The Role of Valuation When Oversight Agencies Increase the Scrutiny Threshold

By

Stanley Jay Feldman, Ph.D.
Chairman and Chief Valuation Officer
Axiom Valuation Solutions

Senators Warren and Sanders are leading a renewed charge that financial crises can be averted or at least minimized if the oversight authorities do a much better job of monitoring the activities of wealthy individuals and of course wall street bankers, large global banks and corporate officers. You do not have to take a position of whether more oversight involvement is good or bad to understand the implications; namely, providing substantive proof that what is being asserted is accurate and can stand up to serious vetting by agencies like the IRS and the SEC. Even without the latest outcries of the system being rigged and the rich not paying their fair share of taxes, the IRS has been spending more time trying to uncover what it views as tax avoidance strategies and puts enormous pressure on those identified to demonstrate that there are real economic benefits to the claims they make. The latest focus on whether micro captive insurance arrangements created by closely held businesses are legal or not is just one example. Senator Warren's wealth tax proposal will certainly result in the IRS looking far more closely at estates that include shares of closely held businesses and other non-traded assets. Even now, the IRS looks askance at claims made by sellers of private C corporations that a large part of the capital gains reported are personal goodwill of the sellers. The reason is that personal goodwill is not a corporate asset and therefore is not subject to double taxation- once at the corporate level and then again at the personal level when the distribution is made to the seller.

Like the IRS, the SEC is reviewing how firms value various types of intangible assets, like trademarks for example, and through comment letters are suggesting that trademarks should be valued according guidelines that are inconsistent with GAAP. It is now customary for firms to receive numerous comment letters from the SEC when they file their S-1s. These comments range from questions about accounting to minutiae related to the volatility measure used in valuing employee stock options even knowing that the associated option expensing has no material impact on the firm's historical financial performance.

The oversight agencies have more resources than ever before, and they are and will continue to leverage this larger resource base consistent with their charter to search and uncover financial fraud. Although there are many implications of this renewed oversight focus, one can be sure that any substantive tax deduction will be reviewed with a level of scrutiny not seen before. This means that when and if the IRS reaches out and questions the basis of a charitable deduction, for example, you better be prepared to demonstrate that the deduction in question is fully supportable and meets all IRS requirements for establishing fair market value. **Of course, the focus will be even greater if the followers of Elizabeth Warren and Bernie Sanders have their way. The oversight landscape has changed. Either be prepared or be audited- your choice.**