MIDWESTONE
FINANCIAL GROUP, INC.

INCREMENTAL VALUE ATTRIBUTABLE
TO
SUBCHAPTER S ELECTION
MARCH 31, 2006

Informed Decisions, LLC
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May 1, 2006

TO: Chief Financial Officer
MidwestOne Financial Group, Inc.

FROM: Rich Place
Informed Decisions, LLC

This memo was prepared as if Informed Decisions, LLC had been engaged to prepare an analysis to quantify the potential benefits to be derived from a shareholder election to have MidwestOne Financial Group, Inc. (Company) taxed as a Subchapter S corporation. This analysis is presented in the attached exhibits, as discussed below.

If Informed Decisions had been engaged to prepare such an analysis, this memo and the attached would have been provided to management for the stated purpose. Its use would be limited to consideration by management and the Board of Directors. It would not be provided to any outside party and is not applicable for any other use. The memo is not an opinion as to the value of the stock issued by MidwestOne.

Informed Decisions, LLC made certain assumptions regarding the legal and tax issues that could impact the analysis. However, neither this memo nor the analysis should be relied on as professional advice regarding legal and tax matters. It does not address whether or not the Company qualifies for Subchapter S tax treatment. The Company should consult with its advisers on such matters.

Including the pro rata share of the Company's S-corp earnings could affect a shareholder's tax return, such as itemized deductions and the alternative minimum tax. The analysis does not address any such possible changes in an individual shareholder's tax return.

The attached exhibits present the analysis used to quantify the incremental value attributable to the shareholder election to have a company taxed as an S-corporation. The underlying basis for this analysis has been used previously for ESOP valuations and estate tax reporting purposes. However, to my knowledge, it has not yet been specifically accepted by the IRS or tested in a court case.

The Federal government does not forgo the taxes on the C-corporation's net income when its shareholders elect to have the company taxed as an S-corporation. The tax is shifted to the shareholders. The benefits to the shareholders are two-fold: First, the dividends received in excess of the shareholders' tax payments attributable to the S-corp earnings are tax free. Second, the earnings retained by the company increase the shareholders' tax basis for calculating the capital gains tax payable upon sale of their stock. The basis for these conclusions is discussed in more detail in Appendices A and B.

Other benefits can be obtained upon sale of the aggregate company. However, consideration of such a sale and any effort to quantify these potential benefits is more speculative in nature and is beyond the scope of this analysis.

SUMMARY: The results of the analysis are summarized in EXHIBIT FOUR. The present value of the tax benefits that accrue to the shareholders as a result of the S-corp election serve to increase the per share value of the common stock to the individual shareholders. Based on this analysis, presented in EXHIBITS ONE through FOUR, the per share calculation presented in the valuation report as of March 31, 2006, dated May 1, 2006, could be increased by $1.09, from $19.80 to $20.89, if the S-chapter S tax treatment were elected.

EXHIBIT ONE: Information regarding personal tax rates in Iowa was reviewed. The primary factor impacting the S-corp analysis is that the Company would be required to pay the state franchise tax at 5.0% on the Federal taxable income plus tax exempt interest income. This expense is a reduction to the S-corp income taxable to the shareholders.

The Iowa franchise taxes paid by the Company are credited against the individual state taxes to be paid by the shareholders at the marginal rate of 8.98%. Interest revenues that are tax-exempt for Federal purposes are taxed at the state level. Federal taxes are not deductible for purposes of calculating the state franchise tax. This analysis is not intended to reflect all the adjustments that could impact the Company's taxable income at the state and Federal levels. The conclusion is that these are the most critical factors to be considered.

The income projections on a C-corp tax basis are taken from the March 31, 2006 valuation dated. These are converted to projections for the S-Corp taxable income based on the 5.0% Iowa franchise tax and the Federal average/marginal tax rate of 34.0%. Adjustments are made to the state franchise tax for tax-exempt income. Projections are developed for the amount of tax exempt income starting with the amount reported for the twelve months ending March 31, 2006 which is projected to hold for the next five years. Supporting calculations are presented in the Tax-exempt Adjustments and the Effective, Adjusted Tax Rate sections of EXHIBIT ONE.

<u>EXHIBIT TWO</u>: Pro forma earnings and dividends on an S-corp tax basis are developed from the C-corp earnings used in the March 31, 2006 valuation and the historical dividend payout ratio. The projected dividend payout ratio in the report reflected the stock buybacks that the Company was expected to continue.

The adjustments reflected here are for the Federal taxes only: the assumption is that the Company would be required to pay the Iowa franchise tax. As discussed in Appendix A, the amounts shown as Federal tax expenses are now paid to the shareholders as dividends to offset their tax obligations arising from the S-corp election. Although the shareholders pay a higher combined tax rate, state plus Federal, the cash payments from the corporation are set at the Federal tax expense plus the C-corp dividends. Given this assumption, there is no impact to the corporation from the election to be taxed as an S-corporation.

<u>EXHIBIT THREE</u>: The taxes to be paid by the shareholders are deducted from the dividends received. The individual tax rates are set at 35% for the S-Corp income, the marginal Federal rate applicable to individuals. The Iowa individual marginal rate is at 8.98% but a credit for the franchise tax paid by the Company is applied to partially offset these taxes. The Federal tax rate is set at 15% for dividends and capital gains. This is combined with the state tax rate of 8.98% which is calculated on an after-tax basis that reflects the assumption that it is deductible for Federal tax purposes.

The relevant terminal value for this analysis is the tax benefit derived from the incremental tax basis attributable to the retained earnings and used in calculating the capital gain for tax purposes. This reflects the Federal capital gains rate of 15% plus the marginal state tax rate of 8.98% which would be deductible at the Federal individual rate of 35%. The present value factors are based on the required rate of return developed for the March 31, 2006 valuation.

<u>EXHIBIT FOUR</u>: The incremental value attributable to the S-corp elections is calculated on an aggregate basis and on a per share basis. The percentage increases are calculated for the pro rata and discounted values presented in the March 31, 2006 valuation. These calculations are made for the current 15% tax rate applicable to dividends and for the 35% marginal, individual tax rate that could be applied to dividends in the future; the Federal capital gains tax rate is maintained at 15% in both scenarios. The increase in after-tax cash flows for 2006 is also calculated for both tax rates.

<u>HISTORICAL SUPPORTING EXHIBITS</u>: These exhibits include:

- **Pages one and two:** six years of historical financial data contained in the valuation report prepared as of March 31, 2006 presented for reference purposes.

- **Page three:** the tax equivalent adjustments calculated from the FR Y-9C reports and the tax-equivalent adjustments to the income statement accounts presented on pages one and two.
- **Pages four and five:** recap of the financial data taken from the footnotes to the Company's audited financial statements presented for comparison purposes.
- **Page six:** basis for comparing the financial data from the FR Y-9C regulatory reports with that contained in the audited financial statements.

Based on these data and comparisons, there are no significant differences in the taxes reported for regulatory purposes and for GAAP purposes. However, some of the adjustments reflected in the regulatory reports may have distorted the tax-equivalent interest revenues and taxes for 2000 through 2005. This did not affect the March 31, 2006 valuation.

Specific tax rates were assumed for purposes of the current analysis, as opposed to relying on historical average tax rates. However, identifying the impact to the Company's tax provision expense in the year the S-corporation election is completed is beyond the scope of this analysis.

APPENDIX A: This was adapted from a write-up prepared to support a valuation of an S-corporation for estate tax purposes. It was not submitted in the final report because it was considered to be too detailed.

APPENDIX B: This includes slides from a presentation to the Subchapter S Bank conference in San Antonio May 6, 2005. These exhibits include listings of court cases and articles relating to the valuation of an S-corporation.

EXHIBITS ONE - FOUR
INCREMENTAL VALUE ATTRIBUTABLE
TO
SUBCHAPTER S ELECTION

EXHIBIT ONE
MIDWESTONE FINANCIAL GROUP, INC.
TAX ADJUSTMENTS
(millions)

		2007	2008	2009	2010	2011
S-CORP TAXABLE INCOME						
Projected C-Corporation income from 3/31/06 valuation		$6.650	$7.452	$8.323	$9.269	$10.295
Federal incomes at average/marginal tax rate	34.0%	3.426	3.839	4.288	4.775	5.304
State franchise tax, with tax exempt adjustment	5.0%	0.619	0.729	0.798	0.873	0.955
PRE-TAX INCOME		$10.695	$12.020	$13.409	$14.918	$16.555
State franchise tax, adjusted for tax exempt	5.0%	(0.619)	(0.729)	(0.798)	(0.873)	(0.955)
PROJECTED S-CORP TAXABLE INCOME		$10.076	$11.292	$12.611	$14.044	$15.599
Average combined tax rate	37.8%					
TAX-EXEMPT ADJUSTMENTS						
Tax exempt income, based on 2005 FR Y-9C		$1.684	$1.684	$1.684	$1.684	$1.684
Tax equivalent adjustment for tax exempt		0.868	0.868	0.868	0.868	0.868
TAX ADJUSTED EXEMPT INEREST INCOME		$2.552	$2.552	$2.552	$2.552	$2.552
EFFECTIVE TAX RATE		34.0%	34.0%	34.0%	34.0%	34.0%
EFFECTIVE, ADJUSTED TAX RATE						
Pre-tax income (TE)		$10.695	$12.020	$13.409	$14.918	$16.555
Federal income and state franchise tax (TE)		4.045	4.568	5.086	5.648	6.259
EFFECTIVE COMBINED TAX RATE (TE)		37.8%	38.0%	37.9%	37.9%	37.8%

EXHIBIT TWO
MIDWESTONE FINANCIAL GROUP, INC.
TAX ADJUSTMENTS FOR S-CORPORATION
(millions)

		2007	2008	2009	2010	2011
TAX ADJUSTMENTS FOR S-CORPORATION TAXABLE INCOME						
C-corporation projected income		$6.650	$7.452	$8.323	$9.269	$10.295
C-corporation Federal taxes only	34.0%	3.426	3.839	4.288	4.775	5.304
S-CORP PRO FORMA TAXABLE INCOME		$10.076	$11.292	$12.611	$14.044	$15.599
TAX ADJUSTMENTS FOR S-CORPORATION DIVIDENDS						
C-Corporation projected dividends	45.1%	$2.996	$3.358	$3.750	$4.176	$4.639
C-corporation Federal taxes only		3.426	3.839	4.288	4.775	5.304
S-CORP PRO FORMA DIVIDENDS		$6.422	$7.197	$8.038	$8.951	$9.943
SHAREHOLDER TAX ON S-CORPORATION EARNINGS						
S-Corporation pro forma taxable income		$10.076	$11.292	$12.611	$14.044	$15.599
Marginal state taxes	8.98%	$0.905	$1.014	$1.132	$1.261	$1.401
Credit for franchise taxes paid		(0.619)	(0.729)	(0.798)	(0.873)	(0.955)
NET STATE TAXES		$0.286	$0.285	$0.334	$0.388	$0.445
S-Corporation pro forma taxable income		$10.076	$11.292	$12.611	$14.044	$15.599
Net state taxes		(0.286)	(0.285)	(0.334)	(0.388)	(0.445)
NET S-CORPORATION TAXABLE INCOME		$9.790	$11.006	$12.277	$13.656	$15.154
Federal personal tax rate		35.0%	35.0%	35.0%	35.0%	35.0%
FEDERAL PERSONAL TAXES		$3.426	$3.852	$4.297	$4.780	$5.304
Net personal state taxes		0.286	0.285	0.334	0.388	0.445
TOTAL PERSONAL TAXES		$3.712	$4.138	$4.631	$5.167	$5.749

EXHIBIT THREE
MIDWESTONE FINANCIAL GROUP, INC.
PRESENT VALUE CALCULATIONS,
AFTER-TAX CASH FLOWS TO SHAREHOLDERS
(millions)

PRESENT VALUE OF S-CORP DIVIDENDS, AFTER-TAX:

		2007	2008	2009	2010	2011	Terminal Value	
Projected S-Corp dividends		$6.422	$7.197	$8.038	$8.951	$9.943	$23.070	Retained earnings
Personal tax liability, S-Corp earnings		(3.712)	(4.138)	(4.631)	(5.167)	(5.749)	20.8%	Combined cap. gains
NET AFTER-TAX TO SHAREHOLDERS		$2.710	$3.060	$3.407	$3.784	$4.193	$4.807	Tax savings
Present value factors	14.0%	0.9366	0.8216	0.7207	0.6322	0.5545	0.5194	
PERIODIC PRESENT VALUES		$2.538	$2.514	$2.455	$2.392	$2.325	$2.497	
TOTAL PRESENT VALUE		$14.721						

PRESENT VALUE OF C-CORP DIVIDENDS, AFTER-TAX:

		2007	2008	2009	2010	2011
C-Corp dividends to shareholders		$2.996	$3.358	$3.750	$4.176	$4.639
Personal tax liability, C-Corp dividends	20.8%	(0.624)	(0.700)	(0.781)	(0.870)	(0.967)
NET AFTER-TAX TO SHAREHOLDERS		$2.372	$2.658	$2.969	$3.306	$3.672
Present value factors	14.0%	0.9366	0.8216	0.7207	0.6322	0.5545
PERIODIC PRESENT VALUES		$2.222	$2.184	$2.140	$2.090	$2.036
TOTAL PRESENT VALUE		$10.672				

EXHIBIT FOUR

MIDWESTONE FINANCIAL GROUP, INC.

INCREMENTAL VALUE OF S-CORPORATION TAX STATUS

INCREMENTAL VALUE OF AFTER-TAX DIVIDENDS

S-corp dividends after-tax present value	$14.721	million
C-corp dividends after-tax present value	10.672	
INCREMENTAL VALUE ATTRIBUTABLE TO S-CORP	$4.049	million
Shares outstanding	3,707,308	
PER SHARE INCREMENTAL VALUE	$1.09	

% INCREASE TO VALUE PER SHARE

	15% Tax on Dividends		35% Tax on Dividends	
	Pro Rata Value	Discounted Value	Pro Rata Value	Discounted Value
Per share, incremental value	$1.09	$1.09	$1.82	$1.82
Values per share: Full/discounted	20.36	19.80	20.36	19.80
VALUE ADJUSTED FOR S-CORP	$21.46	$20.89	$22.18	$21.62
% increase attributable to S-corp	5.4%	5.5%	8.9%	9.2%

2007 INCREMENTAL AFTER-TAX CASH FLOWS

Aggregate	15% Federal Tax on Dividends		35% Federal Tax on Dividends	
After-tax dividends, S-corp election	$2.710	million	$2.710	million
After-tax dividends, C-corp	2.372		1.773	
INCREASE IN AFTER-TAX CASH FLOWS	$0.338	million	$0.937	million
After-tax cash flows, S-corp election	$0.73		$0.73	
After-tax cash flows, C-Corp	0.64		0.48	
INCREMENT ATTRIBUTABLE TO S-CORP	$0.09		$0.25	
INCREASE IN AFTER-TAX CASH FLOWS	14.1%		52.1%	

HISTORICAL SUPPORTING EXHIBITS

SUPPORTING HISTORICAL EXHIBITS
MIDWESTONE FINANCIAL GROUP, INC.
INCOME STATEMENTS
(millions)

	2000	2001	2002	2003	2004	2005
INTEREST INCOME						
Interest revenue (TE) *	$39.178	$40.471	$38.163	$38.141	$37.987	$40.948
Interest expense	21.427	21.427	16.731	14.247	12.822	14.677
NET INTEREST INCOME (TE) *	$17.751	$19.044	$21.432	$23.894	$25.165	$26.271
Provision for loan losses	0.892	1.776	1.070	0.589	0.858	0.468
NON-INTEREST INCOME						
Trust services	-	0.142	0.103	0.096	0.136	0.112
Service charges	1.821	1.456	1.422	1.572	1.611	1.588
Miscellaneous fees, commissions	-	0.162	0.366	0.257	0.425	0.790
Other gains / (losses)	-	0.328	0.465	0.721	0.425	0.426
Other non-interest income	0.705	1.181	1.333	1.545	1.285	1.464
NON-INTEREST INCOME	$2.526	$3.269	$3.689	$4.191	$3.882	$4.380
Security gains / (losses)	0.040	1.018	-	0.167	0.332	0.028
NON-INTEREST EXPENSE						
Salaries and benefits	6.378	7.146	7.745	9.882	10.700	11.151
Occupancy	2.535	2.162	2.339	2.874	3.222	3.468
Amortization expense	1.125	1.050	0.290	0.344	0.308	0.305
Other expenses	3.275	4.109	4.250	4.807	4.769	5.220
NON-INTEREST EXPENSE	$13.313	$14.467	$14.624	$17.907	$18.999	$20.144
NET BEFORE TAXES (TE)*	$6.112	$7.088	$9.427	$9.756	$9.522	$10.067
Provision for income taxes (TE) *	2.111	2.732	3.638	3.830	3.693	3.979
NET INCOME	$4.001	$4.356	$5.789	$5.926	$5.829	$6.088
Effective tax rate	34.5%	38.5%	38.6%	39.3%	38.8%	39.5%
Sub-chapter S election?	No	No	No	No	No	No
	-	-	-	-	-	-
Holding company shares outstanding	3,939,314	3,872,594	3,930,508	3,782,708	3,751,386	3,701,387

* Adjusted to tax equivalent basis for tax exempt securities.

SUPPORTING HISTORICAL EXHIBITS
MIDWESTONE FINANCIAL GROUP, INC.
INCOME STATEMENTS - COMMON SIZED
% of Average Assets

	2000	2001	2002	2003	2004	2005
INTEREST INCOME						
Interest revenue (TE) *	7.93%	7.62%	7.05%	6.31%	6.00%	6.26%
Interest expense	4.34%	4.03%	3.09%	2.36%	2.02%	2.24%
NET INTEREST INCOME (TE) *	3.59%	3.58%	3.96%	3.95%	3.97%	4.01%
Provision for loan losses	0.18%	0.33%	0.20%	0.10%	0.14%	0.07%
NON-INTEREST INCOME						
Trust services	0.00%	0.03%	0.02%	0.02%	0.02%	0.02%
Service charges	0.37%	0.27%	0.26%	0.26%	0.25%	0.24%
Miscellaneous fees, commissions	0.00%	0.03%	0.07%	0.04%	0.07%	0.12%
Other gains / (losses)	0.00%	0.06%	0.09%	0.12%	0.07%	0.07%
Other non-interest income	0.14%	0.22%	0.25%	0.26%	0.20%	0.22%
NON-INTEREST INCOME	0.51%	0.62%	0.68%	0.69%	0.61%	0.67%
Security gains / (losses)	0.01%	0.19%	0.00%	0.03%	0.05%	0.00%
NON-INTEREST EXPENSE						
Salaries and benefits	1.29%	1.35%	1.43%	1.63%	1.69%	1.70%
Occupancy	0.51%	0.41%	0.43%	0.48%	0.51%	0.53%
Amortization expense	0.23%	0.20%	0.05%	0.06%	0.05%	0.05%
Other expenses	0.66%	0.77%	0.79%	0.79%	0.75%	0.80%
NON-INTEREST EXPENSE	2.70%	2.72%	2.70%	2.96%	3.00%	3.08%
NET BEFORE TAXES (TE)*	1.24%	1.33%	1.74%	1.61%	1.50%	1.54%
Provision for income taxes (TE) *	0.43%	0.51%	0.67%	0.63%	0.58%	0.61%
NET INCOME	0.81%	0.82%	1.07%	0.98%	0.92%	0.93%
Average total assets	$493.951	$531.220	$541.028	$604.694	$633.587	$654.624

* Adjusted to tax equivalent basis for tax exempt securities.

SUPPORTING HISTORICAL EXHIBITS
MIDWESTONE FINANCIAL GROUP, INC.
TAX EQUIVALENT ADJUSTMENTS PER FR Y-9C

ADJUSTMENTS CALCULATED FROM FR Y-9C REPORTS:

	2001	2002	2003	2004	2005
ADJUSTMENT CALCULATED FROM NET INTEREST INCOME:					
Net interest income, w/TE adjustment	$19.343	$24.675	$26.563	$27.814	$28.514
Net interest income, reported	18.977	24.354	26.273	27.497	28.067
TAX EXEMPT ADJUSTMENT	$0.366	$0.321	$0.290	$0.317	$0.447
ADJUSTMENT CALCULATED FROM INCOME BEFORE TAXES:					
Net before taxes, w/TE adjustment	$7.088	$9.125	$9.483	$9.224	$9.646
Net before taxes, reported	6.722	8.804	9.193	8.907	9.199
TAX EXEMPT ADJUSTMENT	$0.366	$0.321	$0.290	$0.317	$0.447
DIFFERENCE IN ADJUSTMENTS	$0.000	$0.000	($0.000)	$0.000	($0.000)

ADJUSTMENTS PER VALUATION REPORT:

	2000	2001	2002	2003	2004	2005
TAX EQUIVALENT ADJUSTMENTS AS APPLIED:						
Interest revenues per FDIC	$38.826	$40.404	$41.085	$40.520	$40.319	$42.744
Adjustment for SEC reporting	-	(0.299)	(3.545)	(2.942)	(2.947)	(2.664)
Tax-equivalent adjustment	0.352	0.366	0.623	0.563	0.615	0.868
INTEREST REVENUES (TE)	$39.178	$40.471	$38.163	$38.141	$37.987	$40.948
	-	-	-	-	-	-
Net interest income	$17.399	$18.977	$24.354	$26.273	$27.497	$28.067
Adjustment for SEC reporting	-	(0.299)	(3.545)	(2.942)	(2.947)	(2.664)
Tax-equivalent adjustment	0.352	0.366	0.623	0.563	0.615	0.868
NET INT INCOME (TE)	$17.751	$19.044	$21.432	$23.894	$25.165	$26.271
	-	-	-	-	-	-
Tax provision	$1.759	$2.366	$3.015	$3.267	$3.078	$3.111
Tax-equivalent adjustment	0.352	0.366	0.623	0.563	0.615	0.868
FULL TAX BURDEN (TE)	$2.111	$2.732	$3.638	$3.830	$3.693	$3.979
	-	-	-	-	-	-
Net income, calculated	$4.001	$4.356	$5.789	$5.926	$5.829	$6.088
Check #, net income, FR Y-9C	4.001	4.356	5.789	5.926	5.829	6.088
DIFFERENCE	$0.000	$0.000	$0.000	$0.000	$0.000	$0.000

SUPPORTING HISTORICAL EXHIBITS
MIDWESTONE FINANCIAL GROUP, INC.
INCOME TAXES PER AUDITED FINANCIAL STATEMENTS

	2000	2001	2002	2003	2004	2005
CURRENT/DEFERRED INCOME TAXES						
Current Income taxes						
Federal	$1.225	$2.319	$2.975	$3.219	$3.160	$3.017
State	0.069	0.424	0.546	0.625	0.485	0.446
SUBTOTAL	$1.294	$2.743	$3.521	$3.844	$3.645	$3.463
Deferred income taxes						
Federal	$0.448	($0.322)	($0.437)	($0.462)	($0.481)	($0.325)
State	0.017	(0.055)	(0.069)	(0.115)	(0.086)	(0.027)
SUBTOTAL	$0.465	($0.377)	($0.506)	($0.577)	($0.567)	($0.352)
TOTAL TAXES	$1.759	$2.366	$3.015	$3.267	$3.078	$3.111
TAX RECONCILIATION		-				
Federal tax, statutory rate	$1.958	$2.286	$2.993	$3.125	$3.028	$3.127
Tax exempt	($0.226)	($0.206)	($0.185)	($0.167)	($0.210)	($0.267)
BOLI, cash surrender value	(0.035)	(0.052)	(0.077)	(0.072)	(0.062)	(0.113)
State franchise tax, net	0.057	0.244	0.315	0.337	0.263	0.276
Non-deductible goodwill amortization	0.086	0.086	-	-	-	-
Other, net	(0.081)	0.008	(0.031)	0.044	0.059	0.088
NET ADJUSTMENT	($0.199)	$0.080	$0.022	$0.142	$0.050	($0.016)
REPORTED TAXES	$1.759	$2.366	$3.015	$3.267	$3.078	$3.111

SUPPORTING HISTORICAL EXHIBITS
MIDWESTONE FINANCIAL GROUP, INC.
INCOME TAXES PER AUDITED FINANCIAL STATEMENTS

	2000	2001	2002	2003	2004	2005
BALANCE SHEET ITEMS						
Deferred tax assets:						
Net unrealized loss on securities					$0.031	$0.448
Allowance for loan losses	0.570	0.904	1.415	2.013	2.497	2.702
Deferred compensation	0.116	0.169	0.238	0.521	0.718	0.828
Premium amortization	0.090	0.095	-	-	-	-
Other	-	0.008	-	-	-	-
TOTAL TAX ASSETS	$0.776	$1.176	$1.653	$2.534	$3.246	$3.978
Deferred tax liabilities:						
Depreciation and amortization	$0.333	$0.325	$0.379	$0.649	$0.767	$0.579
Federal Home Loan Bank stock	0.110	0.109	0.109	0.110	0.110	0.109
Premium amortization		-	0.066	0.227	0.390	0.554
Deferred loan fees	0.068	0.048	0.033	0.022	0.016	0.011
Purchase accounting adjustments	0.771	0.813	0.664	0.703	0.564	0.595
Unrealized gain on securities	0.223	0.442	1.057	0.803	-	-
Prepaid expenses, other	0.004	-	0.015	0.066	0.044	0.143
TOTAL TAX LIABILITITES	$1.509	$1.737	$2.323	$2.580	$1.891	$1.991
Deferred tax assets	$0.776	$1.176	$1.653	$2.534	$3.246	$3.978
Deferred tax liabilities	1.509	1.737	2.323	2.580	1.891	1.991
NET DEFERRED ASSETS/(LIABS)	($0.733)	($0.561)	($0.670)	($0.046)	$1.355	$1.987

SUPPORTING HISTORICAL EXHIBITS

MIDWESTONE FINANCIAL GROUP, INC.

TAX EQUIVALENT WORKSHEET PREPARED FROM FR Y-9C

	2000	2001	2002	2003	2004	2005
COMPARISON FIVE YEAR HISTORY TO AUDITED FINANCIALS:						
Adjusted provision for income taxes	$2.111	$2.732	$3.638	$3.830	$3.693	$3.979
Tax equivalent adjustment	(0.352)	(0.366)	(0.623)	(0.563)	(0.615)	(0.868)
REPORTED TAX PROVISION	$1.759	$2.366	$3.015	$3.267	$3.078	$3.111
Reported taxes per audit	1.759	2.366	3.015	3.267	3.078	3.111
DIFFERENCE	$0.000	$0.000	$0.000	$0.000	$0.000	$0.000
REPORTED TAX EXEMPT INCOME PER FR Y-9C:						
Income, tax exempt loans/leases	NA	$0.045	$0.080	$0.074	$0.152	$0.236
Income, tax exempt securities	NA	0.666	0.543	0.489	0.465	0.633
TOTAL TAX EXEMPT	NA	$0.711	$0.623	$0.563	$0.617	$0.869
CALCULATED TAX RATE:						
Reported tax exempt income, FR Y-9C		$0.711	$0.623	$0.563	$0.617	$0.869
Tax adjustment per audited financials		0.206	0.185	0.167	0.210	0.267
EFFECTIVE TAX RATE		22.5%	22.9%	22.9%	25.4%	23.5%

APPENDIX A

INCREMENTAL VALUE ATTRIBUTABLE TO S-CORP TAX STATUS

A company's shares are valued based on its treatment as a C-corporation for tax purposes. This assumption is required for the Market Approach and the Income Approach. The Guideline Companies are taxed as C-corporations so the resulting earnings multiples must be applied to C-corporation equivalent earnings. Similarly, the discount rates applied in the Income Approach are based on those required for C-corporations.

The market investor would assign different values to two sets of equivalent cash flows that are taxed at different rates, as is evident in the yield differential between tax-exempt municipal bonds and taxable corporate bonds. The impact of tax considerations to the market investor is widely accepted in financial theory, whether the tax is paid at the corporate level or at the personal level.

The Federal Reserve publishes the yields on 20 year tax-exempt bonds (municipal bonds) with a mixed quality rating approximating an A1 bond. It also publishes the average yield on long-term AAA rated bonds from Moodey's Investor Services. The published yield on the tax-exempt bond index was 4.79% at December 26, 2002; that for the BAA rated corporate bond was 7.45% in December 2002. The implicit adjustment between these bonds and the tax-exempt municipal bonds is 35.7%, which is slightly below the marginal individual tax rate of 38.6% in effect for 2002 but above the marginal tax rate of 35.0% for corporations.

The impact of taxes on investment yields is a critical consideration in the banking industry. Security portfolios held by financial institutions commonly include both tax-exempt bonds and taxable bonds. To facilitate comparison between the observed yields on these two types of bonds, yields on the tax-exempt bonds are presented on a tax-equivalent basis. This adjustment reflects the calculations presented in the previous paragraph. Lacking such an adjustment, the portfolio manager could not make an informed decision as to whether to invest in tax exempt securities or in taxable securities.

The reality of the need for this adjustment is reflected in the reporting of bank holding company performance to Federal Regulators. In their reports to the Board of Governors of the Federal Reserve System, in form FR Y-9C, bank holding companies with assets in excess of $150 million report their actual net interest income in the body of Schedule HI – Consolidated Income Statement (line 3) and their "Net interest income (line 3 above) on a fully taxable equivalent basis" in the Memoranda sections of the schedule. This reporting requires an assumption regarding tax rates. A difference is reported on these two lines if the institution's security portfolio includes tax-exempt municipal bonds, or if it has tax exempt loans or tax-exempt leases. A difference is reported whether the institution is taxed as a C-corporation or as an S-corporation. Thus, a zero corporate tax rate is not assumed for this purpose even if the holding company has elected to be taxed as an S-corporation.

The favorable tax status as an S-corporation could be lost within a short time either from changes in tax laws or from corporate actions. A reduction in the tax rates on C-corporation dividends reduces the incremental value attributable to the S-corporation tax treatment: the taxes saved on these dividends are reduced. An increase in the marginal tax rates paid by individuals could increase the taxes paid on the S-corporation earnings by the shareholders to a level that would be prohibitive. Prior to reductions in personal tax rates the S-corporation tax structure was used to pass corporate losses through to shareholders to be used to offset income that was being taxed at a relatively high personal tax rate; at that time, the C-corporation tax structure was considered as a tax benefit.

At the corporate level, the S-Corporation tax status could be lost by an increase in shareholders, the addition of an unqualified shareholder. Shareholder agreements entered into in an attempt to prevent these developments limit the marketability of the shares, as discussed below. An acquisition by another corporation generally eliminates the S-corporation tax benefits. The premium received in such a transaction would be measured relative to the acquired corporation's value as a C-corporation, not an S-corporation. The incremental value as an S-corporation and that generally observed for a corporate acquisition are mutually exclusive.

The favorable tax treatment gained from the Subchapter S election does create value, but based solely on the tax benefits to the shareholders and not at the corporate level. These tax benefits arise from the shareholders' ability to receive dividends from the corporation without paying additional taxes on these dividends. Also, at the time of sale, the additional retained earnings on which taxes have already been paid by the shareholder serve to increase the tax basis, which decreases the capital gain taxes.

As noted previously, the corporate income has been shifted from the company to the shareholders for tax purposes, which is explicitly stated in the general instructions to Form 2552 (Rev. December 2002) Election by a Small Business Corporation. Thus, the income is not tax-exempt: it is taxed at the shareholder level.

The shareholders that now have to pay taxes on the corporate net income expect to receive sufficient dividends to pay their incremental taxes related to this income otherwise the value of their investment is impaired. To the extent that the dividends received under the S-corporation tax treatment do not cover these taxes, corporate expenses have been shifted to the shareholders. If this corporate expense is paid by the shareholders without having received the offsetting dividends then the shareholders are, in effect, being forced to reinvest in the Company just as if they were being forced to pay the corporation's interest expense, salaries, or rents.

In valuing a closely-held company, earnings and cash flows are commonly adjusted for excess salaries paid to shareholders in lieu of dividends or below market rents paid to shareholders. The premise underlying these adjustments also applies to a shift in the tax burden from the Company to the shareholders under the S-corporation tax treatment.

Banking regulations in at least one state recognize the special dividend requirements for S-corporations. Minnesota Statutes (Chapter 48) allow for the filing of a plan and agreement for S-corporations to distribute earnings beyond the normal provisions related to a surplus fund and undeclared net profits from prior dividend periods.

After paying the taxes on the S-corporation earnings, assuming the individual's tax situation results in a tax rate comparable to the corporate tax rate, the investor has the same cash flows as under the C-corporation election except for the taxes that would have been paid on the C-corporation dividends. The taxes saved on what would have been C-corporation dividends are the only difference between the two scenarios. Isolating and quantifying this difference facilitates the calculation of the incremental value attributable to the S-corporation tax treatment.

For an existing S-corporation, projections on an S-corporation tax basis are converted to a C-corporation tax basis. The assumption is that all S-corporation dividends not allocable to C-corporation taxes would be paid out as C-corporation dividends. This assumption, that the cash paid out is the same as a C-corporation and as an S-corporation, leaves the company unchanged. This is appropriate: management identified the amount of net income to be retained as capital to support the projections as an S-corporation. Changing these projections would require a different set of assumptions at the corporate level and impact the source of the incremental value attributable to the S-corporation tax treatment. The assumption is that, all else being equal, management is maximizing the value of the corporation under both tax treatments. If the corporate value can be increased under one tax scenario it could also be increased under the other scenario. As stated, the tax burden for the corporate earnings has essentially been shifted to the individual shareholders. The benefit of the S-corporation tax treatment accrues to the shareholder, not the corporation, in the form of taxes not paid on what would have been C-corporation dividends.

The assumption is that the S-corporation pays dividends equivalent to the taxes it would have paid as a C-corporation plus the dividends it would have paid as a C-corporation. To the shareholders, the difference between these two dividend flows is the taxes saved on the normal C-corporation dividends, which are essentially “tax free” to the shareholders.

In both scenarios, the corporation has the same retained earnings because the dividends paid to the shareholders to meet their tax payments under the Subchapter S election would have been paid in taxes by the corporation. (To achieve this balance, the assumption is made that the corporate tax rate is equal to the shareholders’ tax rates, as discussed above. Although this assumption may not be entirely accurate, the net impact to the valuation is not significant and the resulting incremental value is reasonably representative of the economic impact of the tax treatment.) The corporation can generate the same revenue and net income before taxes and dividends in both scenarios.

A five-year horizon is used for this analysis. The implication of this assumption is that the benefits of the favorable tax treatment do not continue indefinitely: the company either reverts back to a C-corporation, for any number of reasons, or it is sold at a price based on its taxation as a C-corporation. In either case, the shareholders have the benefit of the additional retained earnings on which taxes have been paid, which increases their tax basis in the corporation.

An alternative approach to estimating the value of an S-corporation has been to adjust the discount rate in a manner similar to the observed yield differential between the tax-exempt municipal bonds and the taxable corporate bonds. This approach is not appropriate. As noted previously, under the S-corporation election the income to be taxed is shifted from the corporation to the individual. Although the tax rates may differ between these two taxpayers, this is not the basis for the actual tax savings. The actual tax savings comes on the C-corporation equivalent dividends that are not taxed under this election and the reduction in the capital gains due to the increase in the tax basis generated from retained earnings. The preceding analysis is structured to specifically quantify and capture these benefits.

Increasing the required rate of return for the yield differential between tax-exempt bonds has been suggested as a method for determining the value of an S-corporation. This differential based on the rates discussed previously appears to be 2.66% which is added to the required rate of return and applied to the S-corporation dividends.

This adjustment is not appropriate. The difference in yields observed for the two bond categories moved down from the taxable rate to the tax-exempt rate. If the S-corporation earnings were truly tax-exempt, as are the interest payments from the tax-exempt bonds, there would be no tax impact to the shareholders. However, the taxes to be paid by the S-corporation shareholders increase significantly as they report their pro rata share of the S-corporation earnings on their tax returns, but not the dividends received. Conversely, shareholders do not report any part of the C-corporation earnings on their tax returns: they report only the dividends received.

As evidenced with the yields on tax-exempt bonds versus those on taxable bonds, investors consider the tax implications of all investments. Corporate financial managers also consider the tax implications to their current shareholders and to potential investors. In financial theory, the after-tax cost of debt is an underlying factor for selecting this source of funding and the benefits of leverage as set forth in textbooks (Smart, Megginson, Gitman; Corporate Finance (Thompson Southwestern, 2004), chapters 12 and 13, page 411) and taught in MBA level finance courses. Shareholder preferences for capital gains versus dividends are a consideration when financial managers set the dividend policy (Ibid, chapter 14, page 473).

The inter-relationship between the tax situation of a business and its owner is even more critical for closely-held companies This can be made clearer through the examination of the impact of changes in corporate and individual tax rates. In 1980, the marginal, individual tax rate was 70% on income over $215,400. The average corporate tax rate on the first $1.0 of taxable income was 44.1%. At that point, the C-corporation tax election was viewed as a tax shelter. The S-corporation election would be made to pass losses through to shareholders that could use them to offset income taxed at the 70% tax rate.

In 1980, a rational owner of a profitable, closely-held corporation would not have elected to be taxed as an S-corporation. This fact can be illustrated with some simple calculations based on some reasonable assumptions used for illustrative purposes. These include:

- Single shareholder owning 100% of the corporation
- Shareholder has other taxable income of $215,400
- Marginal individual tax rate of 70%
- Corporate taxable income of $1.0 million
- Average corporate tax rate of 44.1%
- No dividends paid by corporation

Given these assumptions, the shareholder has direction over $1.0 million of pre-tax earnings; or $559,000 in after-tax earnings. If the shareholder were to agree to the S-corporation tax treatment, the after-tax net income at the corporation would increase from $559,000 to $1.0 million. However, given the taxpayer's marginal tax rate, the after-tax net earnings over which the taxpayer has direction is reduced to $300,000 after paying taxes at the marginal individual tax rate of 70%. For companies that need to retain earnings for growth, the C-corporation shielded net income from the higher individual tax rate since the owner would be expected to pay out sufficient dividends to cover the incremental tax liabilities at the individual level. In this case, the owner increases the funds available for reinvestment in the company by 86% by retaining the C-corporation tax treatment.

This is an extreme example that assumes no dividends paid. The following chart shows that the S-corporation election provides a reduction in the combined corporate and individual taxes only if 100% of earnings are to be paid out as dividends as a C-corporation.

	Dividend Payout Ratios			
	100%	50%	25%	0%
Income	$1,000	$1,000	$1,000	$1,000
Taxes	441	441	441	441
NET INCOME	$559	$559	$559	$559
Dividends	$559	$280	$140	$0
Tax rate	70%	70%	70%	70%
TAXES	$391	$196	$98	$0

	Dividend Payout Ratios			
	100%	50%	25%	0%
TOTAL TAXES, C-CORPORATION				
Corporate taxes	$441	$441	$441	$441
Individual taxes	391	196	98	0
TOTAL	$832	$636	$539	$441
TOTAL TAXES, S-CORPORATION				
Corporate taxes	$0	$0	$0	$0
Individual taxes	700	700	700	700
TOTAL	$700	$700	$700	$700
Tax benefits, S-Corp.	$132	($64)	($161)	($259)

Thus, in 1980 shareholders would not elect to have a corporation taxed as an S-corporation unless it planned to payout all of its earnings as dividends. Otherwise, the owner would not maximize the return on his investment. The S-corporation election would not have been undertaken by a rational investor.

With changes in the individual tax rates, the benefits from the S-corporation tax treatment have improved. In 2002, the marginal, individual tax rate was 38.6% on income over $307,050. The average corporate tax rate on the first $1.0 million of taxable income was 34.0%. Given the same assumptions as above, including that other taxable income puts the individual taxpayer into the top tax bracket, the above schedule of calculations would be summarized as follows:

	Dividend Payout Ratios			
	100%	50%	25%	0%
2002 Tax benefits, S-Corp.	$209	$81	$18	($46)

The election to be taxed as an S-corporation is feasible only because of the lower individual tax rates. The benefits relate to taxes saved by the shareholders on what would have been received as C-corporation dividends. The benefits are not related to the taxes paid at the corporate level. In effect, the tax burden related to the corporate income is shifted to the shareholders. If the tax rate at the shareholder level is such that the combined taxes paid on the S-corporation earnings are lower than those paid on the C-corporation earnings plus the dividends, the S-corporation election is favorable. The breakeven point for the S-corporation election is a function of the dividend payout ratio and the individual tax rates, illustrated as follows:

	Dividend Payout Ratios			
	100%	50%	25%	0%
Breakeven tax rate	NA	50.8%	40.7%	34.0%

If all net income is to be paid out as dividends, the S-corporation tax treatment is always preferable.

This analysis is critical to the "willing buyer" concept. A rational investor is not going to buy either S-corporation shares or the aggregate corporation based on earnings multiples applied to pre-tax corporate earnings. At a minimum, such an investor undertaking an analysis of the stock would examine the combined tax impact as presented here to determine the possible benefits from the S-corporation election.

A buyer for the aggregate company would not pay a premium to the value as a C-corporation. If the price required by the seller is set based on the S-corporation pre-tax earnings then the potential buyer would not complete the transaction. Completing the transaction would result in a reduction in the buyer's overall wealth: the investor would receive something of less value than the cash surrendered. As an alternative, the investor would buy an equivalent C-corporation at the lower value, pay the fees to complete the S-corporation election to create the wealth supposedly attributable to the S-corporation cash flows, and invest the difference in Treasury notes. The "willing buyer" concept does not exist for an S-corporation value based on multiples applied to pre-tax earnings.

Based on the principles of substitution that underlies most of the valuation theory and the concept of arbitrage that underlies much of modern financial theory, a willing buyer would not pay a premium for an S-corporation relative to the price at which the same corporation, or a comparable corporation, could be acquired if it were taxed as a C-corporation. The willing buyer could buy the alternative C-corporation at the lower price and elect Subchapter S tax treatment. Similarly, the willing seller would not require a significant premium for his ownership interest: he could sell the subject Subchapter S corporation at the lower price, plus one dollar, buy the alternative C-corporation for the lower price and pocket the extra dollar. (This marginal dollar is a basic concept of supply and demand that is a fundamental part of economics and the principle of substitution.)

Just as the changes in the tax rates gave rise to the benefits of the S-corporation election, an increase in the individual tax rates can reduce the benefits. Since 1980, there have been approximately eight changes to the marginal tax rate on individuals and six changes to the average corporate tax rate. In addition, taxpayers must consider the effect that the alternative minimum tax has on the incremental value of the S-corporation tax treatment, as well as the capital gains tax rate and the tax rate applied to dividends. If the S-corporation income were taxed at the shareholder's marginal tax rate but the dividends are taxed at a lower rate, the incremental value of the S-corporation tax treatment is reduced.

APPENDIX B

SUBCHAPTER S BANK CONFERENCE

SAN ANTONIO, TEXAS

MAY 6, 2005

INCREMENTAL VALUE ATTRIBUTABLE

TO

SUBCHAPTER S ELECTION

INCREMENTAL VALUE ATTRIBUTABLE TO SUBCHAPTER-S ELECTION

The shareholder election to have a corporation taxed under Subchapter S of the tax code does increase the after-tax cash flows to the shareholders and, thus, increases the value of their shares. These tax benefits accrue to the shareholders, not to the company: the higher after-tax cash flows increase the value of the shares to the individual taxpayer, but does not increase the aggregate value of the company.

The following exhibits supporting this position were presented to the 8th Annual Subchapter S Bank Conference in San Antonio on May 6, 2005. The implications of this valuation approach could be critical when reporting the value of an ownership interest in a Subchapter S corporation to the Internal Revenue Service for estate tax purposes. From 2001 and 2002, the IRS prevailed in four tax court cases setting values for Subchapter S corporations as if there were no taxes paid on the corporations' earnings. The resulting values were not justified by the tax savings accruing to the shareholders.

Pages three through twelve of the following exhibits summarize the calculation of the incremental value attributable to the Subchapter S election. Pages one and two outline the presentation; page thirteen highlights my professional experience and education.

PAGES THREE AND FOUR: Investors consider the tax impact of their investments as evidenced by the yields observed for tax-exempt municipal bonds relative to taxable corporate bonds; and the level of tax planning undertaken by both individuals and corporations. This applies to the shareholder election to be taxed as an S-corporation.

This discussion would not have been necessary in 1980 given the marginal tax rates paid by individuals and corporations. At that time, electing to be taxed as an S-corporation would have reduced the after-tax cash flows to the shareholders (page three). Prior to 1982 the C-corporation was viewed as a tax shelter for those companies that retained most of their earnings to support growth. The S-corp election was for a company that was reporting taxable losses. This tax treatment allowed the company to pass these through to its shareholders to offset income taxed at a marginal rate of 70%.

As the marginal individual tax rate fell relative to the marginal corporate tax rate (page four), shareholders in companies that distributed most of their earnings as dividends could have benefited from the S-corp election, for the years 1982 through 1987. However, such benefits can prove to be temporary as the relative marginal tax rates change over time.

PAGES FIVE AND SIX: These two pages present reference to the tax court cases and articles written on how to value S-corporations, respectively. Neither the court cases nor the professional writings attempt to value the tax benefits from the S-corp election that accrue to the shareholders.

PAGES SEVEN, EIGHT, AND NINE: Page seven illustrates the present value calculation for a company taxed as a C-corporation. This provides a base value and projections to use in calculating the incremental value attributable to the S-corp election.

Page eight shows the C-corp taxes being added back to the C-corp after-tax income and to the C-corp dividends to determine the equivalent S-corp earnings and dividends. The taxes to be paid by the company's shareholders on the S-corp earnings are calculated at the bottom of the page assuming a marginal tax rate of 35%. Taxes are paid on the S-corp earnings, but by the individual shareholders not the corporation. The Federal government is not foregoing taxes on the corporate income; the tax burden has merely been shifted.

The distributions are the same as a C-corporation or as for an S-corporation. As a C-corporation, distributions are allocated between the Federal government and the shareholders. As an S-corporation, same total amount is distributed directly to the shareholders who then serve as a conduit to the Federal government when they pay their taxes. Page nine shows that the company's financial position remains the same whether it is taxed as a C-corporation or an S-corporation.

PAGES TEN, ELEVEN, AND TWELVE: Page ten shows the calculation of the incremental value attributable to the S-corp election. Present values are calculated for the after-tax cash flows to the shareholders as an S-corporation and as a C-corporation. These calculations reflect the tax savings accruing to the S-corp shareholders that do not pay taxes on the C-corp equivalent dividends. The present value calculation for the S-corp reflects the tax benefits from the reduction in the capital gains tax. The shareholder tax basis increases due to retained earnings so the capital gain and resulting tax are lower. The difference between these two cash flows, presented on page eleven, is wholly attributable to the tax savings accruing to the shareholders.

Page twelve recaps the factors that impact the incremental value attributable to the Subchapter S election.

Incremental Value Attributable to S-Corp Election Outline

- **WHY A SUBJECT FOR DISCUSSION?**
  - S-Corp originally for corporations that were losing money
  - Changes in tax rates
  - Current position

- **VALUATION PROFESSION – ESTATE TAXES**
  - Court cases
  - 23rd Annual Advanced Business Valuation Conference
  - Business Valuation Review (September, 2004. Volume 23, No. 3) Quarterly Journal of the Business Valuation Committee of the American Society of Appraisers

Incremental Value
Attributable to S-Corp Election
Outline

- **FINANCIAL THEORY AND ANALYSIS**
  - Tax exempt municipal bonds
  - Banks: tax-exempt interest income
  - Dividend theory, capital structure theory
  - Competitive bids, negotiations, barriers to entry, arbitrage, marginal pricing theory
  - Cost accounting: isolate the benefits

- **ECONOMICS OF S-CORP ELECTION**
  - Pre-1980
  - Value of a bank as a C-corp
  - Incremental value, S-corp
  - Factors that impact incremental value
  - Tax court cases vs. making the S-corp election

- **CONCLUSION**

S-Corp Impact at 1980 Tax Rates

	C-Corp	S-Corp
CORPORATE LEVEL INCOME:		
Pre-tax income	$1.000	$1.000
Corporate income taxes	(0.460)	
NET INCOME	$0.540	$1.000
DIVIDENDS PAID TO SHAREHOLDER:		
C-Corporation		
Net income	$0.540	
C-corp payout ratio	30%	
C-CORP DIVIDENDS	$0.162	
S-Corporation		
C-corp taxes		$0.460
C-corp dividends		0.162
S-CORP DIVIDENDS		$0.622
TAXES PAID BY SHAREHOLDER:		
Taxable income to shareholder	$0.162	$1.000
Individual tax rate	70%	70%
INDIVIDUAL TAXES	$0.113	$0.700
TOTAL TAXES PAID:		
Corporate income taxes	$0.460	$0.000
Individual income taxes	0.113	0.700
TOTAL TAXES PAID	$0.573	$0.700
AFTER-TAX CASH FLOWS TO SHAREHOLDER:		
Dividends paid to shareholder	$0.162	$0.622
Taxes paid	(0.113)	(0.700)
NET CASH FLOW	$0.049	($0.078)

Historical Tax Rate Changes

	Marginal Tax Rates	
Years	**Individual**	**Corporate**
1971 - 1978	70.0%	48.0%
1979 - 1980	70.0%	46.0%
1981	69.125%	46.0%
1982 - 1983	50.0%	46.0 %
1984 - 1986	50.0%	46.0 - 51.0%
1987	38.5%	40.0 - 42.5%
1988 - 1989	28.0%	34.0%
1990 - 1992	31.0%	34.0%
1993 - 2000	39.6%	34.0 - 38.0%
2001	39.1%	34.0 - 38.0%
2002	38.6%	34.0 - 38.0%
2003 - 2004	35.0%	34.0 - 38.0%

Estate Tax Court Cases

- Walter L. Gross, Jr. etux, et al. v. Commissioner, TC Memo 1999 - 254, No. 4460-97 (July 29, 1999), affd. 272 F. 3d 333 (6th Cir. 20001)
- Estate of John E. Wall v. Commissioner, T.C. Memo. 2001 - 75
- Estate of Richie C. Hecke v. Commissioner, TC Memo 2002 - 34
- Estate of William G. Adams, Jr. v. Commissioner, TC Memo 2002 - 80

Valuation Profession Articles

- 23rd Annual Advanced Business Valuation Conference (October 7-9, 2004, San Antonio, Texas)
  - Valuation of Pass-Through Entities: Have We Reached a Consensus Yet? presented by Nancy J. Fannon, CPA/ABV, MCBA, BVA; James R. Hitchner, ASA, ABV; Christopher D. Treharne, ASA, MCBA, BVAL.

- Business Valuation Review (September, 2004. Volume 23, No. 3) Quarterly Journal of the Business Valuation Committee of the American Society of Appraisers
  - Valuation of Minority Interests In Pass-Through-Tax Entities, by Christopher D. Treharne, ASA, MCBA, BVAL.
  - Are S Corporations Worth More than C Corporations? by Z. Christopher Mercer, ASA, CFA
  - S Corporation Valuations in the Post-Gross World – Updated by Roger J. Grabowski, ASA
  - The S Corporation Economic Adjustment Model by Daniel R. VanVleet, ASA

Base Bank Valuation (Millions)

SUMMARY FINANCIAL PROJECTIONS

	2004	2005	2006	2007	2008	2009
Total Assets	$73.0	$78.0	$80.3	$82.8	$85.2	$87.8
Average Assets		$75.5	$79.2	$81.5	$84.0	$86.5
Return on Assets		1.26%	1.26%	1.26%	1.26%	1.26%
NET INCOME		$0.951	$0.998	$1.027	$1.058	$1.090
Retained Earnings		(0.350)	(0.164)	(0.169)	(0.174)	(0.179)
COMMON DIVIDENDS		$0.601	$0.834	$0.859	$0.885	$0.911

DISCOUNTED CASH FLOWS

		2005	2006	2007	2008	2009	Terminal Value
Common dividends		$0.601	$0.834	$0.859	$0.885	$0.911	$9.356
Discount Factor @	15%	0.9325	0.8109	0.7051	0.6131	0.5332	0.4972
ANNUAL PRESENT VALUE		$0.561	$0.676	$0.606	$0.542	$0.486	$4.652
TOTAL PRESENT VALUE		$7.522					

Informed Decisions, LLC

Adjustments to S-Corp Equivalent Tax Basis Earnings, Dividends, Shareholder Taxes (Millions)

CORPORATE EARNINGS ADJUSMENTS:	2005	2006	2007	2008	2009
C-corp Income	$0.951	$0.998	$1.027	$1.058	$1.090
C-corp Taxes	0.490	0.514	0.529	0.545	0.562
S-CORP PRO FORMA NET INCOME	$1.441	$1.511	$1.557	$1.603	$1.652

CORPORATE DIVIDEND ADJUSTMENTS:					
C-Corp Dividends	$0.601	$0.834	$0.859	$0.885	$0.911
C-corp Taxes	0.490	0.514	0.529	0.545	0.562
S-CORP PRO FORMA DIVIDENDS	$1.091	$1.348	$1.388	$1.430	$1.473

SHAREHOLDER TAXES ON S-CORP EARNINGS:					
S-Corp Income	$1.441	$1.511	$1.557	$1.603	$1.652
Personal Tax Rate	35%	35%	35%	35%	35%
PERSONAL TAX ON S-CORP EARNINGS	$0.504	$0.529	$0.545	$0.561	$0.578

Equity Reconciliation
S-Corp and C-Corp
(Millions)

S-CORPORATION EQUITY:	2005	2006	2007	2008	2009
Beginning Balance	$5.110	$5.460	$5.624	$5.793	$5.966
Net Income, no tax payments	1.441	1.511	1.557	1.603	1.652
Dividend Payments	(1.091)	(1.348)	(1.388)	(1.430)	(1.473)
ENDING BALANCE	$5.460	$5.624	$5.793	$5.966	$6.145

C-CORPORATION EQUITY:	2005	2006	2007	2008	2009
Beginning Balance	$5.110	$5.460	$5.624	$5.793	$5.966
Net Income, before taxes	1.441	1.511	1.557	1.603	1.652
Tax Payments	(0.490)	(0.514)	(0.529)	(0.545)	(0.562)
Dividend Payments	(0.601)	(0.834)	(0.859)	(0.885)	(0.911)
ENDING BALANCE	$5.460	$5.624	$5.793	$5.966	$6.145

EQUITY DIFFERENCES: S-CORP > C-CORP:	2005	2006	2007	2008	2009
S-Corporation Ending Equity	$5.460	$5.624	$5.793	$5.966	$6.145
C-Corporation Ending Equity	5.460	5.624	5.793	5.966	6.145
DIFFERENCE	$0.000	$0.000	$0.000	$0.000	$0.000

Present Value Comparison After Tax Cash Flows (Millions)

PRESENT VALUE OF S-CORP DIVIDENDS, AFTER-TAX:

	2005	2006	2007	2008	2009	Retained Earnings Tax Benefit
S-Corp Dividends (retained earnings)	$1.091	$1.348	$1.388	$1.430	$1.473	$1.036
Personal Tax on S-Corp Earnings at 35%	(0.504)	(0.529)	(0.545)	(0.561)	(0.578)	15%
NET AFTER-TAX TO SHAREHOLDERS	$0.587	$0.819	$0.843	$0.868	$0.895	$0.155
Present Value Factors	0.9325	0.8109	0.7051	0.6131	0.5332	0.4972
PERIODIC PRESENT VALUES	$0.547	$0.664	$0.595	$0.532	$0.477	$0.077
TOTAL PRESENT VALUE	$2.892					

PRESENT VALUE OF C-CORP DIVIDENDS, AFTER-TAX:

	2005	2006	2007	2008	2009
C-Corp Dividends to Shareholders	$0.601	$0.834	$0.859	$0.885	$0.911
Personal Tax on C-Corp Dividends at 15.00%	(0.090)	(0.125)	(0.129)	(0.133)	(0.137)
NET AFTER-TAX TO SHAREHOLDERS	$0.511	$0.709	$0.730	$0.752	$0.774
Present Value Factors	0.9325	0.8109	0.7051	0.6131	0.5332
PERIODIC PRESENT VALUES	$0.477	$0.575	$0.515	$0.461	$0.413
TOTAL PRESENT VALUE	$2.440				

Incremental Value Attributable to S-Corp Election (Millions)

INCREMENTAL, AFTER-TAX VALUE OF TAX SAVINGS

S-corp dividends after-tax present value	$2.892
C-corp dividends after-tax present value	2.440
INCREMENTAL VALUE ATTRIBUTABLE TO S-CORP	$0.452

ADJUSTED S-CORP VALUE

Base value as C-corporation	$7.522
Incremental value for S-corp election	0.452
ADJUSTED S-CORP VALUE	$7.974
% increase for S-corp election	6.0%

Factors that Impact Incremental Value

- Relative tax rates: C-corp, Individuals, Dividends
- Dividend payout ratio
- Retained earnings: increase to tax basis
- Time over which S-corp dividends are paid
- Differing discount rates