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Private Company Valuation Methods and Rev. Rul. 59-60

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Published by Docket · 2026-10-29 · business valuation methods · private company valuation · revenue ruling 59-60 · how to value a private company

Original article: https://docket.capital/articles/business-valuation-methods-rev-rul-59-60



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Value is a judgment, not a lookup

There is no table that returns the price of a private company. Public shares have a quoted price; a closely held company has a set of facts that an appraiser, a buyer and a seller each weigh differently. The most cited US text on this, Revenue Ruling 59-60, says it plainly: "No general formula may be given that is applicable to the many different valuation situations arising in the valuation of such stock" (Rev. Rul. 59-60, IRS-hosted text).

This article sets out the standard approaches, the eight factors the ruling lists, the regulatory text behind them, and how they map onto a lower-middle-market deal. It is a description of methods and primary sources, not valuation, tax or legal advice. Docket does not value businesses.

Two framing points before the methods.

Scope. Rev. Rul. 59-60 was written to outline "the approach, methods and factors to be considered in valuing shares of the capital stock of closely held corporations for estate tax and gift tax purposes" (Rev. Rul. 59-60, IRS-hosted text). It is not a rule for setting a sale price between a sponsor and an owner. It is useful to deal teams because its factors are a disciplined checklist of what drives value, and because appraisers working on owners' estate plans still start from it.

Standard of value. The ruling adopts fair market value: "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts" (Rev. Rul. 59-60, IRS-hosted text). A negotiated deal price is not the same thing. A specific buyer may pay for synergies a hypothetical buyer would not, and a motivated seller is, by definition, under some compulsion.

The approaches: income, market, asset

Valuation practice groups methods into a small number of approaches. Damodaran's survey puts it this way: "In general terms, there are four approaches to valuation" (Damodaran 2006):

1. **Discounted cash flow valuation**, which "relates the value of an asset to the present value of expected future cashflows on that asset."
2. **Liquidation and accounting valuation**, "built around valuing the existing assets of a firm, with accounting estimates of value or book value often used as a starting point."
3. **Relative valuation**, which "estimates the value of an asset by looking at the pricing of 'comparable' assets relative to a common variable like earnings, cashflows, book value or sales."
4. **Contingent claim valuation**, which "uses option pricing models to measure the value of assets that share option characteristics" (real options).

The first three correspond to the trio most practitioners name: the **income approach**, the **asset approach** and the **market approach**. Contingent claim valuation is rarely the frame for an owner-operated services or manufacturing business, though it can matter for assets such as undeveloped licenses or patents; that is framing, not a rule.

Approach	Core question	Main inputs	Where it is weakest
Income (DCF, capitalized earnings)	What are the expected future cash flows worth today?	Normalized earnings, growth, reinvestment, a discount or capitalization rate	Small firms with volatile or owner-dependent earnings; rate selection
Market (relative valuation)	What do comparable assets trade or sell for?	A common metric (earnings, cash flow, sales) and a comparable set	Few true comparables; transaction data for small private deals is sparse
Asset (liquidation, adjusted book)	What are the underlying assets worth?	Balance sheet restated to current values	Service businesses whose value is mostly people, contracts and goodwill

Rev. Rul. 59-60: the eight factors

The ruling lists factors that, "although not all-inclusive are fundamental and require careful analysis in each case" (Rev. Rul. 59-60, IRS-hosted text):

Factor (text of the ruling)	What it asks in practice	Evidence a deal team can gather
(a) The nature of the business and the history of the enterprise from its inception	Stability, growth, diversity of operations	Formation records, years operating, service lines, locations
(b) The economic outlook in general and the condition and outlook of the specific industry in particular	Industry tailwinds and risks	Sector data, regulatory changes, demand drivers
(c) The book value of the stock and the financial condition of the business	Balance sheet strength	Balance sheets, debt schedule, liens
(d) The earning capacity of the company	Normalized, sustainable earnings	Several years of financials, quality of earnings work
(e) The dividend-paying capacity	Cash available to owners	Distributions history, cash conversion
(f) Whether or not the enterprise has goodwill or other intangible value	Customer relationships, brand, licenses	Contract terms, retention, licenses, reputation
(g) Sales of the stock and the size of the block of stock to be valued	Prior transactions; control vs minority	Prior share transfers, cap table, governing documents
(h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter	Public comparables	Public company filings and prices

Three further passages in the ruling matter as much as the list.

Valuation is forward-looking. "Valuation of securities is, in essence, a prophesy as to the future and must be based on facts available at the required date of appraisal" (Rev. Rul. 59-60, IRS-hosted text).

Weights depend on the business. "Earnings may be the most important criterion of value in some cases whereas asset value will receive primary consideration in others" (Rev. Rul. 59-60, IRS-hosted text).

Do not average your way to an answer. Because factors cannot be assigned mathematical weights, the ruling says "no useful purpose is served by taking an average of several factors (for example, book value, capitalized earnings and capitalized dividends) and basing the valuation on the result" (Rev. Rul. 59-60, IRS-hosted text). It also reminds the appraiser that "valuation is not an exact science" (Rev. Rul. 59-60, IRS-hosted text).

Quotations of the ruling in this article are checked against the complete text the IRS reproduces as Appendix A of an October 29, 2014 job aid for its valuation analysts, which says the ruling "should be referred to regularly in valuing interests in a closely held or non-publicly traded entity" (IRS job aid, 2014). The job aid carries its own caveat: it "is not Official IRS position and was prepared for reference purposes only; it may not be used or cited as authority for setting any legal position" (IRS job aid, 2014). It is cited here only as an IRS-hosted copy of the ruling's text; the authority is the ruling itself, published at 1959-1 C.B. 237.

Illustrative example (fictional): why averaging misleads

A fictional appraiser produces three indications for Harborview Pest Control, a route-based services business: $12.0 million from an income approach, $13.5 million from a market approach and $4.0 million from an adjusted-book asset approach. A simple average is ($12.0m + $13.5m + $4.0m) / 3 ≈ $9.8 million, a figure that matches none of the analyses and gives a third of the weight to an asset approach that captures almost none of a route business's value (its customer relationships and recurring service contracts). The ruling's point is that the appraiser must reason about which evidence fits the business, not let arithmetic choose.

Regulatory text: unlisted stock under 20.2031-2 and IRC 2031(b)

The ruling sits on top of statute and regulation, both of which are short and worth reading directly.

Internal Revenue Code section 2031(b) provides that when unlisted stock cannot be valued from bid and asked prices or sales, its value "shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange" (26 U.S.C. 2031). That is the statutory root of factor (h) and of the market approach in this context.

The estate tax regulation, 26 CFR 20.2031-2(f), says that for shares of stock without sale or quote evidence, fair market value is determined by considering "the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors." It lists among those other factors "the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a

stock exchange" (26 CFR 20.2031-2). It adds that "the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case" (26 CFR 20.2031-2).

Read side by side, the statute, regulation and ruling describe the same structure: earnings, assets and comparables, each weighted by judgment about the specific business.

Multiples as shorthand for the market approach

Most deal conversations compress the market approach into a multiple: price divided by a measure of earnings, commonly adjusted EBITDA. Damodaran's description of relative valuation names the two choices that every multiple embeds: "the multiple used in the analysis and the group of firms that comprises the comparable firms" (Damodaran 2006).

A multiple is only as good as three things:

1. **The earnings base.** Adjusted EBITDA for a small company depends on which owner expenses and one-offs are added back; diligence on those adjustments is the job of quality of earnings work.
2. **The comparable set.** Public companies are larger and more liquid than most lower-middle-market targets; private transaction data is sparse and often undisclosed.
3. **Consistency of definitions.** Enterprise value versus equity value, trailing versus forward earnings, and pre- versus post-synergy figures must line up.

This article states no multiple ranges. Published ranges vary by source, date, sector and definition, and a range quoted without that context is not evidence about any particular company.

Discounts and control: what to ask an appraiser

Factor (g) and the regulation both raise control. The ruling notes that while a minority block may be harder to sell, "control of a corporation, either actual or in effect, representing as it does an added element of value, may justify a higher value for a specific block of stock" (Rev. Rul. 59-60, IRS-hosted text). The regulation lists "the degree of control of the business represented by the block of stock to be valued" as a relevant factor (26 CFR 20.2031-2).

This matters in deals that are not a clean 100 percent purchase: minority recapitalizations, rollover equity and partial buyouts. Rather than assuming a discount or premium figure, ask the appraiser:

- Is the value stated on a control or a minority basis, and why?
- Is a marketability adjustment applied, and what evidence supports its size?
- Do the governing documents (transfer restrictions, buy-sell agreements, voting rights) change the answer?
- Is the standard of value fair market value, or something else (for example, a contractual formula)?

How the approaches are used in a lower-middle-market deal

The following is practitioner framing, not a sourced rule.

In a sponsor acquisition of an owner-operated business, the price in a letter of intent is usually expressed as a multiple of an adjusted earnings figure, which is the market approach in shorthand. The income approach sits behind it in the sponsor's model: debt capacity, projected cash flows and the return the fund needs. The asset approach acts as a floor and a cross-check, more relevant for asset-heavy businesses (equipment, real estate, inventory) than for services.

Sequence in practice:

1. **Pre-LOI.** Limited data; the indication is a range built on owner-provided or estimated earnings. Public-record revenue estimation is uncertain, as the article on estimating private company revenue explains.
2. **LOI.** A price or multiple conditioned on diligence.
3. **Diligence.** Quality of earnings work tests the earnings base; legal and commercial diligence test the factors in the table above.
4. **Purchase agreement.** Price mechanics (working capital adjustments, earn-outs, rollover) translate the valuation into cash.

The eight factors are a good diligence checklist at every stage because they force the same question from different directions: what will this business earn, how certain is that, and what would someone else pay for that certainty?

Checklist and illustrative worksheet

Use the worksheet to record the evidence behind each factor before forming any view of value. The entries are fictional.

Factor	Evidence gathered (fictional: Harborview Pest Control)	Source type	Gap / open question
(a) Nature and history	Founded 1998; residential and light commercial routes in two counties	State registry, company website	Ownership history before 2010
(b) Economic and industry outlook	Regulated pesticide licensing; demand tied to housing stock	Regulator pages, industry data	Pending state rule changes
(c) Book value and financial condition	Balance sheet requested; one equipment lien found	Owner documents, UCC search	Vehicle fleet age
(d) Earning capacity	Three years of P&L requested; add-backs not yet tested	Owner documents	QoE not started
(e) Dividend-paying capacity	Owner distributions history requested	Owner documents	S corporation distributions vs salary
(f) Goodwill and intangibles	Recurring service contracts; brand in local market	Contracts, reviews	Contract assignability

Factor	Evidence gathered (fictional: Harborview Pest Control)	Source type	Gap / open question
(g) Prior sales and block size	100% held by founder; no prior transfers	Owner statement	Confirm in governing documents
(h) Public comparables	Listed pest-control and services companies identified	Public filings	Size and liquidity gap to target

Rules for the worksheet:

- Every entry cites a source and a date.
- "Requested" and "not yet tested" are recorded, not filled in by assumption.
- No factor is scored or averaged; the worksheet supports a judgment, it does not produce one.

Docket's Scout and Audit agents record sourced, typed answers about target companies, such as the history and line of business that factor (a) asks about, with each value quoting a retained page; Docket does not produce valuations.

Source links

Links cited in this article, in order of first appearance. Full addresses are provided for readers using extracted text.

1. https://www.irs.gov/pub/irs-lbi/S%20Corporation%20Valuation%20Job%20Aid%20for%20IRS%20Valuation%20Professionals.pdf
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3. https://www.law.cornell.edu/uscode/text/26/2031
4. https://www.law.cornell.edu/cfr/text/26/20.2031-2

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