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Forensic Accounting, Business Valuation and Consulting

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Buying and Selling a Tax Practice

By: Donald P. Wisehart, ASA, CPA/ABV/CFF, CVA, MST

As a tax practitioner for more than 40 years and a business valuation professional for 25 years, sales and valuations of tax practices have crossed my desk numerous times, in addition to making two acquisitions myself. As with most, if not all, tax practice acquisitions, the buyer and seller have very different points of view.

From the seller's perspective, there are two objectives. First, how can a seller maximize the best price, and second, how does the seller place clients with firms offering the same or better quality of service? In a perfect world, the seller will be paid upfront for his or her tax practice, while spending a minimal amount of time transitioning the personal and professional goodwill to their buyer. This type of deal does happen; however, the risk to the buyer is huge. For this reason, few practices are sold in a lump sum.

There are two buyer's objectives as well. First, the buyer wants to maximize new client billings at the best price, while retaining those clients over a long period of time, and second, the buyer wants to make sure that the two merging practices "fit" geographically and in the similar type of tax service offered. For client retention to work, the personal and professional goodwill of the seller(s) must be successfully transferred to the buyers in a reasonable period of time.

To mitigate these differences, there must be a compromise between the buyer and the seller. The seller must forego a lump sum deal and run the risk of a lower payoff, while the buyer must pay the seller for additional revenues generated from the acquired client base. To accomplish this, the price is expressed as a multiple of annual revenue receipts, such as .75, 1.00 or 1.25, depending on the buyer's and seller's perception of the quality of the practice. Why receipts over billings? Simple – cash is "king!" The amount should be paid out monthly over a period of years – generally three to five years – depending on the transition time needed to transfer goodwill to the buyer.

Here's how a typical acquisition would take place. Buyer A buys Seller B's tax practice at a multiple of 1.00, based on the historical client retainage, gross margins and potential for generating additional fees within the client base, as well as other factors that I've listed later in this article. Annual fees received are $500,000, and because the seller does not plan to work after the acquisition date (more on that to come), a four-year payout is agreed upon. In the first two years, there was a drop off in revenues when several clients went their separate ways. However, due to increased fees, revenues returned to the $500,000 level and grew 5 percent in the fourth

Table 1

	Safe Rate	Year 1	Year 2	Year 3	Year 4
Actual annual billings		$ 485,000	$ 496,000	$ 500,000	$ 525,000
Annual payout					
1 ¸ 4 = .25		0.25	0.25	0.25	0.25
Cash received by seller		121,250	124,000	125,000	131,250
Present value factors	2.50%	0.9877	0.9636	0.9401	0.9172
Present value of cash received		119,762	119,491	117,517	120,383
Total present value of cash received by seller		$ 477,153			
Total undiscounted cash received by the seller		$ 501,500			

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Retaining An IRS Qualified Appraiser

By: Steven D. Hyden, CPA/ABV

It is no secret that taxpayers and the IRS are in a constant state of conflict over a number of issues, and one of them is value. Value has traditionally been a subject of much disagreement in the arenas of charitable donations and estate and gift taxes.

When the subject is an interest in a closely held business, the fair market value of the interest is the critical element in the determination of the gift or estate tax liability. The appraisal of the interest is not an objective calculation but rather a subjective exercise. Although the foundation of any business appraisal is the proper application of generally accepted valuation techniques, the utilization of judgment is critical to the process. Because judgment plays such an important role in the determination of the value of a closely held business interest, the IRS has sought to bring some order to the chaos.

One way the IRS has attempted to reduce such controversies is by establishing general qualifications for appraisers. At the sole discretion of the IRS, values of gifts for gift tax purposes and non-gift completed transfers to family members may require a qualified appraisal, as defined by Treas. Reg. § 301.6501(c)-1(f)(3). The IRS's guidance includes the following requirements related to the appraiser:

1. The appraiser holds him/herself out to the public as an appraiser or performs appraisals on a regular basis.
2. The appraiser is qualified to make appraisals of the type of property being valued, as evidenced by background, experience, education and membership in professional appraisal organizations.
3. The appraiser is neither the donor nor donee of the property nor a family member.

The appraisal documentation must contain all of the following:

1. Date of appraisal, date of transfer and purpose of the appraisal
2. A description of the property
3. A description of the appraisal process employed
4. A description of hypothetical and limiting conditions, assumptions used, and restrictions on the property that would affect the conclusion
5. Disclosure of information considered, including, in the case of a business interest, all financial data used in determining value, such that another person can replicate the work and arrive at the appraised value
6. Description of procedures and reasoning supporting the analysis and conclusion(s)
7. The valuation method(s) utilized, the rationale for selecting the method(s) and procedure used in determining value
8. The specific basis for the valuation, that is, discussion of the methods relied upon.

Much of the guidance has been supported in various court decisions. For example, courts have accepted as expert appraisers those who represent business valuation firms or consulting firms providing business valuation services and look favorably on accreditations and credentials such as the AICPA's Accredited in Business Valuation (ABV).

In a future article we will examine in greater detail what certain court decisions have had to say about appraiser qualifications. However, of one thing there is no doubt – ignoring the guidance and retaining an unqualified appraiser, or not retaining an appraiser at all, is an invitation to disaster. Values so determined will most certainly be disallowed, and at a minimum the taxpayer will have to commission a proper valuation, but at that point the taxpayer will be in the unenviable position of playing defense and will be trailing badly. ~

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year. As [Table 1] shows, the actual payout received over the four-year period is $501,500, discounted to $477,153 using a safe rate of 2.5 percent.

Had the seller been an active employee (part-time or otherwise) of the buyer, it would have been possible that the amount received by the seller would have been more. This is because the seller would be in a position to better transfer his personal and professional goodwill. It is my firm belief that the longer the

Table 2

Low Multiple	→	High Multiple
Different	Tax Software	Same
Poor	Sound Office Procedures	Excellent
None	Sound Review Procedures	In Place
Many	Tax Notices	Few
Low	Audit Success Rate	High
Different	Location	Same
Undesired	Location	Desired
No Growth	Location	High Growth
Untrained	Employee Experience	Highly Trained
Short	Length of Employment	Long
None	Non Competition Agreements	In Place
Low	Gross Margins	High

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Announcements:

Michael Mard is honored and pleased to be recognized as an "*Industry Titan, the Financial Consulting Profession's Most Influential*" by the National Association of Certified Valuation Analysts (NACVA). Over the past quarter century, NACVA has helped shape and influence the business valuation and financial forensics disciplines with the support of key subject matter experts leading the charge. During 2016 NACVA is celebrating these subject matter experts and acknowledging the impact they have made to the profession. Mike Mard is grateful to have been nominated and chosen as a "Business Valuation and Financial Forensic Masters" expert who has been instrumental in developing methods and models, codifying standards and ethics, and instructing, mentoring, authoring, publishing and providing resources to thousands of business valuation and financial forensic analysts, attorneys, judges, federal and state regulators, business owners, and other financial consultants around the globe.

Donald Wisehart has been awarded the "*Master Analyst in Financial Forensics*" (MAFF), a credential issued by the National Association of Certified Valuators and Analyst (NACVA). Over the past quarter century, NACVA has helped shape and influence the business valuation and financial forensics disciplines around the globe. NACVA states the "MAFF credential is designed to provide assurance to the legal and business communities—the primary users of financial forensics services—that the designee possesses a level of experience and knowledge deemed acceptable by the Association to provide competent and professional financial forensic support services." To earn the MAFF credential, candidates must attest to having met certain prerequisites and experience requirements plus pass a four-hour proctored exam objectively testing NACVA's Financial Forensics Body of Knowledge. The MAFF credential gives practitioners the foundation needed to deal with the attendant legal or corporate board level support that often enters into business valuation engagements.

seller can be active in the business, the better the goodwill transition. To this point, I would strongly advocate that a potential seller consider "merging" with a suitable firm, one to three years prior to retirement, with the deal modeled in the same manner as my illustration above.

So, what factors are taken into consideration in determining what multiple to use? Not surprisingly, it is subjective at best. However, over the years, I've come to believe that these following 12 factors [see Table 2] would work well to assist you in determining the right multiple to use:

There may be other attributes that you might add to the list; however,

Continued on next page

Table 3

Low Multiple	→	High Multiple	+ / -
Different	Tax Software	Same	0.1
Poor	Sound Office Procedures	Excellent	0.1
None	Sound Review Procedures	In Place	-0.1
Many	Tax Notices	Few	0
Low	Audit Success Rate	High	0.1
Different	Location	Same	-0.1
Undesired	Location	Desired	-0.1
No Growth	Location	High Growth	0
Untrained	Employee Experience	Highly Trained	0.1
Short	Length of Employment	Long	0.2
None	Non Competition Agreements	In Place	-0.2
Low	Gross Margins	High	0.1
		Total	*0.2*

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as I indicated before, I have found these to be more important.

Although I firmly believe that the only "rule of thumb" is that there is no "rule of thumb," it does seem that average-sized tax and accounting practices sell around 1 times their annual receipts. A multiple of 1 would be a good starting point, and then one would increase or decrease the multiple based upon the attributes I charted above. As shown in [Table 3] the multiple of 1 was increased to 1.2. As mentioned before, these are highly subjective attributes, but nonetheless, an excellent starting point in determining the right multiple for you. ~

Author's note: This article was originally published at Intuit ProConnect Tax Pro Center (http://taxprocenter.proconnect.intuit.com/practice-management/buying-and-selling-a-tax-practice/). It is reprinted here with permission.

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