



New Appraisal & Appraiser Requirements

What Every Advisor Should Know

Speaker Profiles

Gerald Barney, MS, CSBA, CMEA

- Gerald Barney is the CEO of American ValueMetrics Corp, a business and equipment appraisal company.
- Barney has 30+ years experience in financial consulting and appraisals both in the securities industry and in small business consulting.

Gerald Barney's Credentials

- M.S. Cybernetic Systems, San Jose State University (1980)
- B. A. Management, Sonoma State University, California (1973)
- A.A. Engineering, San Mateo College, California (1958)
- Graduate, New York Institute of Finance (1974)
- Formerly licensed NASD securities broker (1972-1974)
- Licensed California Real Estate Broker
- Certified Machinery/Equipment Appraiser (CMEA)
- Certified Senior Business Analyst, Society of Business Analysts (CSBA)

Speaker Profiles

Melisa Silverman, JD, CMEA, SBA

- Silverman is a partner of American ValueMetrics Corp, a business and equipment appraisal company.
- Silverman is a partner of Triaz International, a small business transfer specialist company.
- Silverman has 15+ years experience in technology partnerships and small business partnerships.

Melisa Silverman's Credentials

- JD Degree, Nova Southeastern Shepard Broad Law Center
- BA Degree, Indiana University
- Certified Machinery/Equipment Appraiser (CMEA)
- Senior Business Analyst (SBA)
- Member, Society of Business Analysts (SBA)
- Member, National Equipment & Business Brokers Institute (NEBB)
- Board Member, Society of Financial Service Professionals (FSP)
- Former Board Member, San Diego American Marketing Association (AMA)
- Former Associate Member, San Diego Software Industry Council (SDSIC)

Changes in Appraisal Requirements

- This presentation is meant to be an overview of recent changes in policy and law, and the effects on appraisal requirements.
- This presentation is not intended to be a definitive legal resource, but does provide some references for professionals to guide them.

Pension Protection Act of 2006

- This Act changed a number of requirements for business and equipment appraisals.
- There are a number of regulations in development, however interim guidance has been provided by the IRS.

Interim Guidance

- IRS Notice 2006-96 provides **transitional guidance** relating to the new definitions of “**qualified appraisal**” and “**qualified appraiser**” in §170(f)(11) of the IRS Code, and §1219 of the Pension Protection Act of 2006.
- Taxpayers may rely on Notice 2006-96 to comply with the new provisions added by §1219 of the PPA.

The following discussion is based upon this guidance.

Substantiation of Charitable Deductions

- Deductions permitted under §170(f)(11) require “Qualified Appraisals” for property for which a deduction of more than \$5,000 is claimed.

Charitable Deductions under \$5,000

- No appraisal is required.
- Attach description of contributed property.

Charitable Deductions between \$5,000 and \$500,000

- MUST obtain a “qualified appraisal”.
- MUST attach an appraisal summary.

Charitable Deductions over \$500,000

- MUST obtain a qualified appraisal.
- MUST attach the entire appraisal report to tax return.

Appraisal Summary

- IRS form 8283 is the appraisal summary.
- Donee must “accept” the donation at the appraised value (or less) and sign the form 8283. This serves as acknowledgement that form 8382 may be required.
- Donee must file a form 8282 if it disposes of the property within 3 years of receipt rather than the 2 years previously required.

Exceptions

- Car, boat or plane for which the deduction is limited to charity's gross sales proceeds.
- Stock in trade, inventory, or property held primarily for resale in the ordinary course of business.
- Publicly traded securities for which market quotations are readily available.
- Qualified intellectual property, such as a patent.

Multiple Gifts

- Annual totals for property of the same type, gifted to multiple donees, is aggregated to determine whether limits are exceeded.

Failure to Comply

- Disallowance of the deduction.
- Penalties on Donors.
- Penalties on Appraisers.
- Penalties on professional advisors.

Donor Penalties for “Substantial” and “Gross” Valuation Misstatements

- Penalty Rates have not changed as per code section 6662:
 - **Penalty is 20% of underpayment for “substantial” valuation misstatement.**
 - **Penalty is 40% of underpayment for “gross valuation misstatement.**

Thresholds to determine “substantial” and “gross” Misstatements

- For Income Tax purposes "gross" threshold reduced to 200% from 400% of "correct" value, "substantial" reduced to 150% from 200% of "correct" value.
- For Estate and Gift Tax purposes the threshold for "gross" increased to 40% from 25% of "correct" value, "substantial" increased to 65% from 50% of "correct" value.

Appraiser Penalties for Misstatements

- Greater of 125% of the appraisal fee, the greater of \$1,000 or 10% of the tax attributable to the valuation misstatement
- May be barred from practice before the IRS.

Professional Penalties for “Aiding and Abetting” Misstatements

- Includes lawyers, accountants and appraisers.
- \$1,000 or (\$10,000 for corporation).
- Applies whether or not taxpayer knew of or gave consent to the understatement.

“Qualified Appraiser”

- **Has earned a designation from a recognized professional appraisal organization.**
- **Regularly performs appraisals for compensation.**
- **Can demonstrate verifiable education and experience in valuing the type of property being appraised (business, personal, real estate, etc.).**
- **Has not been prohibited from practicing before the IRS within 3 year period preceding appraisal.**

“Qualified Appraiser” – Additional Requirements

- For Real Property, must be licensed in the state in which the property is located.
- For property other than Real Property:
 - Must qualify as a “qualified appraiser” within the meaning of §1.170A-13(c)(5) to make appraisals for the type of property being valued.
 - **After Feb 16, 2007**
 - **Completed college or professional coursework relevant to the property being valued,**
 - **Must have obtained at least two years of experience in the trade or business of buying, selling or valuing the type of property being valued, and**
 - **Must fully describe the education and experience that qualify the appraiser.**

Generally Accepted Professional Designations

- There are many organizations which offer certifications for appraisers generally based upon:
 - Education
 - Experience
 - Examination
 - Peer review of appraisal reports

Generally Accepted Professional Designations

- Some of the more common appraisal designations include but are not limited to:

Professional Associations	Professional Designation	USPAP Compliant
Society of Business Analysts	CSBA	Yes
American Society of Appraisers	ASA	Yes
Institute of Business Appraisers	CBA	?
National Association of Certified Valuation Analysts	CVA	?
NEBBI Certified Machinery & Equipment Appraiser	CMEA	Yes

Who cannot be a “Qualified” Appraiser

- The donor
- The donee
- A party to the donor’s acquisition of property
- A party employed by or related to the donor or donee

“Qualified Appraisals”

- Must be prepared by a “qualified appraiser”
- Must meet generally accepted appraisal standards as defined below:

“An appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards within the meaning of §170(f)(11)(E)(i)(II) if, for example, the appraisal is consistent with the substance and principles of the **Uniform Standards of Professional Appraisal Practice** (“USPAP”), as developed by the Appraisal Standards Board of the Appraisal Foundation.”

Additional information is available at <http://www.appraisalfoundation.org>

Personal Property vs. Real Property

- The California Civil Code defines all property that is not real property as personal property. Therefore:
- Personal Property includes
 - Businesses
 - Intellectual property
 - Securities

Some Common and Uncommon Securities

- S and C Corporation shares
- Limited Partnership interests
- General Partnership interests
- LLC memberships
- Purchase Options
- Some Trusts

Real Estate Appraisal or Business Appraisal?

- If straight real estate investment, without minority or control issues justifying discounts
 - Then have a real estate appraisal by a real estate appraiser licensed in the state.
- If real estate is owned jointly or is the underlying investment for a business entity, both control and marketability discounts could apply.
 - A qualified business appraisal will be required to substantiate the discounts.
 - A real estate appraisal of the underlying real estate may also be required.
- LLC and limited partnership interests should be appraised as a business appraisal, and are usually subject to deep discounts.

What if a Business Owns Real Estate?

- If real estate is generic – can be used for any purpose within its zoning – have a real estate appraisal done
 - Real estate appraisal should be for “highest and best use.”
 - Then have business appraisal completed treating the business as a leasehold tenant at fair market rental rates.
- If real estate is developed for specific and non-general use, have a land only appraisal at “highest and best use” and have improvements appraised as part of business assets.
 - Examples are mini storage, rural resorts, golf courses, etc., where land may not be not used to highest and best use allowed under zoning.

Minority and Control Discount Issues

- Do the shares have voting rights?
- Do the minority shareholders have the right to decide management compensation?
- Are supermajorities required for some votes?
- Are there dissenting shareholder appraisal rights?
- Can a minority shareholder call for dissolution or sale of the company?
- Is there cumulative voting for directors?
- Are there contractual restrictions on Distributions? (preferred returns, etc.)
- Are there any overriding government regulations that significantly limit freedom to conduct business?
- Is there a buy-sell agreement allowing a shareholder to either purchase or sell control?
- Is there a Put Agreement allowing the shareholder to put his shares into the company?
- Is unanimous investor approval required to sell company or its principal assets?
- Are any external agreements in place which supersede the board of directors' control of the company?

Restricted Marketability Discount Issues

- Is there a Shareholders' Agreement restricting the right of a shareholder to sell his/her shares? (Includes Letter Stock)
- Have there been distributions or dividends to shareholders in the past?
- Are future distributions or dividends contemplated?
- Is unanimous shareholder or board of directors approval required for a minority shareholder to sell stock to an outside person?
- Are there key-man or similar insurance policies on key executives?
- What happens to the shares upon the death or disability of a shareholder?
- Can shares be encumbered? (can they be used by a shareholder for collateral on a personal loan?)
- Are there any overriding government regulations?
- Is there a buy-sell agreement giving rights to purchase control?
- Is unanimous investor approval required to sell a company or its principal assets?
- Is the company an S-corporation? (limits shareholders to natural persons who must be legal residents)

Conversion from “C” to “S” Corporation

- **The new S corporation is subject to a built-in-gains tax. A business appraisal is required to determine the basis for the tax.**
- **Refer to Estate of Jelke v. Comm’r, No. 05-15549 (11th Cir. 2007).**

Prohibited Appraisal Fees

- Appraisal will not be qualified if the fees charged are based upon a percentage of the property's appraised value or what the IRS allows as a deduction.
- This would also be a violation of USPAP ethics requirements.

Uniform Standards of Professional Appraisal Practice (USPAP)

The Uniform Standards for Professional Appraisal (“USPAP”) was developed by the Appraisal Standards Board of The Appraisal Foundation in response to the Financial Institution Reform, Recovery, and Enforcement Act (FIRREA). Its standards have become mandatory for all federally related real property appraisals; it has been adopted by most states and federal agencies as a mandatory standard for all appraisal purposes. Because of this, it has become recognized as the “**generally accepted standards of appraisal practice**” and has been adopted by most appraisal societies and professional organizations as a mandatory requirement.

USPAP

- Compliance with USPAP is required when either the service or the appraiser is obligated to comply by law or regulation, or by agreement with the client or intended users. When not obligated individuals may still choose to comply.
- The appraiser's responsibility is to protect the overall public trust and it is the importance of the role of the appraiser that places ethical obligations on those who serve in this capacity. USPAP reflects the current standards of the appraisal profession.

USPAP PREAMBLE

- The purpose of the *Uniform Standards of Professional Appraisal Practice* (USPAP) is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers. It is essential that appraisers develop and communicate their analyses, opinions, and conclusions to intended users of their services in a manner that is meaningful and not misleading.
- The Appraisal Standards Board promulgates USPAP for both appraisers and users of appraisal services. The appraiser's responsibility is to protect the overall public trust and it is the importance of the role of the appraiser that places ethical obligations on those who serve in this capacity. USPAP reflects the current standards of the appraisal profession.
- USPAP does not establish who or which assignments must comply. Neither The Appraisal Foundation nor its Appraisal Standards Board is a government entity with the power to make, judge, or enforce law. Compliance with USPAP is required when either the service or the appraiser is obligated to comply by law or regulation, or by agreement with the client or intended users. When not obligated, individuals may still choose to comply.

USPAP Standards

- Are the only “safe bet” specified in IRS regulations – though others may be acceptable, you may have to argue for them.
- There are separate USPAP standards for:
 - Personal property appraisals
 - Business appraisals
 - Real property appraisals
 - Mass (group) appraisals

Relevant USPAP Ethics Requirements

- Appraiser's fee must not be dependent on results.
- Appraiser is an advocate only for his opinion of value, not for the client.
- Appraiser has a duty of confidentiality.

Recent Changes to USPAP

- Departure (from standards) rule eliminated and replaced by:
 - Broader requirements for the “Scope of Work” rule which now includes:
 - Identification or definition of the problem to be solved,
 - A determination of the scope of work necessary to solve the problem, and
 - Disclosure of the scope of work in the report

Revision to Appraiser's Declaration

- For returns filed after February 16, 2007 the declaration required under §1.170A-13(c)(5)(i) must include the following statement”

“...the appraiser understands that a substantial or gross valuation misstatement resulting from an appraisal of the value of property that the appraiser knows, or reasonably should have known, would be used in connection with a return or claim for refund, may subject the appraiser to a civil penalty under §6695A.”

Definition of Fair Market Value

- *“...the price at which an asset 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, and both parties are able, as well as willing, to trade and are well-informed about the asset and the market for the asset.”*

(It should be noted that this definition is consistent with that adopted by most appraisal organizations, and is also consistent with the IRS code and IRS Revenue Ruling 59-60, and the Uniform Standards for Professional Appraisal Practice)

What does Fair Market Value really mean?

- It is always an opinion – not a fact.
- It represents a probability, not an absolute value.
- It cannot be derived from accounting, it must be an opinion of a person with expert knowledge of and experience in the type of property and relevant markets.
- Though often based upon financial analysis, appraisal is an art – not a science.
- Opinions on value are always based upon subjective interpretation of available information at the time of assessment. This is in contrast to an imposed value, in which a legal authority (law, tax regulation, court, etc.) sets an absolute value upon a product or a service.

Revenue Ruling 59-60

- Is the basis for Fair Market Value as used by the IRS.
- Sets forth the “excess earnings” concept as one approach to determine intangible asset value.

Revenue Ruling 77-287

- Amplifies Revenue Ruling 59-60.
- Provides for discounts for lack of marketability.
- Provides for discounts applicable to publicly traded securities.

Revenue Ruling 93-12

- Revenue ruling 93-12 deals with discounts for lack of control. It was amended by Revenue Ruling 81-253 which aggregated all shares owned by family members to determine whether control exists.
- RR 81-253 was later “overturned” due to court action and revoked. Thus family ownership will not be aggregated to determine control.

When does Book Value = Fair Market Value?

- Never – except by coincidence.

Intangible Asset Value

- The “**Intangible Assets**” are comprised of two principal groups:
 - **Discrete Intangible Assets** which have a legal existence in and of themselves, and
 - **Non-Discrete Intangible Assets** which are integral to and cannot be effectively sold separately from the company per se.

Discrete Intangible Assets Are:

- Subject to specific identification and recognizable description.
- Subject to legal existence and protection.
- Subject to the right of private ownership, and the private ownership should be legally transferable.
- Have some tangible evidence of the existence of the asset.
- Have been created or have come into existence at an identifiable time or as the result of an identifiable event.
- Subject to being destroyed or to a termination of existence at an identifiable time or as the result of an identifiable event.

Non-Discrete Intangible Assets

- Non discrete Intangible assets are inextricably attached to the business enterprise and cannot effectively be sold separately. Most often it is referred to as “goodwill”
- Three elements create a Going-Concern or Goodwill Value. Not all three need to be present to create the value. They are:
 - Assets in place and ready to use as a going-concern (capital, labor and management).
 - Excess economic income over that justifiably allocated to other assets.
 - Expectation of a valuable future event, such as gains on a sale.

Tips for Compliance

- Only engage professional appraisers.
 - There are many so-called financial experts, with impressive resume's, who do not meet IRS requirements.
- Require that appraisals are done to USPAP standards.
- Beware of appraisals wherein the principal approach to value is the discounted cash flow method.
 - With minor manipulation of the assumptions wide differences in value can be obtained. And, they are very hard to defend.

Tips for Compliance

- Insure the appraiser is well versed in IRS regulations regarding the Pension Protection Act, and related regulations.
- Insist that a “sanity test” or “feasibility test” be incorporated in the appraisal report.

Defending the Appraisal Opinion

- Appraisals that “tell a story” are the easiest to defend.
- Using Heuristics methodology to derive value is easier to defend than using Statistics methodology...
- Remember, in the end it is the appraiser’s OPINION, and the justification for it that establishes credibility.
 - Many appraisers try to imply that their opinion of value is more or less factual, and try to “snow” the court or the IRS with obtuse mathematical computations – usually no one, including the appraiser, understands.
- It is important to address all possible relevant issues, even if they do not impact value. Not addressing an issue invites attack.

Questions

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