidation or even a partial sale of assets. The profits are good enough that they could at least pay a beer dividend (some distilleries used to pay a whiskey dividend), but they would rather pay outrageous bonuses to the semicompetent chairman of the board (who also happens to have a controlling ownership in the stock).

It is no wonder that the few trades that do take place in the brewery's stock are at a price a great deal lower than a proportionate share of what the whole thing is worth.

### Degree of Marketability

Like the degree of control, the degree of marketability can cover a wide spectrum. It can range all the way from active public trading (instant sale with cash in three business days) to no trades at all and severe restrictions on any attempt to sell. For example, most stocks traded on the New York Stock Exchange (NYSE) or the NASDAQ markets have very high liquidity. Partnership interests traded on the secondary market for partnerships registered by the Securities and Exchange Commission (SEC) are marketable, but the liquidity of that market is usually much less than that of the major stock markets.

As alluded to, there can be a distinction between "marketability" and "liquidity." Dictionaries define these terms in various ways, but the general theme seems to be that "marketability" relates to the right to sell something, whereas "liquidity" refers to the speed with which an asset may be converted to cash without diminishing its value. On the other hand, financial texts tend to define these terms somewhat differently. Currently, business appraisers tend to use these terms interchangeably and there is no consensus yet on a distinction between these terms. For the purposes of this book these terms are used interchangeably; however, analysts may wish to define these terms in their report if it is important to the analysis.

Investors cherish liquidity and abhor lack of it. When a stock is not readily marketable (i.e., publicly traded), if it does finally sell, it usually will sell at a significantly discounted price from control value or from an otherwise comparable stock that is publicly traded. This is the conceptual basis for the discount for lack of marketability: one does not know when or for how much one's stock can be sold.

The amount of this discount will vary depending on the degree of liquidity attributes (e.g., occasional trades, potential for a public offering, or sale of the company) to restrictions exacerbating the lack of liquidity.

## HOW THE VALUATION APPROACHES USED AFFECT THE LEVEL OF VALUE

Different valuation approaches and methods result in different levels of value. Therefore, in order to understand whether various discounts and/or premiums should be applied to the appropriate base value, the appraiser needs to understand what base value was developed by the valuation method(s) used. This section gives a broad overview, and later chapters discuss more specific detail about how the valuation method(s) impact premiums and discounts.

There is an ongoing debate about whether public stock market multiples, discount rates, and capitalization rates indicate minority or control levels of value. This debate is summarized and examined in more depth in Chapter 2.

### Income Approach

Most analysts believe that the question of whether the income approach produces a minority or control value depends for the most part on whether the income or cash flows to be discounted or capitalized represent a minority basis (generally, business as usual) or are adjusted to reflect whatever policies a control owner could implement.

The discount or capitalization rate in the income approach is derived from public stock market data. There are three methods commonly used to derive discount and capitalization rates from public stock market data:

1. The Capital Asset Pricing Model
2. The buildup model
3. The “Discounted Cash Flow method”

(For descriptions of each of these methods, see *Cost of Capital: Estimation and Applications*.<sup>6</sup>) Regardless of what method is used to estimate the discount rate, *the rate developed is from public market data and reflects the assumption of full marketability. Therefore, if minority interest cash flows are used, the result should be the minority, marketable level of value. If control cash flows are used, the result should be control value*, although there may be room for a modest control premium to reflect the ability to exercise the prerogatives of control and gain economic benefit from doing so. For example, most buyers believe that they can improve profitability by better management.

Since there is no market data to benchmark the discount for lack of marketability for controlling interests, it is a matter of the analyst’s judgment as to whether a discount for lack of marketability is warranted. Discounts for lack of marketability are covered in detail in future chapters.

## Market Approach

Within the market approach, the level of value indicated may depend on whether the guideline publicly traded company method or the merger and acquisition method is used.

**Guideline Publicly Traded Company Method.** Stock of the guideline public companies are actively traded minority interests. Therefore, the guideline publicly traded company method traditionally has been assumed to produce a marketable minority level of value. However, this assumption has been seriously challenged and there is good reason to believe that such may not always be the case. A full discussion of the debate surrounding this issue is included in Chapter 2.

**Guideline Merged and Acquired Company Method.** If using merged and acquired guideline companies to derive market multiples, the transactions usually represent controlling interests, so the method is assumed to reflect a control value. Also, this method may reflect synergies, especially in acquisitions of larger companies, which would not be reflected in fair market value.

## Asset-Based Approach

Whether the adjusted net asset value or the excess earnings method is used, the general assumption is that asset methods reflect control over the assets and a control value with respect to the levels-of-value chart. This is because, in both methods, individual assets or classes of assets are adjusted to fair market value (often relying on appraisals from other disciplines), and 100% ownership (control), typical market conditions, and no restrictions on transfer are assumed.

## USE OF PUBLIC COMPANY DATA TO QUANTIFY DISCOUNTS AND PREMIUMS

The emphasis in this book is on applying discounts and/or premiums in the context of private company valuations, although most of the principles and some examples used are applicable to public companies as well. To illustrate the reality of the discounts and premiums, it is necessary to rely heavily on data from the public markets because this is the only place that actual investor behavior can be observed with respect to most discount and premium issues.

For example, there are virtually no data on prices at which minority interests change hands in private companies compared to the price of a controlling interest in the same company. But we have data on literally thousands of acquisitions of public companies, which relate to exactly that.

Most decision makers, analysts, and courts would rather have an empirical basis for justifying both the reality and the quantification of the premium or discount rather than just an opinion, with nothing to support the analyst's judgment. For the most part, such data are available only in the public market.

## HOW THE STANDARD OF VALUE AFFECTS DISCOUNTS AND PREMIUMS

The three primary standards of value that we use for various valuation purposes are:

1. Fair market value
2. Investment value
3. Fair value

While these standards of value are well defined in the appraisal literature, they often are used much more loosely (or ambiguously) in court opinions, especially in family law courts. It is important that the analyst, the attorney, and the court agree on the relevant standard of value, because it may mandate or influence the applicability of certain discounts or premiums, especially with respect to the issue of minority/control and marketability.

### Fair Market Value

Fair market value is a concept of value in exchange. It is defined as "the net amount that a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."<sup>7</sup> It is assumed to be a cash value.

It is important to note that the buyer and seller are "hypothetical," as opposed to any one specific, identified buyer or seller. This is intended to eliminate the influence of one buyer's or seller's specific motivations. However, if there is an active group of competing buyers or sellers with a common set of motivations, this group could constitute the market in which the "hypothetical" buyer and seller might meet to transact, and thus the price that the group would find acceptable could constitute fair market value.

Fair market value is the statutory standard of value for all federal tax cases.<sup>8</sup> It often is the standard of value in bankruptcy proceedings. In some states, precedential case law has established fair market value as the standard of value in property valuations for divorce. The analyst or lawyer must be very careful, however, in the

divorce context, because court opinions often use the phrase “fair market value” and then go on to actually apply a standard that is different from the one defined here. Except in Ohio, fair market value is *not* the standard of value in dissenting-stockholder or minority-oppression cases.

Under the standard of fair market value, the focus must be on the specific property (ownership interest) being valued, basically “as is,” including control and marketability characteristics. Therefore, minority interests in closely held corporations or partnerships are valued to reflect lack of control and lack of marketability characteristics.

## Investment Value

Investment value differs from fair market value as defined in the literature of appraisal in that *investment value* means the value to some *particular* buyer or seller rather than to a *hypothetical* buyer or seller.

Investment value, therefore, might incorporate the synergistic value that some particular buyer may be willing to incorporate into an *acquisition premium* over and above just a control premium that others might pay for the prerogatives of control.<sup>9</sup>

Investment value is often found in legal precedents, especially in the family law courts, where judges often seek “value to the owner,” or to the marital community, as opposed to value in exchange. For example, if a company is family owned, there may be no minority discount for a minority owner because, through family attribution, that owner is assumed to be part of a control group.

The analyst and attorney must be extremely careful in studying the relevant case law, because it is quite common to find the phrase “fair market value” in precedential opinions, especially in the family law context, and then find that, in fact, the valuation methodology accepted by the court has actually brought in elements of investment value. Family law courts also sometimes refer to investment value as “intrinsic value.”

## Fair Value

Fair value is a creature of state legislatures, primarily as the standard of value for dissenting stockholder suits and minority oppression suits. Until 1999 it was defined by the Model Business Corporation Act as “the value of the shares immediately before effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable.”

This definition clearly eliminates any acquisition premium that would incorporate synergistic value with an acquirer over and above the company’s control value on a stand-alone basis. However, the definition does not address the questions of the lack of control or lack of marketability of the shares in question.

In 1999 the Model Business Corporation Act introduced language to the effect that fair value would not incorporate either minority discounts or discounts for lack of marketability. However, as of this writing (mid-2001), no state has yet incorporated that modification into its dissenting stockholder statutes or its shareholder dissolution (minority oppression) statutes.

As of now, there is no clear majority position among the states regarding the interpretation of fair value with respect to the issues of minority/control or lack of marketability, although the trend is toward not applying discounts for these factors in determining fair value. In fact, some treat these issues differently in the context of dissenting stockholder versus corporate dissolution statutes. In each situation, the analyst and the attorney must carefully study the relevant case law. When there is no precedential case law, states often turn to persuasive case law from other states with similar statutory law.

## SUMMARY

This chapter has provided a broad overview of business valuation discounts and premiums. I distinguished between those discounts and premiums that affect the whole enterprise and all its owners, called *entity-level* discounts, and those that are specifically a result of ownership characteristics (control and marketability or lack of either), called *shareholder-level* discounts and premiums. Since entity-level discounts impact the whole enterprise, they usually are applied to a control value, derived by any valuation approach or method. However, if the guideline public company method (or some other method producing a minority value) is used without ever reaching a control value, the entity-level discounts are still applicable.

Shareholder-level discounts or premiums, on the other hand, are very specific to the ownership characteristics of the base to which they are applied. Therefore, when dealing with adjustments to value arising from ownership characteristics, the assumptions as to the ownership characteristics of the base to which they are applied must be very clearly defined, or the adjustments are meaningless.

I introduced the traditional levels-of-value chart, which assumes that public market data as applied to a private company, gives a “marketable minority” level of value that is less than control. I also introduced an alternative levels-of-value chart that treats public market value and control value nonlinearly such that public market value could be less than, equal to, or greater than control value. Finally, I have shown how the standard of value (fair market value, fair value, or investment value) has an effect on whether premiums or discounts apply in specific cases.

Following chapters discuss both the concepts and measurement of the various discounts and premiums in detail. They also include details of how various courts have accepted or rejected the application and quantification of these discounts and premiums in contexts such as tax, marital dissolution, dissenting and oppressed stockholder actions, and bankruptcy cases.

## Notes

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1. *Swope v. Siegel-Robert, Inc.*, 74 F. Supp.2d 876 (E.D. Mo. 1999) *aff'd in part, reversed in part* by 243 F.3d 486 (8th Cir. 2001). (In this case, the district court declined to apply either the control premium or the marketability discount and concluded a value of \$63.36 per share, finding them to be discretionary. But the Eighth Circuit reversed, holding that no discounts or premiums should be applied in determining fair value as a matter of law.)
2. *Estate of Weinberg v. Commissioner*, T.C. Memo 2000-51, 79 T.C.M. (CCH) 1507 (2000).
3. *Mandelbaum v. Commissioner*, T.C. Memo 1995-255, 69 T.C.M. (CCH) 2852 (1995), *aff'd*, 91 F.3d 124 (3d Cir. 1996).
4. *Estate of Mitchell v. Commissioner*, T.C. Memo 1997-461, 74 T.C.M. (CCH) 872 (1997), *aff'd in part, vacated in part*, by 2001 U.S. App. LEXIS 7990 (9th Cir. 2001).
5. Mercer, Z. Christopher, *Quantifying Marketability Discounts* (Memphis: Peabody Publishing, LP, 1997), p. 6.
6. For methods to estimate discount and capitalization rates, see Shannon P. Pratt, *Cost of Capital: Estimation and Applications* (New York: John Wiley & Sons, 1998), especially Chapter 8, "Build-up Models," Chapter 9, "The Capital Asset Pricing Model (CAPM)," and Chapter 12, "The DCF Method of Estimating Cost of Capital."
7. 26 CFR 20.2031-3 valuation of interests in businesses.
8. Certain collections matters may differ from the fair market value standard.
9. Some may refer to this standard of value as a form of "value in use," although the appraisal profession considers "value in use" to be a premise of value; that is, the condition of the company when the transaction takes place.