FINANCIAL AND ESTATE PLANNING

NOVEMBER 2006

NEW TAX LAW PLANNING

Expert's Article: Appraiser Oversight Under Pension Protection Act of 2006

By: J.L. Pierson, ASA

On August 17, 2006, the President signed into law the Pension Protection Act of 2006 (PPA), which includes a number of provisions redefining the practice of appraisals for tax purposes. These new rules are generally effective for appraisals prepared for returns and submissions after August 17, 2006. Combined with significant changes made by the 2006 Uniform Standards of Professional Appraisal Practice (USPAP)[1], which became effective at mid-year, the new rules represent overdue changes which the professional appraisal societies had long lobbied for and should make appraisals for federal tax purposes a better defined product with expectations on the part of the Service and taxpayers.

Appraiser Oversight Under PPA

The new appraisal rules (new Code Sec. 170(f)(11)) generally codify IRS regulations (Reg. Sec. 1.170A-13(c).) They apply to all property (other than cash, publicly traded securities, and any qualified vehicle) in connection with charitable contributions for income tax purposes. Charitable contributions in excess of $5,000 must be substantiated with a "qualified appraisal "prepared by a "qualified appraiser." The appraisal must be performed in accordance with generally accepted appraisal standards and any regulations or guidance prescribed by the Department of the Treasury. Since there are few valuation regulations or guidance issued by the Treasury at this point, this is generally understood to mean USPAP. It is an important step to tie-in tax rules to the generally accepted appraisal standards, including USPAP.

A "qualified appraiser" is an individual who: (1) has earned an appraisal designation from a recognized professional appraisal organization or has otherwise met minimum education and experience requirements set forth in regulations, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed in regulations or other guidance. Code Sec. 170(f)(11)(E)(ii). An individual may not be treated as a qualified appraiser with respect to any specific appraisal unless (1) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and (2) the individual has not been prohibited from practicing before the IRS at any time during the three-year period ending on the date of the appraisal. Code Sec. 170A(f)(11)(E)(iii).

Appraiser Penalties

Penalties are now available for violations. Code Sec. 6695A. The penalties apply for income tax purposes, not for estate and gift tax purposes. They apply to all appraisers, including those who are not qualified appraisers. Penalties are imposed if the appraiser knows, or reasonably should have known, that the appraisal would be used in connection with a return or a claim for a refund. The amount of the penalty is equal to the lesser of (1) the greater of (a) 10 percent of the amount of the underpayment or (b) $1,000, or (2) 125 percent of the gross income received by the person who prepared the appraisal. However, no penalty is imposed if the person establishes to the satisfaction of the IRS that the value established in the appraisal was more likely than not the proper value.

Insight
Appraisal societies have indicated that the new rules could be made to apply, by Treasury regulation, to all appraisals for tax purposes, including gift and estate. Time will tell whether they mitigate Treasury concerns.

USPAP Valuation Standards

The 2006 USPAP includes a significantly recast of Standards 9 and 10 which govern business valuations. USPAP establishes a set of minimum standards for appraisals. The following is a summary of these standards.

<u>Standards Rule 9-1:</u> The appraiser must be aware of, understand and correctly apply those recognized approaches, methods and procedures that are necessary to

[1] *USPAP was first created by The Appraisal Foundation in 1987. The Financial Institution Reform, Recovery and Enforcement Act [FIRREA] of 1989 requires that it be updated after public input. It has been updated annually ever since. The Appraisal Foundation is quasi-public body.*

produce a credible appraisal; not commit a substantial error of omission or commission that significantly affects the appraisal; not render appraisal service in a careless or negligent manner, such as making a series of errors that in the aggregate affect the credibility of those results.

Standards Rule 9-2: The appraiser must identify the client and other intended users; identify the each type of report. An Appraisal Report must be consistent with the intended use and, at a minimum must state the identity of the client and any other intended users by name or type. Among many other requirements, the report must summarize information sufficient to identify the business or intangible asset and the interest appraised; and state the extent to which the interest appraised contains elements of ownership control, elements of marketability and/or liquidity. A Restricted Use Appraisal Report must be consistent with the intended use and include, among other disclosures, a prominent use restriction that limits use of the report to the client.

Standards Rule 10-3. Each appraisal report must contain the following certification.

I certify that, to the best of my knowledge and belief,

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and is my personal, impartial, and unbiased professional analyses, opinions and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon developing or reporting predetermined results.
- My compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the *Uniform Standards of Professional Appraisal Practice.*
- No one provided significant business and/or intangible asset appraisal assistance to the persons signing this report.

J.L. Pierson, ASA is a business appraiser specializing in estate and gift tax valuations. Based in Darien, CT, he can be reached at jlp@NYNJCT-BV.com or 203-325-2703.

This information is a general discussion of the relevant federal tax laws. It is not intended for, nor can it be used by any taxpayer for the purpose of avoiding federal tax penalties. This information is provided to support the promotion or marketing of ideas that may benefit a taxpayer. Taxpayers should seek the advice of their own tax and legal advisors regarding any tax and legal issues applicable to their specific circumstances.

Financial and Estate Planning: INSIGHTS & STRATEGIES (ISSN 1065-6413) is published 12 times per year and is available to the public at an annual subscription price of $125.00 or at a single copy price of $15.00 per issue. Subscription and single copy orders should be addressed to Karen Erickson, Customer Services, Insights & Strategies, Financial Ink Corporation, P.O. Box 64299, St. Paul, MN 55164-0299. Phone number 651-665-5998, ©2005 Financial Ink Corporation, Executive Editor: Myron Kove; Assistant Editor: James M. Kosakow, (all of the firm of Kove & Kosakow, LLC). 212-822-0646. Facsimile 212-822-0648.