

Estate & Gift Tax Controversies:



Next Stop – The Tax Court

Chicago
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By Lance S. Hall, ASA

Current State – Future Environment

- **Discussion Context:**

- **IRS Circular 230 Disclosure:**

To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U.S. Internal Revenue Code, or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Probability of Audit

Next Stop – Tax Court

- **Greater Risk of Audit**
 - 2002
 - \$1.0-Million Exemption
 - 45,000 Taxable Estates
 - Approximately 345 Estate Tax Attorneys
 - 130 Taxable Estates per Attorney

- **Greater Risk of Audit**
 - 2008
 - \$2.0-Million Exemption
 - 22,800 Taxable Estates
 - Approximately 188 Estate Tax Attorneys
 - 121 Taxable Estates per Attorney

- **Greater Risk of Audit**
 - 2009
 - \$3.5-Million Exemption
 - 6,400 Taxable Estates
 - Approximately 188 Estate Tax Attorneys
 - 34 Taxable Estates per Attorney

Next Stop – Tax Court

- **Greater Risk of Audit**

- 2009

- \$3.5-Million Exemption
- Economic Recession Reduces Wealth by 30%
- \$5.0-Million Exemption Equivalent
- 2,200 Taxable Estates
- Approximately 188 Estate Tax Attorneys
- 12 Taxable Estates per Attorney



Next Stop – Tax Court

- **Greater Risk of Audit**
 - **“Hot Button” Valuation Issues:**
 - Conservation Easements
 - Discounts over 15% for Undivided Interests
 - DLOM over 40%
 - Marketable Securities FLP/FLLC
 - Near-Death Formations
 - Inconsistent 1st and 2nd Death Valuation Positions

Expert Credentials

- ***Tax Reform Act of 1984:***

A qualified appraiser is...

- One who “holds himself or herself out to the public as an appraiser.”

Next Stop – Tax Court

- ***2006 Pension Protection Act (August 17, 2006)***
 - A qualified appraiser is “an individual who:
 - a) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary, or other guidance,

- ***2006 Pension Protection Act***
(August 17, 2006)

- A qualified appraiser is “an individual who (cont.):

- b) regularly performs appraisal for which the individual receives compensation, and

- c) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.”

Appraiser Concerns

- ***SB/SE Interim Guidance on Gross Valuation Misstatements Penalty (August 18, 2009)***

- “The purpose of this memorandum is to provide interim guidance to ensure all of our examiners are aware of the procedures for assertion of the IRC section 6695A Penalty.”

- ***SB/SE Interim Guidance on Gross Valuation Misstatements Penalty (August 18, 2009)***

- The “6695A penalty is the lesser of the greater of 10 percent of the amount of the underpayment ... attributable to the misstatement or \$1,000, or 125 percent of the gross income received from the preparation of the appraisal.”

- ***SB/SE Interim Guidance on Gross Valuation Misstatements Penalty (August 18, 2009)***
 - “... an IRC section 6695A penalty against an appraiser will not be proposed until the related tax examination is completed at the group level.”

- ***SB/SE Interim Guidance on Gross Valuation Misstatements Penalty (August 18, 2009)***

- “The penalty does not apply if the appraiser can establish that it was ‘more likely than not’ that their appraisal value was correct.”

- ***SB/SE Interim Guidance on Gross Valuation Misstatements Penalty (August 18, 2009)***

- If there is a substantial or gross valuation misstatement, “the examiner should open an IRC section 6695A penalty case to determine if sanctions against the appraiser are warranted.”

Expert Testimony

◦ *Parker v. Commissioner*

- “We evaluate opinion evidence in the light of the qualifications of the expert and all other evidence of value.” 86 T.C. 547, 561 (1986)

◦ *Rabenhorst v. Commissioner*

- “We recognize that [the expert] has respectable credentials, but we are troubled by his unfamiliarity with relevant Treasury regulations and revenue rulings. While such unfamiliarity does not in and of itself convince us that [the expert] was incapable of rendering an accurate valuation, it does raise some suspicion.” T.C. Memo. 1996-92 (February 29, 1996)

Next Stop – Tax Court

- ***Med Diversified, Inc. v. Addus Healthcare, Inc.***

- “In determining whether expert testimony is admissible under Rule 702, the Court is charged with the task of ensuring: (1) the evidence is relevant, (2) the expert is qualified, and (3) the expert's testimony rests on a reliable foundation.”

334 B.R. 89; 2005 Bankr. LEXIS 2236

- ***Estate of Furman***

- “Expert testimony sometimes aids the Court in determining values and sometimes it does not. (expert testimony is not useful when the expert is merely an advocate for the position argued by one of the parties). We are not bound by the formulas and opinions proffered by an expert witness and will accept or reject expert testimony in the exercise of sound judgment.” T.C. Memo. 1998-157 (April 30, 1998)

- ***Estate of Furman***

- “...while we may accept the opinion of an expert in its entirety, we may be selective in the use of any part of such opinion, or reject the opinion in its entirety.” T.C. Memo. 1998-157 (April 30, 1998)

- ***Revenue Ruling 59-60***

- “A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighting those facts and determining their aggregate significance.”

Issues Requiring Attorney Direction

- ***Legal Rights of Interest***

- Chapter 14
- Section 2703
- Section 2704(b)
- Built-in Capital Gains Tax Methodology
- Assignee v. Partner Interest

Next Stop – Tax Court

The Report

- ***2006 Pension Protection Act
(August 17, 2006)***
 - A qualified appraisal is an appraisal “conducted by a qualified appraiser in accordance with generally accepted appraisal standards... .”

- ***Appraisal Standards Board
Summary of Actions Related to
Proposed Changes***
 - “The goal of the Uniform Standards of Professional Appraisal Practice is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers.” American Society of Appraisers (April 3, 2009)

- ***USPAP Standards Rule 10-3***
 - “A signed certification is an integral part of the appraisal report. An appraiser who signs any part of the appraisal report, including a letter of transmittal, must also sign this certification.”

◦ *Kohler v. Commissioner*

- The IRS’s expert did not “provide the customary USPAP certification, which assures readers that the appraiser has no bias regarding the parties...and that the conclusions in the report were developed in conformity with USPAP.”
- “...these concerns lead us to place no weight on [the IRS’s expert’s] report as evidence of value... .” T. C. Memo. 2006-152 (July 25, 2006)

Changing the Report before Trial

Next Stop – Tax Court

- ***Estate of Davis***

- “We reject any contention by respondent that [the Taxpayer’s expert] should not be permitted to change in his rebuttal report and at trial the position that he had taken in his expert report... . The Court is interested in reaching the proper result, aided by witnesses who will recognize and correct an error. We are not interested in attempts to force a party to maintain an erroneous or unreasonable position for strategic advantage.” 110 T.C. No. 35 (June 30, 1998)

Having Multiple Experts

- ***Competing Concerns***

- ***Dallas v. Commissioner*** – Adding back over-market compensation
- ***Estate of Davis*** and ***Estate of Litchfield*** – Dollar-for-Dollar v. FMV deduction for unrealized built-in gain taxes
- ***Estate of Hillgren*** – Changing Position

◦ *Dallas v. Commissioner*

- “[Taxpayer’s second expert] copied portions of its report verbatim from the [first expert’s] report.”
- “[Taxpayer’s second expert] was substantially unfamiliar with [his own] report.”
- “We give [the second expert’s] testimony little weight.” T.C. Memo. 2006-212 (September 28, 2006)

◦ *Dallas v. Commissioner*

- “...we have no more reason to assume changes in [the Company’s] executive compensation policies than we have to assume changes in dividend paying policies or a change in its S corporation status. On this record we...do not assume [the Company’s] projected profits will increase as a result of reduced compensation to petitioner and his sons after the hypothetical sale of [the Company] stock.”

T.C. Memo. 2006-212 (September 28, 2006)

Next Stop – Tax Court

- ***Estate of Davis***
 - Expert #1 – Dollar-for-Dollar
 - Expert #2 – Something less than Dollar-for-Dollar

- ***Estate of Davis***

- “...where no liquidation of [the company] or sale of its assets was planned or contemplated on the valuation date, the full amount of [the company’s] built-in gains tax may not be taken as a discount....” 110 T.C. 530 (June 30, 1998)

Next Stop – Tax Court

- Dollar-for-Dollar:

- 11th Circuit – ***Estate of Jelke III*** – No. 05-15549
(November 15, 2007)
- 5th Circuit – ***Estate of Dunn*** – No. 00-60614
(August 1, 2002)

- Fair Market Value:

- 2nd Circuit – ***Eisenberg v. Commissioner*** –
No. 97-4331 (August 18, 1998)
- 6th Circuit – ***Estate of Welch*** – Lexis 3315 –
Unpublished Opinion (2000)



- ***Estate of Litchfield***

- Question: Do you hire one expert or two (one for each dollar-for-dollar and something other than dollar-for-dollar)?

Built-In Capital Gains Tax

- “...the estate does not ask us to apply a full dollar-for-dollar valuation discount for estimated built-in capital gains taxes. Therefore, we need not decide herein whether such an approach would be appropriate in another case where that argument is made.” Estate of Litchfield – T.C. Memo. 2009-21 (January 29, 2009)

Next Stop – Tax Court

- ***Estate of Hillgren*** - T.C. Memo. 2004-46 (March 3, 2004)
 - Expert #1 – Valued FLP
 - Expert #2 – Valued FLP and Assets Subject to Business Loan Agreement

Next Stop – Tax Court

- ***Estate of Hillgren*** - T.C. Memo. 2004-46 (March 3, 2004)
 - The Winner
 - Expert 2, whose discounts for the BLA exceeded the original discounts on the FLP.

The IRS's Position

Next Stop – Tax Court

- ***Joseph F. Stemach (Former IRS Estate and Gift Tax Attorney)***
 - “...an IRS engineer’s report is of limited value since Regional Counsel will generally not litigate a valuation case without an ‘outside’ or independent appraisal.”

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Lance S. Hall, ASA is Co-Founder and President of FMV Opinions, Inc. Mr. Hall also supervises the firm's New York office. A prolific author and expert witness, Mr. Hall is a highly sought after speaker known for his exciting, dynamic and informative presentations. Mr. Hall is an Accredited Senior Appraiser of the American Society of Appraisers, and earned his MBA from Brigham Young University. Mr. Hall also sits on the Editorial Advisory Board of *Business Valuation Update*, and writes a regular column for *Valuation Strategies* and *The Journal of Practical Estate Planning* magazines.