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CARES Act Causing Business Valuation Concerns for Divorces, Estate Plans and Partnerships

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By James Gallagher, AICPA

The COVID-19 pandemic and federal Coronavirus Aid, Relief and Economic Stimulus (CARES) Act are having a major impact on business valuations, affecting large companies to small, Main Street businesses.

Those valuation changes can have major financial implications for divorcing couples, estate planning, those looking to buy or sell a business, or becoming an equity partners in an enterprise.

“Depending on your position, there are potential windfalls in these valuation changes or huge losses,” said Paul Wapner, CPA, ABV, CGMA, senior manager of valuation services for the Association of International Certified Professional Accountants. “It’s important that people consider how valuation changes will affect them financially both now and in the long term.”

Business valuations are forward-looking and there are multiple approaches to them. An income approach to valuation applies an opportunity cost of capital to an expected future benefit stream, such as cash flows or net income, while a market approach applies multiples, such as price-to-earnings, derived from reasonably comparable companies.

The pandemic forced the closure of many businesses, such as bars, restaurants, and gyms, while others were able to remain open but at different operating levels. This will have a major impact on cash flow and net income, driving down valuations.

The CARES Act added other considerations into the mix. Changes to tax laws can create one-time surges in cash flow, while the Paycheck Protection Program is providing additional funding, much of which will not have to be repaid if conditions are met. These efforts have helped many businesses stay afloat but may not be enough to maintain or enhance their value.

Those who may be affected should consult with a CPA or valuation expert before making major financial decisions.

The business of breaking up

For the approximately 800,000 couples who get divorced each year, they are looking at major potential changes in the value of their real estate, investment portfolios or jointly owned business interest, and this could alter how much one must pay the other in the divorce settlement.

“If you started divorce proceedings at the end of 2019 and determined your asset and business values before February 2020, you should consider updating those figures for the economic effects of COVID-19,” said Nathan DiNatale, CPA, ABV and member of the American Institute of CPA’s (AICPA) CARES Act Valuation Impact Task Force and immediate past Chair of the AICPA Valuation Committee.

Recent economic changes may have reduced the values of their home, shared investments or businesses, and it may be many years before the values of those assets return. Depending on how those assets are divided, one spouse may be set up for a bigger rebound in the future or paying more than they should.

“What is good for one spouse, many not be good for the other,” said DiNatale.

Divorcing couples should look at their settlement plans to determine whether they need to consider re-valuing their jointly held assets before concluding the dissolution of their marriage.

Estate considerations

For those managing large estates, now may be an opportune time to transfer ownership stakes of a business, real estate or investment holding company to family members or a trust. The IRS limits your lifetime giving exemption to $11.4 million.

The COVID-19 pandemic has pushed some stock prices down, forced many businesses to close or cut back operations, and may have reduced real estate values. But like many investments, these drops are likely temporary.

Investment holders who have been considering passing their holdings on to family members or a trust can take advantage of the current lower valuations to transfer more shares or a greater percentage of their ownership stake and stay under IRS limitations.

There are other valuation considerations as well, such as discounts for lack of marketability or lack of control, that can be applied in some situations to increase estate tax savings. Marketability discounts reduce the market value of closely held or restricted shares of enterprises that do not have an active market, while lack of control discounts reduce the market values when the ownership interest lacks control over the entity.

CPA estate planners can work with valuation professionals to help those looking to distribute their wealth to optimize their giving and minimize their tax liability as part of a holistic tax planning strategy.

Buying or selling a business

It's more of a mixed bag for people looking to buy into or sell a business.

For those looking to buy into a business, now may seem like an ideal opportunity, as one can get in at a lower cost. But it can be more complicated than that, depending on the type of business and other equity partners.

If existing owners or partners do not need immediate additional capital, they can opt to hold off on taking in new partners until the value returns or maintain their initial price with expectations that the business will recover quickly.

For those looking to sell a business, they have to weigh several factors, including a potentially reduced sales price resulting in a lower tax bill on the sale and how fast they need to get out.

"If owners can wait to sell, valuation specialists can help them model forecast scenarios and determine what may need to be done to help recover lost business value and how long that might take," said Bethany Hearn, CPA, ABV, CFF and chair of the AICPA's ABV Credential Committee.

The AICPA also recently released a set of FAQs discussing ways the CARES Act can impact valuations and how valuation professionals can address them.

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