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# Qualified Appraisals and Qualified Appraisers

*Expert Tax Valuation Witness Reports,  
Testimony, Procedure, Law, and Perspective*

MICHAEL R. DEVITT  
LAWRENCE A. SANNICANDRO

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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.  
Published simultaneously in Canada.

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#### Library of Congress Cataloging-in-Publication Data

Names: Devitt, Michael R., author. | Sannicandro, Lawrence A., author.

Title: Qualified appraisals and qualified appraisers : expert tax valuation witness reports, testimony, procedure, law, and perspective / Michael R. Devitt, Lawrence A. Sannicandro.

Description: Hoboken, New Jersey : Wiley, 2017. | Series: Wiley finance | Includes index. |

Identifiers: LCCN 2017041390 (print) | LCCN 2017041873 (ebook) | ISBN 9781119438205 (pdf) | ISBN 9781119438175 (epub) | ISBN 9781119437574 (hardback)

Subjects: LCSH: Tax assessment—Law and legislation—United States. | Valuation—Law and legislation—United States. | Tax assessment—United States—Data processing. | Tax administration and procedure—United States. | Forensic accounting—United States. | Evidence, Expert—United States. | United States. Internal Revenue Service. | BISAC: BUSINESS & ECONOMICS / Accounting / General.

Classification: LCC KF6759.5 (ebook) | LCC KF6759.5 .D48 2017 (print) | DDC 343.7305/42—dc23

LC record available at <https://lcn.loc.gov/2017041390>

Cover Design: Wiley

Cover Image: © O.C Ritz /Shutterstock

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

*To my father, Frank Richard Mascari,*

*Not a day goes by that I do not think about you and our many fun family times with Mom, Daniel, Barbara, Sandra, Frank, and Connie. At 38 years old, God took you from us way too young. I just wish you could have met my amazing and brilliant wife, Stacie, and our wonderful and loving children, Isabella and Michael. The kind, thoughtful wisdom you imparted to me at a very young age has stayed with me and made me a better man. I will always love you.*

*—Michael R. Devitt*

*To my wife, Alyson*

*—Lawrence A. Sannicandro*





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# Foreword

**V**alutors are often called upon to assist tax professionals in connection with the filing of tax returns and in tax litigation. And, while many valutors understand how to value property, few understand the specific technical requirements in tax that can affect the intended purpose of the valuation, whether that purpose be to secure an intended tax benefit in connection with filing a tax return or at trial.

The stakes in tax cases are high and mistakes are costly to everyone involved. Tax authorities frequently audit valuation-related tax issues to disallow tax benefits on hypertechnical grounds that can expose valutors and tax professionals, as well as clients, to significant civil penalties and professional sanctions. One such hyper-technical ground that has been at the forefront of tax litigation in recent years is the disallowance of tax benefits for failing to obtain a “qualified appraisal” prepared by a “qualified appraiser.” What it means to be “qualified” in valuation and tax disciplines is the overarching focus of this book.

This book explains, in stunning detail, what it takes to have a “qualified appraisal” performed by a “qualified appraiser,” requirements that are imposed in various sections of the Internal Revenue Code and related Treasury Regulations. Next, this book highlights the procedural rules and pragmatic considerations that bear on selecting an expert witness, ensuring the witness can testify at trial, and making sure expert witness reports are admitted at trial. Then, this book introduces readers to a relatively new technique some federal courts are using to receive expert testimony: concurrent witness testimony (or “hot tubbing” as it is known more informally). This book also covers a range of other topics, including the proper role of attorneys in the appraisal process; the penalties that can apply to valutors and tax return preparers; and practical strategies to overcome defects in appraisal reports when filing a tax return or during litigation.

The authors are uniquely qualified to educate the reader on the cross-disciplinarian areas of valuation and tax, with an emphasis on qualified appraisals and qualified appraisers. Professor Michael Devitt has more than 30 years’ experience practicing complex civil litigation in various jurisdictions around the United States and teaching courtroom evidence and trial advocacy. Lawrence Sannicandro has a wealth of experience, including his former employment as counsel for the IRS and his service as a law clerk with the United States Tax Court. Together, these authors have created an invaluable resource for valutors and tax professionals working on assignments where valuation and tax overlap.

Shannon P. Pratt, CFA, FASA, MCBA, MCBC, CM & AA



# Foreword

**W**ho is a qualified appraiser and what constitutes a qualified appraisal? These are the questions that Professor Michael Devitt and Lawrence Sannicandro, Esq., answer in this volume. These authors provide a thoughtful, detailed practical approach for making such determinations, coupled with explanations designed to continue a necessary dialogue concerning these issues that all appraisal stakeholders should consider.

The authors are uniquely qualified to educate the reader on the issues and nuances of the subjects of qualified appraisers and appraisals. Professor Michael Devitt is both an accomplished lawyer and a highly respected *Professor of Law*, teaching in the areas of courtroom evidence and advocacy. Lawrence Sannicandro is an experienced tax practitioner. Together, these authors offer the readers vast experience and knowledge that will serve them in this dynamic field of valuation.

Billions of dollars are involved in the multitude of appraisals performed every year. The United States Tax Court is often the forum where many controversial valuation issues are litigated. These adjudications, while specifically pertaining to federal tax issues, have often found application in forums addressing non-tax issues. As such, this book can be seen as addressing the use of qualified appraisers performing qualified appraisals in a much broader context.

Everyone needing an appraisal wants both the appraisal and the appraiser to be qualified. This book addresses the multiple aspects of what it takes, in all appraisal disciplines, to be qualified. It covers topics ranging from the practicalities of expert selection, discovery, and preparation to the evolution of the Supreme Court decision in *Daubert* and its progeny mandating the trial judge to take a critical look at expert witness admissibility. At the same time, the book addresses a multitude of pragmatic topics such as expert reports and substantial compliance and offers fresh insight on very important valuation topics.

The novel and controversial topic of concurrent witness testimony, often called hot tubbing, is the subject of a very thoughtful chapter. Professor Devitt is a true expert on hot tubbing and a proponent for such methodology's utilization here in the United States. Indeed, Judge David Laro of the United States Tax Court has pioneered Professor Devitt's concepts by adopting the procedure of concurrent witness testimony in the courtroom.

With the proliferation of appraisal designations and the avalanche of written materials, webinars, and conferences available to appraisers and appraisal users, this volume comes at a very propitious time. We owe Professor Devitt and Lawrence Sannicandro a debt of gratitude for assembling a volume that provides clarity on these very important controversial issues.

Jay E. Fishman, FASA



# Preface

**V**aluation events and issues permeate our very complex Internal Revenue Code. Billions of dollars are involved in the multitude of appraisals that are performed every year. To state the obvious, valuation is critical to our laws and our business transactions. It is the fabric of estate and gift planning as well as commercial activity.

Approximately 340 sections of the Internal Revenue Code require taxpayers to make fair market value determinations in order to accurately assess and report tax liabilities. Not surprisingly, the Internal Revenue Service (IRS), the IRS Office of Appeals, and the IRS Office of Chief Counsel have developed sophisticated techniques to challenge questionable valuations throughout the audit, litigation, and collection processes. These valuation-related issues are frequently litigated before the United States Tax Court (Tax Court). In 2016 alone, valuation was at issue in one form or another in upwards of 35 percent of all opinions released by the Tax Court where the taxpayer was represented by counsel.

As a result of the significant effect of abusive valuations on tax revenues, Congress, the United States Department of the Treasury, and the IRS have imposed specific technical requirements with which taxpayers must comply to receive many tax benefits. For example, tax law mandates that for charitable contribution deductions of more than \$5,000, transfers to charitable remainder trusts and qualified settlement funds, and deductions for claims against an estate, taxpayers must obtain a “qualified appraisal” that is prepared by a “qualified appraiser.”

Over the past ten-plus years, there have been a substantial number of tax controversies as to what constitutes a “qualified appraisal” and who is a “qualified appraiser.” Armed with technical sections of the Internal Revenue Code and the Treasury Regulations, the IRS now vigorously and routinely challenges taxpayer appraisals intended to support and substantiate millions of dollars of tax deductions. Current Treasury Regulations establish multiple, specific requirements that must be met for the appraisal to be qualified and consequently useful to the taxpayer wanting to substantiate a deduction on her tax return. An appraisal that does not meet these mandated standards is likely to fail to achieve its purpose.

In a broader sense, everyone needing an appraisal wants the appraisal to be qualified and the person creating the appraisal analysis to be qualified regardless of whether a tax deduction is at issue. This book addresses the technical and commonsense standards that both the appraisal and appraiser must meet to be successful in the valuation world.

Chapter 1 of this book discusses basic concepts of tax valuation with which all competent valuers and tax professionals must be familiar. This chapter also documents the practical necessity for obtaining reliable expert appraisals in most valuation scenarios.

Chapters 2 through 4 of this book discuss what it takes to have a “qualified appraisal” performed by a “qualified appraiser,” requirements that are imposed in

various sections of the Internal Revenue Code and related Treasury Regulations. These chapters address the many technical hurdles necessary to meet and overcome IRS challenges to taxpayer appraisals and appraisers.

Given the omnipresent nature of valuations in the United States tax system, it is wise for valuers and tax professionals to develop wise and knowledgeable cross-disciplinary skills in valuation and tax. This is especially true since courts have adopted detailed rules concerning the qualification of valuers as expert witnesses, the admissibility of expert reports, and the discovery of expert material in connection with litigation. Thus, Chapters 5 through 10 inform readers of the procedural rules and practical considerations that bear on selecting an expert witness and making sure she can testify in a valuation case.

Chapter 11 discusses a relatively new technique some federal courts are using to receive expert testimony: concurrent witness testimony (known colloquially as “hot tubbing”). The authors have a special fondness for this unique chapter. It presents a new and exciting development in expert witness testimony. Attorneys and experts will want to get familiar with this new technique where the parties’ experts have a joint discussion with the trial judge explaining their opinions and thoughts on the subject valuation.

Given the ubiquity of valuation in tax, numerous rules have been implemented to ensure that valuers satisfy a minimum duty of competence in tax and that tax practitioners satisfy a minimum duty of competence in valuation. Penalties abound for professionals who fail to exhibit this minimum duty of competence in valuation. Thus, Chapter 12 discusses penalties that can apply to preparers and valuers in connection with faulty appraisal reports.

Many attorneys struggle to understand their role in the appraisal process. Accordingly, Chapter 13 discusses attorney involvement in the appraisal report process during the tax reporting, administrative, and litigation stages of valuation cases.

Finally, Chapter 14 discusses common errors with appraisals and details the steps practitioners should take to remedy these problems in connection with filing a tax return or during litigation.

We would like to thank Judge David Laro for his many years of kind thoughtful mentorship to us both. Judge Laro stands as a shining example of selfless professionalism for us all. With his 25 years of service on the United States Tax Court and his commonsense deep critical thinking, Judge Laro has helped shape and define many areas of the law, including his thoughtful opinions in the area of qualified appraisals.

Many other people contributed to the ideas and concepts discussed in this book. We thank those who have made contributions to this book by way of research, writing, editing, or commenting. We especially thank Dr. Shannon Pratt, CEO, Shannon Pratt Valuations, Inc., Jay E. Fishman, FASA, Managing Director, Financial Research Associates, Jane Larrington, Head of Reference, University of San Diego School of Law, Helen Y. Trac, Esq., Hogan Lovells, and the many wonderfully hardworking and talented individuals from John Wiley & Sons, Inc., including Sheck Cho, Judy Howarth, Shelley Flannery, and Banurekha Venkatesan.

We hope you enjoy reading this book and wish you all the success in presenting your valuation cases and controversies.

Michael R. Devitt  
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# Tax Valuation and the Necessity for Expert Appraisals

## SUMMARY

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The appraisal profession, which includes specialized valuation determinations of real estate, businesses, interests in businesses, intangible assets, machinery and equipment, and private personal property, has made great strides in the last decade. With these advancements, appraisals have become increasingly technical. Attorneys, return preparers, and appraisers are finding that courts and regulators are much more inclined to scrutinize all aspects of the valuation and appraisal processes. In response, tax professionals increasingly rely upon expert valuers to support tax reporting positions in civil and criminal tax controversies with the IRS, the Tax Division of the U.S. Department of Justice, and state and local tax authorities.

Tax professionals who rely upon valuers, and valuers who provide support to tax professionals, must develop cross-disciplinary skills in valuation and tax to better serve their clients. This chapter summarizes the necessity of involving well-qualified and knowledgeable experts in all aspects of the appraisal process, especially since appraisals often involve significant valuation technicalities and many deal with major sums of money for the participants.

## THE NEED FOR VALUATION EXPERTS

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Valuation is pervasive in our tax system; complex valuation disputes have filled court dockets for centuries. Approximately 340 sections of the Internal Revenue Code require determinations of fair market value in order to accurately assess and report tax liabilities.<sup>1</sup> Indeed, valuation litigation is so frequent that it accounts for between

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<sup>1</sup>As of the time of this writing, the term *fair market value* appears in 344 different sections of the Internal Revenue Code. Roughly 290 of these sections concern the calculations of income, estate and gift, employment, and excises taxes. The other 54 sections deal with valuation in procedural and administrative areas of the tax law, mostly as it relates to third-party reporting on information returns. One section relates to Coal Industry Health Benefits.

20 and 35 percent of all Tax Court cases in which the taxpayers are represented by counsel.<sup>2</sup>

Valuation methodology has become highly sophisticated, and valuation-related tax issues often perplex even the most experienced tax professionals. It is against this backdrop that knowledgeable valuers have become indispensable to the tax reporting and tax litigation processes. Following are the areas where valuation and tax are likely to overlap.

### Valuation in Tax Reporting

As applied to tax reporting, the federal tax law generally *requires* taxpayers to hire a *qualified appraiser* to prepare a *qualified appraisal* in connection with:

- Claiming a charitable contribution deduction of more than \$5,000 where the donated property is not cash, publicly traded securities, a qualifying vehicle, or certain intellectual property;<sup>3</sup>
- Valuing assets of charitable remainder trusts;<sup>4</sup>
- Valuing claims and counterclaims against an estate;<sup>5</sup> and
- Transferring property to a qualified settlement fund.<sup>6</sup>

Moreover, obtaining a qualified appraisal prepared by a qualified appraiser may help a taxpayer avoid accuracy-related penalties under section 6662 of the Internal Revenue Code.<sup>7</sup> The terms *qualified appraisal* and *qualified appraiser* are technically and specifically defined in the Internal Revenue Code and the federal Treasury Regulations. Chapter 2, *Qualified Appraisal*, and Chapter 3, *Qualified Appraiser*, analyze and discuss each of these terms in detail.

As applied to tax reporting, practitioners may hire expert valuers to accurately compute and report tax liabilities. A nonexclusive list of the areas where such expertise is typically utilized is:

1. Charitable contribution deductions, including, but not limited to, donations to real property, personal property, grants of air rights, development rights, and conservation easements;
2. Business formations;
3. Inventory valuations;

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<sup>2</sup>The Tax Court published 422 opinions in 2014. Of these 422 opinions, 148 involved taxpayers represented by counsel and 274 involved taxpayers appearing *pro se* (i.e., unrepresented by counsel). Questions of valuation were resolved, in one form or another, in roughly 52 of the 148 cases involving taxpayers represented by counsel, which means that valuation was at issue in approximately 35.1% of cases in represented taxpayer cases in 2014. Similarly, the Tax Court published 443 opinions in 2013. Of these 443 total opinions, 98 involved taxpayers represented by counsel and 345 involved taxpayers proceeding *pro se*. Valuation issues of some sort were resolved in 20 of the 98 cases involving taxpayers represented by counsel, which means that valuation was at issue in approximately 20.4% of cases in which practitioners had entered an appearance for taxpayers.

<sup>3</sup>See I.R.C. § 170(f)(11)(A), (C), (D).

<sup>4</sup>See Treas. Reg. § 1.664-1(a)(7).

<sup>5</sup>See Treas. Reg. § 20.2053-4(b).

<sup>6</sup>See Treas. Reg. § 1.468B-3(b).

<sup>7</sup>See Treas. Reg. § 1.6664-4(h).