



Advanced Markets Blog

Business Valuation – *Knowledge is Power*

Contributor: Carly Brooks

Date: 07/27/2021

Business owners typically have a host of competing planning objectives, including retaining and recruiting employees and concerns about business succession. For many, ensuring their own retirement and legacy goals are satisfied is usually at the top of the list. Today, with the chance for tax law changes on the horizon, including the potential for increased capital gains rates, repeal of the step-up in basis at death, and/or a reduction in estate tax in exemption amounts, some business owners may be looking to act on plans soon, either by gifting or selling business interests to intentionally defective grantor trusts. If tax legislation appears imminent, these clients may need to act quickly, hence the urgency around engaging an estate planning attorney as soon as possible to draft trusts and other documents. A sometimes overlooked, but equally critical component of the planning process is understanding the intrinsic value of the business.

Importance of business valuation

Business valuation is a process that helps determine a business' current monetary value. This type of proactive planning and assessment can help reduce future disagreements, confusion and possible litigation. A business valuation may yield a value that can be relied upon for federal transfer tax purposes and is usually necessary to determine the appropriate amount of life insurance needed to fund a buy-sell arrangement.

Here are a few other examples of when business valuation is needed:

- Sale of a business interest
- Death of an owner
- Retirement or disability of an owner
- Estate planning and current gifting of shares of an interest in a business
- Divorce of an owner
- Bankruptcy or insolvency of an owner



Valuation methods

There are several different business valuation methods, including: fixed price, book value, capitalization of earnings, appraisal, cut throat, and a combination of the book value and capitalization of earnings methods. Depending upon the circumstances, including the size of the business and industry, one method may work better or be more appropriate than the others. See our [Buy-Sell Client Guide](#) for more information on the various business valuation methodologies.

Opportunities for business owners today

If income tax rates increase, there could be an enormous opportunity to replace the funds that will go to taxes with life insurance. Having an accurate understanding of the business' value will be essential to ensuring the client's business and family are adequately protected. Additionally, if we see a repeal in the step-up at death, there would be a critical need to revisit all buy-sell plans to (1) make sure the buy-sell is properly funded, and (2) to address a new need that would arise for the seller to cover capital gains taxes at death. If the selling owner no longer receives a basis step up at death, there could be an additional capital gains tax triggered when the sale occurs at the death of the selling business owner. Life insurance on the selling business owner could be used to offset the capital gains tax recognized by the selling party at death. This new life insurance need would be in addition to the life insurance the purchasers need to own on the seller's life to fund the buy-sell arrangement.

It's likely there will be tax legislative changes this year — when and to what extent is still unknown — which makes it even more critical that business owners are working with financial professionals now, including insurance professionals, estate planning attorneys, and valuation experts. Life insurance is a valuable tool that allows the business owner to protect the value of the business by having access to liquidity at the most critical times, can help to equalize an estate amongst non-employee children, and can be used to meet a variety of other planning objectives. Understanding valuation is key to ensuring your clients have enough coverage.

Our business valuation calculator – [JHBusinessValuation.com](#) – is a great place to start helping many of your business-owner clients. For more information on business valuation or how to find a qualified business valuation expert in your area, contact John Hancock Advanced Markets at: 866-266-7498, option 3 or 4.

Call *Advanced Markets* at 888-266-7498, *option 3* to speak with an *Advanced Markets Consultant*, or email advancedmarkets@jhancock.com

For agent use only. Not intended for use with the general public.

This material does not constitute tax, legal, investment or accounting advice and is not intended for use by a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on tax law current as of the time we produced the material.

All information and materials provided by John Hancock are to support the marketing and sale of our products and services and are not intended to be impartial advice or recommendations. John Hancock and its representatives will receive compensation from such sales or services. Anyone interested in these transactions or topics may want to seek advice based on his or her particular circumstances from independent advisors.

Trusts should be drafted by an attorney familiar with such matters in order to take into account income and estate tax laws (including the generation-skipping tax). Failure to do so could result in adverse tax treatment of trust proceeds.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.