Choosing The Appropriate Standard Of Value In Asset Appraisals

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Value-In-Use

Value-in-use is generally the appropriate standard for determining the values of the assembled assets of an integrated business enterprise either for the purpose of allocating purchase price or for determining the value of an enterprise through a build-up approach. Value-in-use is the value of a property for a specific use or to a specific user, reflecting the extent to which the property contributes to the utility and/or profitability of the enterprise of which it is a part.[1]

The value-in-use of specific, tangible assets is alternately referred to as turnkey value.[2] This term reflects the capitalization and addition of turnkey factors, such as financing charges during construction, and contractor's contingencies, overhead and profit, to the reproduction or replacement cost of the asset itself. Reproduction or replacement cost includes the item price, plus soft costs such as sales tax, freight, engineering costs, installation charges, and supervision. The tax court, in Miami Valley Broadcasting, reasoned that "a put-together plant in good all-around working shape not a congeries of uncoordinated physical assets liable as not to fail to work as a unit... was worth more than the sum of the untested and uncoordinated parts..." and allowed the plaintiff to include turnkey factors in the depreciable bases of the individual, tangible assets acquired.

The value-in-use of a business enterprise reflects the assemblage and integration of numerous component assets, tangible and intangible. The whole is generally greater than the sum of its parts, even in the absence of goodwill. The court, in Concord Control, Inc. vs. Comm[3] declined to find goodwill in the acquired enterprise due to the competitiveness of the industry, the lack of differentiation of product lines among competitors and little perceived customer loyalty. Nonetheless, the court determined that the taxpayer had purchased an operating business, not merely a collection of disorganized assets, and allocated part of the purchase price to a non-asset-specific increment of value which it called going concern value. "The court implied that whenever a going concern is purchased, part of the price paid will be allocated to going concern value regardless of the parties' agreement."[4]

Going concern value is defined as the additional element of value which attaches to [the assembled assets] by reason of [their] existence as an integral part of a going concern.[5] It represents the ability of a business to continue to function and generate income without interruption as a consequence of a change in ownership. The components of going concern value include the avoidance of economic rents paid out during the siting, acquisition, construction and testing of the requisite, tangible assets; a trained and assembled workforce; and immediate access to acquired levels of profits.

Unlike turnkey factors which attach to tangible assets, the components of going concern value are intangible assets and are generally non-depreciable for tax purposes. As stated by the Ninth Circuit in United States vs. Cornish,[6]

> *The going concern element of an operating business cannot be classified as an enhancement in market value of depreciable assets for the purposes of depreciation. While the individual tangible assets may wear out and be replaced, going concern value does not wear out with the individual assets...*
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> *And when a worn out intangible asset must be replaced the cost to the business of doing so is not augmented by the fact that the acquisition is to become part of a going concern. Thus it is not within the meaning of section 167 of the Code to allow taxpayers to recoup the cost they paid for the going concern value...*

Section 1.167(a)-3 of the Code does, however, set forth the general rule that if an intangible asset is known from experience or other factors to be of use in a trade or in the production of income for a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. The depreciability of an asset of this nature is a factual question, the determination of which rests on whether the taxpayer establishes that the assets have

1. an ascertainable value separate and distinct from goodwill; and
2. a limited useful life, the duration of which can be ascertained with reasonable accuracy.[7]

Thus, when the avoidance of start-up costs and/or the immediate access to acquired levels of profits can be directly linked to a specific, intangible asset with a limited, useful life, these components of going concern value attach to the intangible assets and may be depreciated over its life.

Value-In-Exchange

Value-in-exchange, as distinguished from value-in-use, is the appropriate standard of value only for assets that are identified as surplus or non-operating properties; for assets that are sold recurringly in the normal course of business; or for operating assets which no longer generate sufficient earnings to provide a fair and reasonable return to the enterprise in relation to their values-in-exchange.

Value-in-exchange is considered, herein, to be synonymous with fair market value, a definition of which is:

> *The cash price in an active market, which would probably be agreed upon by a seller willing but under no compulsion to sell and a buyer willing but under no compulsion to buy, where both have reasonable knowledge of the facts.*

Value-in-exchange reflects the supposition that the seller has sufficient time and resources to secure the highest price obtainable for an individual, detached asset in the market in which that asset would typically trade. Stated simply, value-in-exchange is the highest price obtainable in alternate use.

Under the value-in-exchange standard, turnkey factors included in the values-in-use of tangible assets and components of going concern value included in the values-in-use of intangible assets may be absent from consideration. These additional elements of value may not be transferrable with a detached component of an otherwise integrated whole property. In fact, in dislocating an asset from its physical or organizational surroundings, substantial costs may be incurred. One may find, also, less than an active, secondary market in which to sell the item. Therefore, it should come as no surprise that appraisers often observe substantial disparity between an asset's value-in-use and its value-in-exchange.

NOTES

1. John L. Gadd, FASA, "Defining Value-In-Use", ASA Journal, February 1987.
2. Miami Valley Broadcasting Corp. vs. U.S., 499 f.2d 677-680 (CT.Cl.1974).
3. 78 TC NO 49 (C.C.H.) Dec. 38 972.
4. Doernberg, Richard L. and Hall, Thomas D., The Tax Treatment of Going Concern Value, The Geo Washington Law Review, Vol 52:353, 1984, p. 360.
5. VGS Corp. vs. Comm, 68 T.C. 563 (1977) p. 590-591.
6. 348 F.2d 175 (9th Cir. 1965), p. 185.
7. Revenue Ruling 74-456.

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