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**Adjusting for Reasonable
Compensation**



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Leveraged Input

- Compensation does not move value dollar for dollar, but rather the benefit stream, which gets capitalized.
- Owners set their own pay for tax and family reasons, so normalization substitutes a market derived figure that reflects the business rather than the owner's preferences.

Level of Value Governs

- A controlling owner can change compensation, but a minority holder cannot, so normalizing a minority interest may be inappropriate.
- Applying a control level normalization and then a lack of control discount is appropriate in certain circumstances.
- Statutory fair value in dissenting and oppressed shareholder matters often reaches a different result than fair market value.
- An expert who normalizes without stating the standard and level of value has skipped an attackable step.

Attn. Family Law Attorneys: Double Dipping

- The same dollar cannot be both an income stream for maintenance and support and a capitalized asset subject to equitable distribution.
- The compensation figure is the dividing line, so moving it up sends more to support and moving it down sends more into the value of the business.
- This single input is doing double duty, so the expert's selection must be internally consistent with the position taken on support.

What to Look for Beyond the W-2

- Include bonus, S corporation distributions that function as pay, retirement contributions, and insurance premiums.
- Include auto, travel, entertainment, club dues, and personal expenses run through the general ledger.
- Include family members on payroll who provide no services, and related party rent above or below market.
- If compensation rises by \$200,000, employer payroll taxes rise too, and ignoring the tax effect leaves the adjustment incomplete.

Points of Dispute

- Percentiles can differ by 100% or more, and the selection must be justified by performance and results, not defaulted to the median.
- If the model uses seller's discretionary earnings, compensation is already added back and should not be normalized again.
- Set compensation high enough and the business has no earnings and therefore no value.

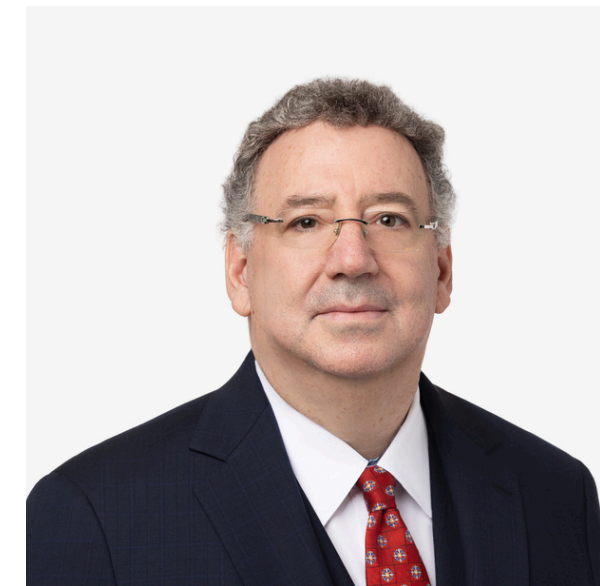
Questions?

*Have a specific accounting
or valuation question about
your case? Call me.*



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