



Revenue Rulings

RR 77-287 Lack of Marketability Discount

RR 77-287 provides guidance on applying a discount for lack of marketability (DLOM). The revenue ruling was initially intended to address discounts for publicly traded restricted stocks. An example would be stocks that fall under Rule 144. Publicly traded restricted stocks came about as a way for companies to bypass some, if not all, of the SEC filing requirements. As a tradeoff, these stocks were not able to have free trading capabilities.

The revenue ruling has been used to apply a discount to minority interests of private companies. The courts have allowed the discount simply because they have realized that a minority share in a private company has restrictions. Such restrictions include, but are not limited to the inability to sell assets of the company, initiate dividend disbursements, and initiate public offerings. In short, minority interests can not make controlling interest decisions. There are three basic sources to build a DLOM for minority interests. Those sources are: court cases, initial public offering (IPO) studies, and restricted stock studies. Some of the more common IPO studies include but are not limited to; Willamette Management Associates study, John Emory study, and Valuation Advisors study. The most common restricted stock studies are: Securities and Exchange Commission Institutional Investor Study, Gelman Study, Trout Study, Moroney Study, Maher Study, Standard Research Consultants study, Silber Study, and FMV Opinions Study. The process of how you might calculate the DLOM is outside the scope of this educational piece. However, the studies have shown a minority interest DLOM to average 25% to 45%.

A discount for minority interests for DLOM is well accepted in the business appraisal industry. One discount that is less accepted and sometimes outright disagreed on, is the controlling interests DLOM. It is my opinion that a discount for controlling interest depends on the business and the aspects of the appraisal at hand. (I invite you to call me if you would like to have an in-depth discussion on this topic). Business appraisers can not agree on whether or not a controlling interest DLOM should be applied. The courts do have a history of allowing such a discount however, not for all cases.

Housekeeping notes:

- 1.) Do not confuse the discount for lack of marketability with the discount for lack of control. These are two separate issues.
- 2.) The definition for control varies from state to state and at times from topic to topic. Consult your legal counsel to determine if you have control.
- 3.) Marketability is synonymous with liquidity. For our purpose, marketability (liquidity) is defined as the ability to convert into cash in three (3) days.
- 4.) Control premium will be discussed in a future educational piece.

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