



Revenue Rulings

RR 68-609 “Excess Earnings Method

Before we can discuss RR 68-609, we need to take a look at earlier revenue rulings and appeals and review memorandums (ARM). We will briefly discuss ARM 34, RR 65-192, and 65-193. These ARMs and RRs contributed to what is now known as RR 68-609.

ARM 34 was issued in 1920 to provide guidance on valuing intangible assets, primarily the intangible value lost by breweries and distillers due to prohibition. The guidance that was provided has become known as the “Formula Approach”. ARM 34 was amended by ARM 68, which provided examples of returns and capitalization rates. It must be stressed that these rates were only examples and not hard facts to be used in appraisals.

The IRS did not issue a major ruling on the “Formula Approach” until 1965 when it issued RR 65-192. RR 65-192 basically did two things. First, it modified RR 59-60 to make it applicable to not only estate and gift taxes, but also to income and other taxes. Second, RR 65-192 states that the “Formula Approach”, which was created in ARM 34, should be used only for the intangible assets of the business and not the tangible assets. The ruling also mentions the fact that the “Formula Approach” should be used for intangible assets only if there is no other method better suited.

RR 65-193 was issued in conjunction with RR 65-192. RR 65-193 was issued, eliminating wording from RR 59-60 that required a separate appraisal for tangible and intangible assets.

This brings us to RR 68-609. You guessed it! It was issued in 1968. RR 68-609 is the successor to ARM 34 and discusses the “Excess Earnings Method” (or the “Formula Approach”). Included in this revenue ruling is guidance for returns on tangible assets and the capitalization rates on the intangible assets. The revenue ruling reiterated that the “Formula Approach” may be used only if there is no better method to determine the value of intangible assets.

In reading this, I hope you have discovered two things. The first is that RR 59-60 is the foundation of business appraisal as far as the IRS is concerned. Second, there have been many revenue rulings issued, but RR 68-609 is the only one that materially altered RR 59-60.

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