

Making a Gift is Only Part of the Process:

Meeting IRS Appraisal Requirements

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||| Agenda

- IRS Requirements
- Forms 8283 & 8282
- How to Find a Qualified Appraiser?
- What is the Appraiser's Role?
- Review of Appropriate Methodology
- Tangible Personal Property
- Special Appraisal Issues
- Appraisal Disasters

||| Form 8283

- A donor must file a Form 8283 with her income tax return to support every charitable deduction represented by a non-cash gift valued at more than \$500



||| Form 8283

- All gifts of publicly-traded securities greater than \$500 – with no upper limit – must be reported in Section A. No appraisal is required.
- All other gifts valued at less than \$5,000 must be reported in Section A. No separate appraisal is required.
 - One exception: gifts of privately held securities with a value less than \$10,000 may be reported in Section A.
- The value of items of a similar nature must be reported together.

||| Form 8283

- Special rules relate to gifts of "vehicles."



||| Form 8283

- Other gifts valued at more than \$5,000 must be reported in Section B.
- The donor must receive a "qualified appraisal."
- The "qualified appraiser" must sign the Form 8283.
- The Charity must sign the Form 8283.

Questions

- Who can (or can't) be a "qualified appraiser?"
- What is required for the appraisal to be a "qualified appraisal?"
 - Hint: see Reg. 1.170a-13-13 (c)(3)
- Are there dates within which the appraisal must be done?
- How should the 8283 be processed by the Charity?

Questions

- Can/should the Charity pay for the 8283?
- What does the Charity need to book the gift?



Form 8282

- The Charity must report a sale within 3 years of the gift to the IRS on a Form 8282.
- What if the donor asks the Charity to retain the gift for 3 years?
- What do you report: gross or net sales proceeds?



Valuation of Business Interests

- Difficult to give money away!
- Does the Charity even want your property?
- Must comply with IRS regulations.



What is a Qualified Appraisal?

- IRS Notice 2006-96
 - Defines "Qualified Appraiser" & "Qualified Appraisal"
 - To substantiate charitable contribution deduction
- Qualified Appraisal: § 170(f)(11)(E)(i)
 - "Conducted by qualified appraiser in accordance with generally accepted appraisal standards and any regulations or guidance prescribed by the Secretary."

What is a Qualified Appraisal?

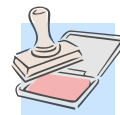
- Does not involve a prohibited appraisal fee
- Relates to an appraisal made not earlier than 60 days before the date of contribution of appraised property
- Meets all requirements of:
 - Reg. 1.170a-13-13 (c)(3)

Who is a Qualified Appraiser?

- No definitive tests for estate/gift tax or litigation context in "Adequate Disclosure" regulations or elsewhere
- Business appraisers not licensed by the State
- Defined for charitable deduction purposes
 - As a result of the 2006 Pension Act

Qualified Appraiser

- Earned an appraisal designation from a recognized professional organization or other minimum experience
- Regularly performs appraisals & receives compensation for services
- Verifiable education experience in valuing type of property subject to appraisal
- Has not been prohibited from practicing by IRS



Qualified Appraiser

- Must be Independent
 - Cannot be a party to the transaction (i.e., donor, donee)
- Appraiser penalties for gross valuation misstatements



Professional Designations

- American Society of Appraisers
 - Accredited Senior Appraiser (ASA)
- AICPA
 - Accredited in Business Valuation (ABV)
- Nat'l Assoc. of Certified Valuation Analysts
 - Certified Valuation Analyst (CVA)
 - Accredited Valuation Analyst (AVA)
- Institute of Business Appraisers
 - Certified Business Appraiser (CBA)



Report Standards

- Limited guidance
- Uniform Standards of Professional Appraisal Practice (USPAP)
 - Developed by Appraisal Standards Board of the Appraisal Foundation
 - Cited as an example of acceptable standards in IRS Notice 2006-96



How to Find a Qualified Appraiser?

- Appraisal Credentials
- Stability & Longevity
- Relevant Experience
 - At minimum, 2 years experience per IRS Notice
- Appropriate Educational Background
- Primary Vocation
 - Don't want an accountant who dabbles...
- Violation of Professional Ethics for Contingent Fees


How to Find a Qualified Appraiser?

- Search Professional Association Websites
 - ASA: www.appraisers.org
 - NACVA: www.nacva.com
 - IBA: www.go-iba.org
 - AICPA: www.aicpa.org




Appraiser's Role

- Understand & Define the Assignment
 - Purpose of the appraisal
 - Standard of Value
 - Valuation Date
 - Specific Interest Being Valued
 - Control vs. Minority, etc.
 - Fee Structure
 - Timing



Appraiser's Role (Cont.)

- Prepare an Engagement Letter
 - After assignment is defined
- Gather Relevant Information
 - Financial statements & tax returns
 - Corporate documents
 - Real estate or equipment appraisal
 - Interview with management




Appraiser's Role (Cont.)

- Perform Appraisal & Develop Opinion
 - Which valuation methodologies are appropriate?
 - How should value be allocated among debt, preferred stock, etc.?
 - Valuation adjustments
 - Discounts for Lack of Control & Marketability
 - Key Man Discount
 - Built in Gains Taxes


Appraiser's Role (Cont.)

- Present Valuation Report
 - Preliminary drafts
 - Valuation Reports
 - Clear & Detailed
 - In Conformity to USPAP, in most cases
 - In Conformity with Adequate Disclosure regulations
 - Unbiased
- Sign Form 8283



Appraiser's Role (Cont.)

- Archive Workpapers
 - Retain for a minimum of 5 years
- Support Conclusion
 - Explain to clients & advisors
 - Participate in audit process
 - Testify in litigation matters



Review of Appropriate Methodology

- Three Approaches to Value
 - Asset Approach
 - Income Approach
 - Market Approach
- Application of all approaches is neither necessary nor appropriate
 - Methodology must be tailored for each assignment
 - Explain why method was selected or rejected

Asset Approach

- Relevant for holding companies/partnerships with substantial assets
- Real Estate
- Securities
- Hedge Funds



Income Approach

- Relevant for operating companies or service based businesses
- Normalized earnings and applicable rate of return



Market Approach

- Based upon comparable sales
- Limitations
 - How comparable is data?
 - Difficult to obtain transactions
- Examples
 - Stock in community bank
 - Accounting firm

Review of Appropriate Methodology

- Was the correct standard of value utilized?
- Is the valuation date correct?
- Has the correct interest been valued?
 - For example: 50% interest vs. 1% interest
 - Control vs. minority adjustments
- Is the conclusion logical and well supported?
- Does the report conform to USPAP?

Review of Appropriate Methodology

- Common Pitfalls
 - Getting lost in the weeds
 - Over or underestimating long-term future growth
 - Failing to make appropriate adjustments
 - Balance sheet
 - Income statement
 - Improper valuation multiples
 - Failing to develop nexus between empirical evidence and fact pattern of subject business



Examples of Business Gifts

- Family Limited Partnership Interests
 - Real Estate Holding
 - Securities/Hedge Funds
- Corporate Shares
 - Stock in closely-held community bank
 - Pre-IPO stock
- Fractional Interests in Real Estate
- Large Family Businesses (Operating)
 - Unlikely

Valuation Discounts

- Lack of Control
 - A minority interest is not as desirable as a controlling interest
 - Securities/Hedge Funds
- Lack of Marketability
 - Illiquid investment
 - Restrictions in Partnership/Shareholder Agreement
- Fractional Interest Discounts (Real Property)

Charitable Giving vs. Estate Planning

- Donor's desire?
- Goal to minimize taxes
- Give appreciated assets?
- What can Charity do with business interest?
- Valuation Discounts
 - Can't have it both ways



Tangible Personal Property

- Related Use Rules
- Auctions
- Issue: Donor gives a painting to be sold at an auction. Her basis is \$10,000 and the FMV is \$50,000. Is an appraisal required?



Special Appraisal Issues

- Gifts of Insurance Policies
- Gifts of Life Income Interests in CRTs
- Special Issues re: gifts of real estate
- Gifts through CRTs


Appraisal Disasters

- Heavy equipment distributor
 - No proprietary product lines/manufacturers
 - No barriers to entry
 - Razor thin gross margins (especially due to economic conditions)
 - High debt & negative equity
 - Significant sales volume (\$6-7 M)
 - Operating losses over past 5+ years
 - No growth in earnings projected!




||| Appraisal Disasters


- Heavy equipment distributor
 - Was valued using market approach at \$1 M!
 - Price/ revenue multiple used
 - Not appropriate when revenues are irrelevant
 - Price/margin or price/earnings multiples more appropriate
 - Old transaction data not relevant for current economic period
 - No adjustment for lack of earnings
 - My conclusion: company had zero equity value!

||| Appraisal Disasters 

- Operating Co., Significant Assets
 - Negative earnings from operations
 - A discounted cash flow methodology was used
 - Projection used negative earnings
 - Determined a negative \$2M operating value and then added non-operating assets
 - Asset Approach more appropriate
 - Value understated by \$2M!
 - Can't have negative equity value; value stops at zero!

||| Appraisal Disasters 

- Appraisal Process Gone Horribly Wrong
 - Farmland in Sacramento floodplain to be purchased by School District for \$13 M from prominent developer (\$325,000 per acre)
 - Inflated real estate appraisal – 6x actual value
 - Property value based on land with water, sewer, & single-family residences
 - Attorney had non-disclosed conflict of interest
 - Represented school district in transaction but represented developer previously

||| Appraisal Disasters 

- Appraisal Process Gone Horribly Wrong
 - School district filed suit
 - \$2.6 M settlement with law firm
 - \$350,000 settlement with appraiser
 - Suit pending with developer
 - Make sure you hire qualified appraisers
 - Make sure the correct interest is being valued
 - Make sure assumptions are correct and concluded value is logical

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Questions?