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PRACTITIONER'S GUIDE TO VALUATION IN BUSINESS SUCCESSION AND ESTATE PLANNING



INTRODUCTION:

WHEN VALUATION BECOMES THE CONVERSATION

Most estate and succession planning engagements proceed without incident until valuation becomes the issue. A client is transferring a business interest into a trust and the IRS questions the reported value. A founder wants to gift equity to family members but the business is tightly held, owner-dependent, and difficult to benchmark. A fund manager's estate includes carried interest whose value depends entirely on future performance and waterfall mechanics that most generalist appraisers have never modeled.

In each of these situations, the planning strategy may be sound and the legal structure well-designed, but the outcome depends on whether the valuation holds. A well-supported, independently prepared valuation does not guarantee a particular result, but an inadequate one creates exposure that no amount of sophisticated planning can fully offset.

This guide is intended to help estate planning attorneys, wealth advisors, and CPAs identify when specialized valuation support is warranted, understand how these engagements are structured, and engage more effectively with valuation professionals as part of a coordinated advisory team. It covers five areas where valuation complexity most frequently intersects with estate and succession planning work: personal goodwill, business interest transfers through family structures, carried interest for fund manager clients, buy-sell agreements, and management company succession.

1 PERSONAL GOODWILL:

SEPARATING INDIVIDUAL VALUE FROM ENTERPRISE VALUE

Many of the businesses that appear in estate and succession planning contexts are owner-dependent in ways that are immediately recognizable to advisors who work with them, but that are difficult to quantify without rigorous analysis. The owner is the relationship. The owner sets the direction. In some cases, the owner is the reason clients stay.

This dependence creates an analytical challenge that carries real consequences. When a business is sold, structured for transfer, or incorporated into an estate plan, the portion of value attributable to the individual owner - personal goodwill - needs to be clearly identified and appropriately supported. Mischaracterization in either direction creates risk: overstatement invites IRS scrutiny, while understatement may leave value on the table or produce a transaction structure that does not reflect economic reality.

Personal goodwill is the value attributable to an individual's relationships, reputation, expertise, and continued involvement, as distinct from enterprise goodwill, which is the value embedded in the business itself through brand recognition, systems, contracts, and transferable customer relationships. Most founder-led businesses contain both. The challenge is determining how much of total value depends on the individual and how much belongs to the enterprise.

Several factors shape that determination: the concentration of customer relationships, the owner's role in revenue generation, the existence of non-compete and employment agreements, the strength of institutional systems and documented processes, and the realistic cost of replacing the owner's function. These are not mechanical inputs. They require judgment, and that judgment needs to be clearly explained and well-grounded.

For advisors, the practical implications extend across multiple planning contexts. In a C-corporation asset sale, proceeds allocated to personal goodwill may avoid double taxation by being treated as individual rather than corporate assets, but the allocation must be supportable. In a marital dissolution, the distinction between personal and enterprise goodwill can be outcome-determinative. In a succession context, understanding how much value is owner-dependent is essential to designing a transition that preserves it.

Engaging a valuation professional early in the planning process, before structural decisions are made, allows for analysis that informs the strategy rather than reacting to it. For clients with significant owner dependency, that timing can make a material difference.

2 BUSINESS INTEREST TRANSFERS: FLPS, GRATS, AND THE ROLE OF VALUATION

Family limited partnerships, grantor retained annuity trusts, and similar transfer structures are well-established tools for moving business value out of a taxable estate. Their effectiveness depends, in significant part, on the rigor of the valuation analysis supporting the transfer.

When executed well, these structures allow clients to transfer meaningful value at a fraction of its eventual worth. Value is transferred at a discount that reflects the minority interest and lack of marketability characteristics of the interests being gifted, and future appreciation occurs outside the taxable estate.

When poorly supported, these structures attract IRS attention at exactly the moment the client's estate is most exposed.

Discount analysis is where these engagements are most frequently scrutinized. The discount for lack of control reflects the limited ability of a minority holder to influence business decisions, distributions, or strategic direction. The discount for lack of marketability reflects the absence of a liquid market for the interest. Each discount must be grounded in empirical data and clearly tied to the specific characteristics of the interest being transferred, not applied as a default percentage without analytical support.

The underlying business valuation matters as well. A minority interest discount applied to a poorly supported enterprise value produces a conclusion that is vulnerable at both levels. Advisors who have experienced IRS challenges on these structures often trace the exposure back not to the structure itself but to the supporting valuation, whether in the discount analysis, the underlying business value, or both.

For clients contemplating these structures, the quality of the valuation analysis is not a detail to be addressed after the structure is designed. It is a foundational input that determines whether the structure achieves its intended purpose.



3 CARRIED INTEREST:

VALUING A CONTINGENT, ILLIQUID ASSET

Fund managers present a distinctive planning challenge. A meaningful portion of their expected economic value may reside in carried interest, an asset whose value is contingent on future fund performance, governed by complex waterfall mechanics, and essentially illiquid. These characteristics make it both difficult to value and, in some cases, difficult to defend without analytical work that most generalist appraisers are not equipped to perform. For estate planning attorneys and wealth advisors with fund manager clients, understanding how carried interest is valued and when it makes sense to transfer is increasingly relevant.

Carried interest, often referred to as the promote or carry, represents the general partner's share of fund profits once specified return hurdles are achieved. Its value depends on a detailed understanding of the fund's waterfall provisions: preferred returns, catch-up mechanisms, clawback obligations, and tiered distribution structures. Two funds with similar portfolios may produce very different carried interest values depending on how and when realizations occur, which is why the valuation analysis must model the specific economics of the fund agreement rather than rely on generalized assumptions.

The analytical frameworks applied to carried interest valuations, including discounted cash flow analysis, Monte Carlo simulation, and option-pricing models, reflect the forward-looking, probabilistic nature of the asset. The methodology selected depends on the type of fund, the complexity of its economics, and the availability of data. Regardless of approach, the discount rate and scenario assumptions require careful construction and clear documentation, as these are areas of particular IRS focus.

Timing is a meaningful consideration in planning. Early-stage funds, where performance hurdles have not yet been achieved and the value of the carry may be modest, can present favorable conditions for transfer, allowing future appreciation to occur outside the taxable estate. Later-stage transfers can still be beneficial depending on the structure and applicable discounts, but the analysis requires careful evaluation of where the fund stands in its lifecycle.

When a partial interest in carried interest is transferred, discount analysis for lack of control and lack of marketability applies, and these discounts can be significant given the illiquid, transfer-restricted nature of the asset. As with other privately held interests, a well-supported discount analysis grounded in empirical data is essential.

For advisors with fund manager clients who have not yet addressed carried interest in their estate plans, an early conversation about timing and structure is worth initiating. The window for favorable transfers narrows as funds mature and performance hurdles are approached.

4 BUY-SELL AGREEMENTS:

VALUATION AS A PLANNING TOOL, NOT AN AFTERTHOUGHT

Buy-sell agreements are among the most commonly used planning tools for business owners with co-owners or partners. They are also among the most commonly mishandled, particularly when it comes to valuation.

The fundamental purpose of a buy-sell agreement is to establish a mechanism for transferring ownership interests under specified triggering events: death, disability, retirement, divorce, or a voluntary desire to exit. When the agreement is well-designed and the valuation provisions are carefully structured, transitions happen with clarity and minimal conflict. When the valuation provisions are poorly drafted, outdated, or anchored to a fixed formula that no longer reflects economic reality, the agreement that was meant to provide certainty often produces exactly the opposite.

Several valuation-related issues arise frequently in practice. Fixed price provisions, where the agreement specifies a dollar amount rather than a methodology, become stale quickly and often bear no relationship to current value at the time of a triggering event. Formula-based provisions can be equally problematic if

the formula was designed around conditions that no longer apply. Book value, for example, may be a defensible proxy for value in some businesses and completely disconnected from fair market value in others.

For estate planning purposes, the valuation standard and methodology embedded in a buy-sell agreement have direct implications. Under IRS guidance, a buy-sell agreement can establish the value of a business interest for estate tax purposes, but only if it meets specific requirements. Among them: the price must be consistent with arm's-length dealing, the agreement must have been entered into for legitimate business purposes, and the terms must be comparable to those in similar agreements among unrelated parties. An agreement that does not meet these standards may not bind the IRS to the agreed-upon price.

Advisors working with business owners who have existing buy-sell agreements should evaluate whether the valuation provisions reflect current economic reality and whether they would satisfy the applicable requirements if a triggering event occurred today. Agreements that were drafted years ago, or that have not been revisited since the business changed materially, are frequently due for review.

Engaging a valuation professional in connection with buy-sell planning, whether drafting a new agreement, revisiting existing terms, or valuing an interest in connection with a triggering event, supports a cleaner, more defensible outcome for all parties.

5 MANAGEMENT COMPANY SUCCESSION: PLANNING FOR THE VALUE WITHIN THE STRUCTURE

For principals of private equity and venture capital firms, hedge funds, and registered investment advisers, the management company itself, distinct from the funds it manages, is often a significant and underplanned component of the estate.

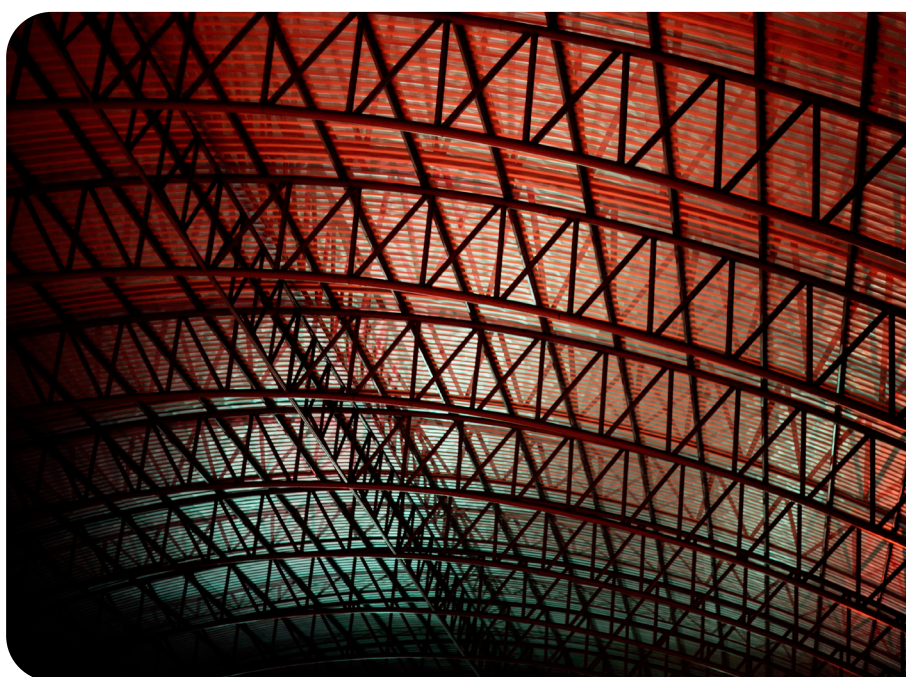
The management company generates fee income, carries the firm's track record, and houses the relationships and infrastructure that give the business its value.

It is also a professional services business whose value is meaningfully dependent on key individuals, which creates planning considerations that overlap with the personal goodwill analysis described earlier in this guide, but with structural and regulatory dimensions specific to investment management.

Management company interests commonly appear in estate and succession planning in several contexts: lifetime gifting of equity to family members or into irrevocable trusts, estate tax reporting at the death of a principal, succession planning among founders or partners, and ownership restructuring as firms grow and evolve.

The valuation of a management company interest requires a clear understanding of how the business generates and sustains value. Fee income is the primary driver, but the stability, duration, and contractual basis of that income varies significantly across firm types and structures. A multi-strategy platform with diversified, recurring revenue presents very differently than a single-fund manager nearing the end of its investment period. The analysis needs to reflect those differences explicitly rather than applying a generalized multiple.

Several factors receive particular analytical attention: track record and performance history, the number of funds managed, revenue stability and fee structure, plans for future fundraising, key person concentration,



and the governance structure of the entity. Each of these factors requires judgment in the context of multiple selection and discount analysis, and that judgment needs to be supported with clear reasoning and grounded in market data.

Timing, as with carried interest, is a meaningful planning consideration. Principals who transfer interests early in a firm's development, before AUM has scaled and earnings have matured, may benefit from a lower valuation, allowing future appreciation to occur outside the taxable estate. For more established firms, the analysis shifts to the magnitude of applicable discounts and the strategic value of the interest being transferred.

Coordination among valuation, estate planning, and tax advisors is particularly important in management company engagements. The interaction between management company value, carried interest, and any co-investment or GP commitment creates a planning picture that requires all advisors to work from a common analytical framework.



WORKING WITH A VALUATION PROFESSIONAL: WHAT TO EXPECT

Across all five areas covered in this guide, the engagement process follows a similar arc. It begins with a document and information request tailored to the specific type of interest being valued. The valuation professional reviews the materials, develops preliminary findings, and shares a draft report with the client and advisors for review and comment. This collaborative phase ensures that the factual record is accurate and that the analytical framework reflects a complete understanding of the business before the report is finalized.

For estate and gift tax purposes, advisors should be attentive to the qualification requirements under Treasury regulations. A qualified appraisal must be prepared by a qualified appraiser, one with demonstrated education, credentials, and experience relevant to the type of property being valued, and must meet specific content requirements regarding the description of the interest, the valuation methodology, and the appraiser's qualifications. Timing requirements also apply; the appraisal generally must be conducted within a prescribed window relative to the date of the transfer.

Engaging a valuation professional early in the planning process, rather than after structural decisions have been made, consistently produces better outcomes. Early engagement allows the valuation analysis to inform the strategy rather than simply documenting a conclusion that must now be defended.



HOULIHAN CAPITAL'S ROLE IN TRUST AND ESTATE VALUATIONS

Houlihan Capital brings focused experience in the valuation of privately held business interests, carried interest, and management company equity for trust, gift, and estate purposes. With expertise dating back to 1996, the firm has developed analytical capabilities across the asset types that present the greatest complexity in estate and succession planning: owner-dependent businesses, investment management companies, fund economics, and closely held structures where standard approaches require significant adaptation.

Engagements in this area reflect an understanding of how IRS scrutiny is applied, where valuation reports tend to be challenged, and what level of documentation and analytical rigor is required to support a conclusion over time. The firm's work is designed to hold up, not because outcomes can be guaranteed, but because the process, methodology, and documentation reflect the standard that scrutiny demands.

Houlihan Capital approaches each engagement as a member of the advisory team. The goal is not simply to deliver a number but to ensure that the valuation analysis integrates cleanly with the legal and tax strategies being designed by counsel and advisors, and that all parties are working from a common understanding of value.

For questions about how a valuation engagement may apply to a current or upcoming client situation, contact Houlihan Capital at info@houlihancapital.com or 312.450.8600.

This guide is intended for informational purposes only and does not constitute legal, tax, or investment advice. Consult qualified professionals regarding the specific circumstances of any planning matter.