DON'T LEAVE HOME WITHOUT IT!

The Twenty-First Annual Estate and Gift Tax Conference
March 1, 2013

Douglas L. Youmans
Wagner Kirkman Blaine
Klomparens & Youmans LLP
10640 Mather Blvd., Suite 200
Mather, CA 95655
Phone: (916) 920-5286
Email: dyoumans@wkblaw.com

Mark C. Higgins, ASA
Higgins, Marcus & Lovett, Inc.
800 South Figueroa Street, Suite 710
Los Angeles, CA 90017
Phone: (213) 617-7775
Email: mhiggins@hmlinc.com

I. Substantiation Needed:

Estate and Gift Tax Returns:

Gift Tax. The "adequate disclosure" Regs (Regs. §301.6501(c)-1(f)) require the following to toll the statute of limitations (to apprise the IRS of the "nature of the gift and the basis for the value so reported):

- a detailed description of the method used to determine the value;
- any financial data utilized in determining the value;
- any restrictions that were considered in determining the value; and
- a description of any discounts claimed

Estate Tax. Regs. §301.6501(c)-1(f)(3) can serve as a guide.

II. Substantiation – Estate and Gift Tax Returns:

An **appraisal report** can be submitted in lieu of the above if:

- It is prepared by one who:
  - Holds himself or herself out as an appraiser or regularly performs appraisals.
  - Is "qualified" to appraise the property being valued.
  - Is not the donor or donee; a family member (as defined in IRC §2032A(e)(2)); or any person employed by the donor, the donee, or a family member; an
- It contains:
  - The dates of the transfer and the appraisal.
  - The purpose of the appraisal.
  - Descriptions of the property. the appraisal process, the assumptions made and any restrictions that affect the analyses, opinions, and conclusions.
  - The information considered, including in the case of a business interest, all financial data that was used.
  - The appraisal procedures followed and the reasoning that supports the analyses, opinions, and conclusions.
  - The valuation method utilized and the rationale for using that method.
  - The specific basis for the valuation.

III. Substantiation - Income Tax Returns/Charitable Contributions:

According to Regs §1.170A-13, taxpayers must maintain:

<u>For Charitable Contributions of *Money*</u>:

- A cancelled check.
- A receipt from the donee. . .
- . . . other reliable written records showing the name of the donee, the date of the contribution, and the amount of the contribution, and a statement that no goods or services were provided.

IV. Durden:

Contributions made by check to a 501(c)(3) church were disallowed because the church's "first acknowledgement" lacked a statement that no goods or services were provided (even though that statement was provided).

A written acknowledgment is contemporaneous if it is obtained by the taxpayer on or before the earlier of: (1) the date the taxpayer files the original return for the taxable year of the contribution; or (2) the due date (including extensions) for filing the original return for the year. (IRC §170(f)(8)(C); Regs. §1.170A-13(f)(3)).

V. Substantiation - Charitable Contributions of *Property*:

A receipt must show:

- The name of the donee;
- The date and location of the contribution; and
- A description of the property.

If the amount claimed exceeds $5,000, the following *substantiation requirements* must be met:

- a *qualified appraisal*;
- A fully completed *appraisal summary* [Form 8283] must be attached to the tax return;
  - if the contribution is worth greater than $500,000, *a qualified appraisal* must be attached to the tax return; and
- records must be maintained for so long as they may be relevant.

VI. Qualified Appraisal:

For returns filed on or before August 17, 2006, a "*qualified appraisal*" means an appraisal which:

- Is made no earlier than 60 days prior to the date of contribution and no later than the due date of the return;
- Is prepared by a *qualified appraiser;*
- Does not involve a prohibited fee; and
- Includes:
  - A description of the property and its physical condition;
  - The date (or expected date) of its contribution;
  - The terms of any agreement that relates to the property;
  - The name, address, and identifying number of the appraiser and the appraiser's employer;
  - The appraiser's qualifications;
  - A statement that the appraisal was prepared for income tax purposes;
  - The date on which the property was appraised;
  - The appraised FMV of the property on the date of contribution;
  - The method of valuation used; and
  - The basis for the valuation.

VII. Substantiation:

Item	**(Estate &) Gift Tax (Regs. §301.6501(c)-1(f)(3)**	**Income Tax (IRC §170(f)(11)(E)(i)**
1.	The dates of the transfer and the appraisal.	The date on which the property was appraised. The date (or expected date) of its contribution.
2.	The purpose of the appraisal.	A statement that the appraisal was prepared for income tax purposes.
3.	Descriptions of the property, the appraisal process, the assumptions made and any restrictions that affect the analyses, opinions and conclusions.	A description of the property and its physical condition. The terms of any agreement that relates to the property.
4.	The information considered, including in the case of a business interest, all financial data that was used.	
5.	The appraisal procedures followed and the reasoning that support s that analyses, opinions and conclusions.	
6.	The valuation method utilized and the rationale for using that method.	The method of valuation used.
7.	The specific basis for the valuation.	The basis for the valuation. The appraised FMV of the property on the date of contribution. The name, address and identifying number of the appraiser and the appraiser's employer. The appraiser's qualifications.

VIII. Qualified Appraisals—Notice 2006 – 96:

With respect to returns filed after August 17, 2006, a "*qualified appraisal*" means an appraisal which is:

- treated as a *qualified appraisal* under the aforementioned regulations or other guidance; and
- conducted by a qualified *appraiser* in accordance with generally accepted appraisal standards (USPAP) and any regulations or other guidance prescribed.

IX. Qualified Appraisals—*Qualified Appraiser*:

With respect to returns filed on or before August 17, 2006, a "*qualified appraiser*" means an individual who:

- holds themself out as an appraiser or performs appraisals on a regular basis;
- is qualified to make appraisals of the type of property being valued;
- understands that they may be subject to civil penalties under IRC §6701
- does not charge a fee based on a percentage of the appraised value of the property; and
- is not otherwise "**excepted**" or "**excluded.**"

X. *Qualified Appraisers*—Exceptions and Exclusions:

<u>Exception</u>: Anyone a reasonable person would expect to falsely overstate the value.

<u>Exclusions</u>:

- The donor or the taxpayer who claims a deduction for the contribution;
- A party to the transaction in which the donor acquired the property;
- The donee;
- Any person employed by any of the foregoing;
- Any person related to any of the foregoing under §267(b), or whom is married to a person in a relationship described in §267(b) with any of the foregoing;
- An appraiser who is regularly used by any person described above who does not perform a majority of his or her appraisals for other persons. (i.e., no "in house" appraisers)

XI. Qualified Appraisers—Notice 2006-96:

With respect to returns filed after August 17, 2006, a "*qualified appraiser*" means one who:

- has earned an appraisal designation or has met certain education and experience requirements;
- regularly performs appraisals for compensation;
- meets such other requirements as may be prescribed; and
- has not been prohibited from practicing before the IRC at any time during the 3-year period ending on the date of the appraisal.

XII. Qualified Appraisers—Notice 2006-96:

- An appraisal designation is earned from a recognized professional organization if the designation is awarded on the basis of competency in valuing the property being appraised.

- An appraiser will demonstrate verifiable education and experience if they make a declaration that, because of their background, experience, etc., they are qualified to appraise the property being valued.

  - For returns filed after February 16, 2007, the declaration must include a statement that the appraiser understands that a substantial or gross valuation misstatement may subject them to a penalty under IRC §6695A.

XIII. Qualified Appraisers—Notice 2006-96:

An appraiser has the requisite education and experience if:

- For real property, the appraiser is licensed or certified for the type of property being appraised in the state in which the real property is located.

- For property other than real property, the appraiser has

  - Is successfully completed college or professional-level coursework relevant to the property being valued;

  - at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued; and

  - fully described the education and experience which qualify them to value the type of property being valued.

XIV. Boltar, L.L.C. v. Commissioner:

In ***Boltar, L.L.C. v. Commissioner***, 136 T.C. No. 14 (Daubert Challenge), the Tax Court:

- granted the government's motion to strike the taxpayer's appraisal because it was "unreliable and irrelevant;"

Because the taxpayer was then left without any evidence supporting his position, the Tax Court upheld the government's notice of deficiency—only $42,400 out of the $3,245,000 deduction the taxpayer claimed was allowed.

XV. Effect/Weight of Regs:

- Historically (pre *Mayo*) we have distinguished:

  Interpretive Regs (Some guidance) *v.* Legislative Regs (Substantial deference)

- Then, along came *Mayo*, a 2011 Supreme Court case which suggests that there is no distinction. Does this mean that Regs now get more deference than court cases?

- Fallout from *Mayo*:

  - Must we now give strict adherence to the Regs.? (Note: The Tax Court rulings immediately following *Mayo*.)

- Does *Bond's* substantial compliance doctrine survive *Mayo*?

XVI. Qualified Appraisal/Substantial Compliance:

Bond v. Commissioner, 100 T.C. No. 4 (1993) (*Substantial Compliance*).

The critical question is whether the regulatory requirements relate "to the substance or essence of the statute." If so, strict adherence to all statutory and regulatory requirements is mandated.

Holdings:

The essence of §170 relates to whether certain taxpayers should be allowed a charitable deduction.

The *reporting requirements* of Regs. §1.170A-13 facilitate the processing and auditing of returns.

The *reporting requirements* of Regs. §1.170A-13 do not relate to the substance or essence of whether a charitable contribution was made. Therefore, the *reporting requirements* are directory, not mandatory, and strict compliance is not required.

XVII. Substantial Compliance:

Hewitt v. Commissioner, 166 F.3d 332 (1998) (*Substantial Compliance*).

Taxpayer donated non-publically traded stock valued at the average per share trading price of the stock as traded in contemporaneous arm's-length transactions, but did not obtain a *qualified appraisal*.

Taxpayer argued *substantial compliance*.

Noting language in the Senate Finance Committee reports on the 1984 Act (DEFRA) that *the principal objective of section 155 was to provide a mechanism whereby the IRS could obtain sufficient return information in support of the claimed valuation so they could deal more effectively with the prevalent use of overvaluations*, the Tax Court denied the deduction for any amounts in excess of the taxpayer's basis (the "old school" approach) because the taxpayers furnished practically none of the information required.

XVIII. Substantiation:

Todd v. Commissioner, 118 T.C. No. 19 (2002) (Qualified Appreciated Stock).

Taxpayer formed a Foundation and transferred the "Shares" to the Foundation. The Form 8283 attached to their return included their basis in the Shares, their determination of the FMV of the Shares, and a statement of the method used to determine that FMV: "Sales of other shares at same time." The portion of the Form 8283 which provided for the certification of an appraiser was without entries. No appraisal summary was attached.

Finding that the stock was not "publically traded securities," the Tax Court denied the deduction because the Taxpayer could not prove compliance with the **three substantiation requirements**:

1. There was no evidence that they met the requirements for a *qualified appraisal*;
2. No appraisal summary was attached to the Form 8283, and
3. There was no evidence they had records containing the information required by the Regs.

XIX. Facade/Conservation Easements:

Simmons v. Commissioner, T.C. Memo. 2009-208 (2009).

Commissioner v. Simmons, 107 AFTR 2d 2011-2632 **(CA Dist Col)**. (Façade; Qualified Appraisals).

The IRS argued:

(a) That a clause in the deed that stated, "Nothing . . . shall be construed to limit the grantee's rights to . . . consent to, . . . changes in the façade or to abandon all of its right hereunder," meant that the easement was not protected in perpetuity; and

(b) There was no language in the easements that provided for continuity of the easements if the trust ceased to exist.

Noting that the trust had been holding easements since 1978 and had never failed to enforce its rights, the appellate court held that allowing some change to the easements may be necessary to accommodate change.

Citing Regs §1.170A-14(g)(3): "A deduction shall not be disallowed merely because the interest that has transferred to the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible," the court concluded that the taxpayer's deductions could not be disallowed based on a remote possibility that the trust will abandon the easements.

Addressing the issue of *qualified appraisals:*

The IRS argued that the taxpayer's appraiser did not explain the methodology; pointing out that the percentages relied on by the appraiser were from an article published by the IRS.

The taxpayer replied that the appraiser used the "before and after" methodology because there were no comparable easement transactions.

The Appellate Court held that the Tax Court did not err in finding that the taxpayer's appraisal was a *"qualified appraisal,"* although they noted that the appraiser could have elaborated further on the valuation methodology to avoid the litigation.

XX. Façade Easement; Substantiation—*Qualified Appraisals*:

Scheidelman v. Commissioner, T.C. Memo. 2010-151 (2010)

The taxpayer donated a façade easement. To determine the value, the appraiser reviewed other court cases and determined that the IRS had found façade easement values of 10-15% of the total property value were appropriate. Based upon other façade easements for similar properties in New York, the appraiser set the easement value at 11.33% of the value of the property as a whole.

As part of the donation process, the easement holder, Natural Architectural Trust ("NAT"), required the taxpayer to pay 10% of the easement value when the easement was accepted. NAT characterized the payment as an "agreed upon cash donation" (even though it was mandatory).

The Tax Court ruled Scheidelman's appraisal was not a "*qualified appraisal*" because it:

1. Lacked a meaningful analysis of the specific, qualitative attributes of the property to support the determination of the value. Rather, it "applied mechanically a percentage with no demonstrated support as to its derivation other than acceptance of similar percentages in prior controversies."

2. Lacked certain information required by the Regulations, including a description of the property, the terms of the deed of easement, and a statement that it was prepared for tax purposes.

The taxpayer argued *substantial compliance*, but the Court ruled that "the lack of a recognized methodology or specific basis for the calculated after-donation value is too significant for us to ignore under the guise of substantial compliance."

With respect to the taxpayer's cash payment to NAT, the Tax Court found that the taxpayer failed to prove (i) that she received nothing of substantial value in return; or (ii) that the payment greatly exceeded the value of the benefits received. Therefore, the deduction (for the "agreed upon cash donation") was not allowed.

XXI. *Scheidelman*, the Second Round – **[2d Circuit Reversed/ Remanded**:

Second Circuit Court reversed holding that the appraisal sufficiently detailed the method and basis of valuation such as to constitute a qualified appraisal; and that there was no quid pro quo on the contribution/payment as the taxpayer received nothing of value, thereby allowing the "agreed upon cash donation".

XXII. Façade Easement—Qualified Appraisals:

Rothman v. Commissioner, T.C. Memo. 2012-163 (2012).

Similar to *Scheidelman*, the **Second Circuit reversed and remanded** a Tax Court decision favorable to the IRS, when it found that the information provided by the taxpayer on the value of a façade easement met the requirements for a *qualified appraisal* under Reg. §1.170A-13(c)(3)(ii).

The primary issue in the case was whether taxpayer's appraisal met two particular requirements in the Regs: (1) that the appraisal specify the method of valuation used to determine FMV; and (2) that the appraisal provide the specific basis for the valuation, such as comparable sales or statistical sampling.

As in *Scheidelman*, the taxpayer satisfied the first requirement using the before-and-after method, an accepted means of valuing conservation easements where there is insufficient market data. The taxpayer also satisfied the second requirement by supplying sufficient statistical data. Although the appraisal lacked certain statistical data, the lack of data went to the persuasiveness of the appraisal, not to whether it was a *qualified appraisal*.

XXIII. Conservation Easement—*Qualified Appraisal*:

Irby v. Commissioner, 139 T.C. No. 14 (Oct. 25, 2012).

Petitioners were members of an LLC which conveyed conservation easements encumbering two parcels of land in bargain sale transactions. The purchase portion of the transactions was funded with grants from governmental agencies which were established to assist in the conservation of open land. The LLC reported gain with respect to the sale portion and a charitable contribution with respect to the bargain portion. Petitioners reported their respective shares of the gain and deducted their respective share of the charitable contributions on their respective individual tax returns. In disallowing the charitable contribution deductions, IRS determined that:

(1) the conservation purpose for the easements was not protected in perpetuity because COL was required to reimburse the government agencies in the event it received proceeds should the land be condemned and the easements extinguished;

(2) the appraisal was not a "qualified appraisal" because the report did not include statements that the appraisal was prepared for income tax purposes; and

(3) Taxpayers did not obtain contemporaneous written acknowledgements indicating the amount of goods or services received for the contributions.

Held: The conservation purpose of the easements was protected in perpetuity; Taxpayers' appraisal met the requirements of a *qualified appraisal* and Taxpayers obtained the required contemporaneous written acknowledgement of the transactions.

XXIV. Conservation Easement:

Mitchell v. Commissioner – 138 T.C. No. 16 (April 3, 2012).

The Mitchells donated a conservation easement on 180 acres of their 456-acre property and took a $504,000 charitable contribution deduction. However, they had purchased a portion of the property only two years earlier and still owed the seller for that purchase. Two years after the donation, the Mitchells entered into an agreement with the seller which subordinated the seller's right to receive future payments from the Mitchells to the rights of the donee organization. Notwithstanding the subsequent subordination, the Court ruled, "the mortgagee's rights in the property must be subordinate to the conservation easement on the date the conservation easement is granted." Moreover, "Petitioners cannot avoid the strict requirement . . . [of the] Regs. simply by showing that they would most likely be able to satisfy both their mortgage and their obligation to ... [the charity]."

The grant of the conservation easement failed to qualify for a charitable deduction because it was not enforceable in perpetuity because, at the time interest was conveyed, the deed of trust securing a mortgage on the property was not subordinated to the donee organization. The "so-remote-as-to-be-negligible" standard, with respect to the probability of the donor defaulting on the mortgage on the property prior to the subordination of the deed of trust to the donee organization, did not apply in determining whether the subordination requirement was met. An oral agreement with the mortgagee that the property would not be subdivided or developed did not protect the conservation easement purpose in perpetuity because the mortgagee still could have foreclosed on the property.

XXV. Conservation Easement:

DiDonato v. Commissioner – T.C. Memo. 2011-153 (June 29, 2011).

Taxpayer contributed a land conservation easement claiming a charitable deduction on his 2004 tax return. The charitable contribution arose from a settlement of a lawsuit initiated by Taxpayer against the Donee. While the Memorandum of Settlement was entered into in 2004, the actual conveyance of the property required receipt of the statutory and regulatory approvals required by the State of New Jersey. Those final approvals were not granted until 2007. The Court held that Mr. DiDonato's "obligation to transfer those rights had not yet matured [as of 2004] and were not certain to do so." Accordingly, "the settlement agreement does not qualify as a contemporaneous written acknowledgement within the meaning of section 170(f)(8)(A)."

XXVI. Façade Easement:

Kaufman v. Commissioner, 134 TC 182 (2010), 136 TC 294.

A married couple who contributed a façade easement and cash to a qualified donee organization. The property was subject to a mortgage and the lender retained a prior claim to all proceeds of condemnation and all insurance proceeds as a result of any casualty, hazard, or accident until the mortgage was satisfied and discharged. Because the donee organization's right to its proportionate share of future proceeds was not guaranteed, the Tax Court upheld the IRS disallowance of the deduction.

Kaufman v. Shulman, 687 F.3d 21, 110 A.F.T.R.2d 2012-5278, 2012-2 USTC ¶ 50,472 (2012). On appeal, **the First Circuit reversed, holding that**:

[1] Claimed deductions could not be disallowed based upon the remote possibility that donee organizations would abandon easements since governing law did not deprive donee organization of flexibility to deal with remote contingencies.

[2] Defects in an appraisal summary with regard to a deduction for a contribution of a façade easement that were not prejudicial to IRS did <u>not</u> doom the summary. *The procedural regulations for charitable contributions requiring an appraisal report and summary are designed to provide information sufficient to permit the IRS to evaluate the taxpayer's reported contribution and monitor and address concerns about overvaluations.* However, whether a charitable contribution or gift valuation was overstated, grossly or otherwise, is a factual question different from whether the formal procedural requirements were met, either strictly or under the "substantial compliance" doctrine.

[3] The substantial compliance doctrine allows taxpayers to overcome technical noncompliance if they make a showing that a regulatory requirement is unimportant, unclear or confusingly stated.

XXVII. Conservation Easement:

Carpenter v. Commissioner (T.C. Memo. 2012-1, Jan. 3, 2012).

Motion for summary judgment. As in *Kaufman*, the Tax Court determined that the conservation easement at issue failed to comply with the "enforceability in perpetuity" requirements under the Regs.

The conservation easement deeds were virtually identical to the deeds in *Kaufman*, *Lord* and *Friedburg*, and contained the following clause regarding extinguishment:

> Extinguishment - If circumstances arise in the future . . . that render the purpose of this Conservation Easement impossible to accomplish, this Conservation Easement can be terminated or extinguished, . . . in whole or in part, by judicial proceedings, or by mutual written agreement of both parties, provided no other parties will be impacted and no laws or regulations are violated by such termination. * * * [Emphasis added by the Court.]

As the IRS was able to convince the Tax Court that the easements were not protected in perpetuity because the deeds allowed the parties to extinguish the conservation easements by "mutual agreement," *Carpenter* suggests that the language in the contract is critical in the structuring of an easement donation that will pass IRS scrutiny and hold up in court. While the Taxpayers' donation in *Carpenter* was a qualified easement in use, and donated to a qualified organization, because the "protection in perpetuity" test was not met, the deduction failed.

XXVIII. Façade Easement; Substantiation; Penalties:

Schrimsher v. Commissioner, No. 945-09 (27 Mar 2011).

The Taxpayer made a charitable contribution of a façade easement valued at $705,000. The primary issue concerned language within the Easement Agreement which stated, "for and in consideration of the sum of TEN DOLLARS, plus other good and valuable consideration ...." According to the Taxpayer, this language was "typical boilerplate" which should be disregarded.

Although the Court recognized that, in some situations an exception may apply, it noted that the Taxpayer did not raise "any issue as to the applicability of any exception to the contemporaneous written acknowledgment of section 170(f)(8).

Not only was the Taxpayer's deduction disallowed, but it appears that the Taxpayer was also subject to a 20-percent accuracy related penalty under section 6662(a) for "negligence or disregard of rules or regulations."

XXIX. Conservation Easement:

Averyt et al, v. Commissioner, T.C. Memo 2012-198.

Taxpayers donated a conservation easement. Upon receipt of the conservation easement, the donee organization sent a letter acknowledging receipt of the easement and stated that they would be sending a "pen and pendant." The letter failed to provide a "good faith estimate" of the value of the pen and pendant, neither of which was ever sent.

The Tax Court rejected the taxpayer's contention the requirements of §170 should be disregarded because the pen and pendant were of nominal value. However, after reviewing the deed of conveyance, the court concluded that (1) the "pen and pendant" was an unconditional gift because no consideration was received in exchange for them; and (2) because the conservation deed constituted the entire agreement between the parties, the conservation deed satisfied the substantiation requirements of §170(f)(8).

XXX. Qualified Appraisals; Conservation Easements:

Lord v. Commissioner, T.C. Memo. 2010-196 (2010).

A *qualified appraisal* must include:

The date (or expected date) of [the] contribution;

The date on which the property was appraised; and

The appraised FMV of the property on the date (or expected date) of the contribution.

In addition, the appraisal must be made no earlier than 60 days before the contribution date of the appraised property and no later than the due date of the tax return on which a deduction is first claimed.

XXXI. Penalties:

D'Arcangelo v. Commissioner, T.C. Memo. 1994-572 (1994).

The taxpayer was a CPA who befriended an artist and assisted the artist with substantial loans. When the artist was unable to maintain his shop, the taxpayer removed artwork, art supplies, and frames, donated the items to a high school and claimed a $40,000 charitable deduction.

The Tax Court disallowed the $40,000 deduction because the items were not valued by a qualified appraiser. Moreover, there was no substantial compliance because the items were appraised by the high school's principal who testified that: (i) He had no experience in the appraisal of printing equipment; (ii) He had only visited the shop 6 years before the contribution; (iii) In order to do a proper valuation, he would have to spend at least 2 weeks in the shop (but he only spent 1 hour there); (iv) He never examined the books of the business nor any comparable business; (v) He did not know if the items he saw in the shop were the items contributed; (vi) the items contributed in 1986 had the same value they did when he saw them in the late 70s; (vii) He knew that reusing the silkscreens would affect (diminish) their value but had no idea how many times they might have been used; and (vii) Most of the silkscreens were discarded by the high school as useless.

Noting that Regulations expressly prohibited an employee of the donee from making the appraisal and that the taxpayer did not submit a fully completed appraisal summary, the Tax Court found the evidence the taxpayer put forth was insufficient because his "expert" did not even look at the items and never appraised the type of items before. Noting the taxpayer was a CPA, the Tax Court upheld the (old) penalties for negligence, substantial understatement and valuation overstatement.

XXXII. Qualified Appraisals; Penalties; Reliance:

Friedman v. Commissioner, T.C. Memo 2010-45.

A couple was denied noncash charitable contribution deductions because they neither obtained timely and complete *qualified appraisals*, nor maintained adequate records related to the donated property.

The taxpayers argued that they should be excused from penalties because they relied on the advice of their CPA.

The Court noted that a taxpayer relying on professional advice must show:

(3) the adviser was a competent professional;

(2) the taxpayer provided necessary and accurate information to the adviser; and

(3) the taxpayer relied in good faith on the adviser's judgment.

Here, the Tax Court found that, because they did not provide full and accurate information to their CPA, they could not have relied *in good faith* on his advice. Hence, they were liable for the penalties

XXXIII. (No) Penalties:

Thompson v. Commissioner, 370 Fed.App. 141 (2010) .

The IRS imposed an accuracy-related penalty against the estate because the estate's valuation of the asset was less than 25% of the correct valuation.

The Tax Court found that the estate was not liable for the accuracy-related penalty because the valuation of the asset was particularly difficult. (The appellate court affirmed.)

XXXIV. Penalty Defense—Reasonable Reliance:

Esgar Corporation, T.C. Memo. 2012-35, Feb. 6, 2012.

The Court did not apply a Section 6662(a) valuation understatement penalty because the taxpayers reasonably relied on professional advice—they met the **three requirements**:

(1) The adviser was a competent professional who had sufficient expertise to justify reliance;

(2) the taxpayer provided necessary and accurate information to the adviser; and

(3) the taxpayer actually relied in good faith on the adviser's judgment.

XXXV. Substantiation:

Consolidated Investors Group v. Commissioner, T.C. Memo 2009-290 (2009).

Taxpayer made a bargain sale to Ohio Turnpike Commission of property for a state highway interchange. Because the FMV of the property transferred exceeded the amount the partnership received, the partnership had donative intent when it transferred the property. The partnership *substantially complied* with the substantiation requirements of Regs. §1.170A-13(c)(2).

A portion of a payment is deductible as a charitable contribution under §170 if the following two conditions are met: "First, the payment is deductible only if and to the extent it exceeds the market value of the benefit received. Second, the excess payment must be made with the intention of making a gift." *Id.*

In response to IRS arguments that the partnership failed to substantiate its claimed charitable contribution deduction with a "*qualified appraisal*" because the appraisals submitted were obtained more than 60 days before the date of contribution and lacked some of the info required by the regulations (the date the contribution, a statement that the appraisal was prepared for income tax purposes, and the FMV of the property as of the date of contribution), the court found that, *similar to the taxpayer in* ***Bond****, the partnership timely provided nearly all of the info required in the Regs*.: the IRS was provided with the date of the contribution and the FMV of the property on the date of contribution on the partnership's completed Form 8283. The appraisal did lack a statement that it was prepared for income tax purposes; but the court found that omission to be insubstantial -- *The info provided was sufficient to permit the IRS to evaluate the contribution and monitor and address concerns about overvaluation and other aspects of the contribution.*

XXXVI. Penalties:

<u>§6662—Accuracy-Related Penalty</u>.

A **20 percent penalty** shall apply to:

- Negligence.
- Any *substantial understatement*.
- Any *substantial valuation misstatement*.
- Any *substantial estate* or *gift tax valuation understatement*.

XXXVII. Valuation Misstatements and Understatements:

There is a *substantial valuation* ***misstatement*** if the value or the adjusted basis of any property claimed on a return is 150 percent or more of the amount determined to be the correct amount. (e.g., if the value claimed = "true value" X 1.5 or more)

Substantial Estate Or Gift Tax Valuation ***Understatement***. [*NOTE THE DIFFERENCE—THERE IS A DIFFERENT MOTIVATION FOR THE VALUATION!!!]*

There is a *substantial estate or gift tax valuation* ***understatement*** if the value of any property claimed is 65 percent or less of the amount determined to be correct (e.g., if the value claimed = "true value" X .65 or less)

Limitation. No penalty shall be imposed unless the underpayment exceeds $5,000.

XXXVIII. Gross Valuation Misstatements:

If there is a ***gross valuation misstatements***, the ***penalty shall be increased to "40 percent***."

The term "gross valuation misstatements" means:

- any substantial valuation **misstatement** determined by substituting "*200 percent*" for "150 percent" (e.g., if the value claimed = true value X 2.0 or more);

or

- any substantial estate or gift tax valuation understatement as determined by substituting "40 *percent*" for "65 percent" (e.g., if the value claimed = true value X .40 or less).

XXXIX. §6694—Understatement By Tax Return Preparer:

With Respect to *Unreasonable Positions*, the penalty is equal to the greater of $1,000 or 50 percent of the income derived.

With Respect to Willful or Reckless Conduct, the penalty is equal to the greater of $5,000, or 50 percent of the income derived.

Abatement. If there is no understatement, the penalty shall be abated.

XL. §6701—Aiding and Abetting an Understatement:

$1,000 penalty, unless the return relates to the tax liability of a corporation, in which case the penalty is $10,000.

XLI. “New” §6695A:

Anyone who prepares an appraisal knowing the appraisal is going to be used in connection with a return is subject to a penalty if the appraised value results in a substantial or gross valuation misstatement.

XLII. Penalty Avoidance/Defenses:

Regs §1.6662-3(b)(3) ***Reasonable Basis*:**

If a return position is reasonably based on one or more of the authorities set forth in §1.6662-4(d)(3)(iii) . . ., the return position will generally satisfy the *reasonable basis* standard even though it may not satisfy the *substantial authority* standard.

The *reasonable cause* and good faith exception in §1.6664-4 may provide relief if a return position does not satisfy the *reasonable basis* standard.

XLIII. §1.6662-4(d)—Substantial Authority:

If there is *substantial authority* for an item, the item is treated as if it were properly reported.

Substantial Authority Is Present—

- If the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. All relevant authorities (pro & con) must be taken into account.

  - The weight of authorities is determined in light of the pertinent facts and circumstances

There may be *substantial authority* for more than one position.

Because the *substantial authority* standard is objective, the taxpayer's belief that there is *substantial authority* is <u>not</u> relevant.

XLIV. Penalty Avoidance/Defenses:

Standard	**Percentage**
• More likely than not	Greater than 50%
• Substantial authority	Between 50% and 33.33%?
• Reasonable basis	33.33%?
• Arguable/Colorable claim	
• Frivolous/Patently improper	

XLV. 1.6662-3(c)—Adequate Disclosure:

No penalty may be imposed under §6662(b)(1) with respect to a position which is *adequately disclosed* if the position has a reasonable basis and the taxpayer keeps adequate books and records

XLVI. §1.6664-4—Reasonable Cause And Good Faith:

No penalty may be imposed under §6662 to the extent there was *reasonable cause* for the position and the taxpayer acted in *good faith*.

- Whether a taxpayer acted with reasonable cause and in *good faith* is determined on a case-by-case basis, taking into account all pertinent facts and circumstances. . . . ***Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability.***

- Reliance on an information return or on the advice of a professional tax advisor or an appraiser does <u>not</u> necessarily demonstrate reasonable cause and good faith.

- Reasonable cause and good faith ordinarily is <u>not</u> indicated by the mere fact that there is an appraisal. Other factors considered include:

  - the methodology and assumptions underlying the appraisal,
  - the appraised value,
  - the relationship between appraised value and purchase price,
  - the circumstances under which the appraisal was obtained, and
  - the appraiser's relationship to the taxpayer or to the activity in which the property is used. . . .

XLVII. Reliance on Opinion or Advice:

All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice. Reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

- The requirements of this "defense" are not satisfied if the taxpayer fails to disclose a fact relevant to the proper tax treatment of an item.
- The advice must not be based on unreasonable assumptions and must not unreasonably rely on any representations, statements, findings, or agreements
- A taxpayer may not rely on an opinion or advice that a regulation is invalid unless the taxpayer adequately discloses the position that the regulation in question is invalid.

XLVIII. Valuation Misstatements of Charitable Deduction Property:

There may be reasonable cause and good faith with respect to an underpayment attributable to a substantial (or gross) valuation misstatement of charitable deduction property only if:

(i) the claimed value of the property was based on a *qualified appraisal* by a *qualified appraiser*; and

(ii) the taxpayer made a good faith investigation of the value of the contributed property.

NOTES:

1. Requirements (i) and (ii) (above) apply regardless of whether Regs §1.170A-13 permits a taxpayer to claim a charitable contribution deduction for the property without obtaining a *qualified appraisal*; and
2. The rules requiring a *qualified appraisal* by a *qualified appraiser* to show reasonable cause and good faith with respect to an underpayment attributable to a substantial (or gross) valuation misstatement of charitable deduction property apply in addition to the generally applicable rules concerning *reasonable cause* and *good faith*.