

< FINANCIAL SERVICES GUIDE

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## Find your silver lining in this economic slowdown



Valuations will be significantly lower relative to recent years, and this in turn presents longer-term opportunities for business owners to lower taxes or execute a succession plan.

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Jul 10, 2020

The current economy is at a stand-still. The stock market recently experienced record declines and unprecedented levels of volatility. The population is quarantined and schools have been closed for months. Non-essential businesses have been ordered to close. The uncertainty and fear are, at times, palpable.

This is not our first experience with a dramatic decline in the economy. The stock market declines, job losses, bank failures, and housing foreclosures that began in late 2008 are held in our collective memory. Thinking back even further, we remember the shock of the 9/11 attacks and the instantaneous negative impact on the airlines and tourism industry.

One of the primary differences between the current economic crisis compared to these previous downturns is the existence of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), through which the government is offering unprecedented help to small businesses, assisting with continuing operations in the short term.

As difficult as the current crisis is, there are potential long-term benefits to business owners.

In business valuation, there are many scenarios in which the objective is a high value. However, it is just as common for a low value to be optimal. For example, when the valuation is performed for tax reporting purposes, a low value means a reduced tax burden. In a marital dissolution, the spouse that is keeping the business wants a low value. Also, when an owner wants to transfer ownership to a key employee, a lower value is often needed for it to be viable.

Due to the increased uncertainty, weakening economy and lower stock market prices as a result of the Covid-19 pandemic, valuations of privately held companies will be significantly discounted relative to values in recent years, or even relative to values of just a few months ago before the economic impact of the virus was known. This can therefore be an opportunity for a business owner to execute a succession plan, or to transfer ownership to key employees or family members at discounted values.

In 2008, with valuations at record lows, an auto dealership owner was able to take advantage of the economic situation to execute his transition plan. This auto dealer's plan was to transfer a 20% ownership interest to his son and general manager in the current year, and to transfer another 20% interest in 2012 and again in 2016. A business appraisal was performed in late 2008 to set the value. The engagement also included the valuation of an option to purchase the 20% interest in four years, and again in eight years, at the pre-determined 2008 price. This well-executed plan allowed the business owner to lock in the low valuations inherent in 2008 for eight additional years, thereby minimizing tax implications to his son.

Another opportunity at present is in the arena of estate taxes. When a business owner passes away, a valuation is conducted as of the date of death or as of the "alternate date of death" which is six months after death. Consider an estate with a shipping logistics company with most of its product coming from China. The owner passed away in November 2019 but the alternate date of death of May 2020 should be considered to reduce estate taxes. In November 2019, economic conditions indicated "business as usual" but since that time, revenues have declined by over 15% and management noted uncertainty related to the company's future financial performance and its long-term viability.

The lower valuations also apply to real estate and family limited partnerships that hold real estate. An appraisal of an apartment building in the Portland metropolitan area would have a materially lower value today relative to February 2020 or earlier. When schools closed and all non-essential

businesses shut down in mid-March, many workers lost their jobs, which in turn may mean that tenants will be unable to pay their rent. The property owner has little recourse in the short-term as Oregon’s governor put a 90-day moratorium on evictions starting March 22, 2020.

As businesses struggle to keep their doors open, keep employees on payroll and weather this virus-driven storm, the silver lining is that valuations will be significantly lower relative to recent years, and this in turn presents longer-term opportunities for business owners to lower taxes or execute a succession plan.

It is unclear whether the economic impact of Covid-19 will be short lived or last several years but when the economy recovers, this opportunity will be lost. Take advantage of this economic environment to achieve your long-term goals by working with **professional advisors** and an experienced business valuation firm.

*Markee Valuations is a business valuation firm. We conduct business valuations for a variety of purposes and regularly testify as experts in support of our findings. From our Vancouver-based office, our team of four full- time employees serve clients in Oregon, Washington and across the country.*

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