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When subsequent events count

Anyone who's played the stock market can appreciate the benefit of hindsight. Before investing in a company, who wouldn't like to know that a hurricane will destroy the business's primary warehouse, or its technology will become obsolete next year — events that might affect the price knowledgeable investors are willing to pay per share?

Like investing in public stocks, private business appraisal must be based on information available at the time — specifically, on the required date of appraisal, according to Revenue Ruling 59-60. The valuation date is an important cut-off. Valuators generally consider only information that was "known or knowable" on the valuation date.

Exceptions to the rule

Valuators cannot benefit from hindsight any more than investors can. But there are exceptions.

In *Estate of Jung v. Commissioner*, the U.S. Tax Court considered a subsequent sale when valuing a business interest more than a year after Jung's death. The court concluded, "Actual sales made in reasonable amounts at arm's length in the normal course of business within a reasonable time before or after the valuation date are the best criteria of market value."

Jung made an important distinction between subsequent events that *affect* fair market value and those that provide an *indication* of value. Within the first category, only reasonably foreseeable subsequent events may be factored into a valuator's analysis.

But if a subsequent event provides an indication of value, it might be considered — even if it wasn't foreseeable — as long as it occurs within a reasonable time frame and at arm's length. A valuator also considers whether intervening facts and circumstances have drastically changed the value of the business since the valuation date.

Gray areas

Several gray areas exist when a valuator handles subsequent events. In some circumstances, an event is knowable yet unknown on the valuation date.

For instance, suppose corporate counsel has confided in the company president about an imminent criminal investigation. Should a valuator factor confidential information, such as a pending criminal investigation, into the value conclusion if it's undisclosed on the valuation date? In general, unknown subsequent events that would be uncovered during reasonable acquisition due diligence may be considered in an appraisal.

Handle with care

Appraisers consider all subsequent events and rule out some of them when valuing a business. The "known or knowable" benchmark isn't the only guideline for proper handling of subsequent events. Courts may view actual arm's-length transactions of a private company's stock before *or after* the valuation date as the best indicator of value.

Do you have a Question? or want to speak to

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