

## NOTES FROM THE THIRD NATIONAL VALUATION SYMPOSIUM

STEVESLETTERS@LEIMBERGSERVICES.COM

### Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1823

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**From:** Steve Leimberg's Estate Planning Newsletter

**Subject:** [Dennis Webb: Notes from the Third National Valuation Symposium](#)

For the third year, the **Los Angeles Chapter of the American Society of Appraisers** presented its **National IRS Symposium in Los Angeles**. This is a program designed by IRS and supported as part of their outreach efforts. Its focus is valuation issues, particularly those seemingly intractable ones that generate audits and fill dockets, and that are now the very personal concern of appraisers, lawyers and estate planners.

**LISI** is the only estate planning publication to provide a summary of these proceedings. This summary was prepared by **Dennis Webb**, a **LISI** contributor who also organized the conference on behalf of the ASA.

**Dennis A. Webb, ASA, MAI, FRICS**, is designated in both real estate appraisal and business valuation, and has specialized in fractional interest valuation for more than 15 years. He is a frequent speaker, and his articles have appeared in *Valuation Strategies*, *Estate Planning*, *The Appraisal Journal*, the *Journal of Business Valuation and Economic Loss Analysis*, and others. He wrote the case study textbook "Valuing Undivided Interests in Real Property: Partnerships and Cotenancies" published by the Appraisal Institute. In the past, Dennis has provided **LISI** members with his views on case of *Ludwick v. Commissioner* in *Estate Planning Newsletter* #[1687](#), and with his provocative take on inappropriate tax benefit limits in "Estate Plans in Chains," *Estate Planning Newsletter* #[1802](#). He can be contacted at: [dwebb@primusval.com](mailto:dwebb@primusval.com) (949) 443-0800.

Now, here is Dennis' commentary:

### **EXECUTIVE SUMMARY:**

The Symposium offered a list of both enlightening and explosive commentaries. That was the idea, and we were not disappointed. The continuing goal of the Symposium is to advance the long path to some sort

of draw-down in the taxpayer v. IRS arms race, so any positive steps are welcome. **James S. Halpern, U. S. Tax Court Judge**, provided an ongoing test of opinions and counterpoints throughout the day that clearly demonstrated the sort of rigorous testimony that he expects in his courtroom.

Other presenters contributed news, views and pointers that can help to smooth the way for your successful presentation of evidence for value. Select the topics that affect your practice. Further comments on each bullet follow, and a more detailed summary may be found [here](#).

## FACTS:

Breaking news from the Symposium:

- Ludwick does not redefine acceptable valuation methods. IRS examiners would apparently like to think otherwise, but there should be nothing to fear from Judge Halpern's decision.
- Discount premium bombshell to foul some gifting schemes. Valuations on those 99%/1% ownership structures can be blasted out of the water fairly easily with a fairly common-sense notion that is now a challenging valuation model.
- Motions in limine to increase, risk to attorneys. Daubert tests are increasingly used by IRS, and the attorney's case can easily be left with no expert evidence.
- Privilege and appraiser work file protection lost. A recent 9th Circuit case, U.S. vs. Richey, denied appraiser file protection, but should not affect appraisal consulting in support of legal advice.
- A common appraisal blunder that lawyers can head off. Lessons from Peracchio that can lead to successful evidence, but may require the lawyer's guidance.
- There's always an elephant in the room. In this case, the elephant is IRS' ongoing campaign to rid itself of what it considers inadequate taxpayer evidence for value. If nothing changes, will there be a sequel to the recently enacted and very personal enforcement provisions under IRC §6695A? Any bets on what Congress will come up with next?

## COMMENT:

**Ludwick does not redefine acceptable valuation methods.** Judge Halpern's decision in Ludwick[i] has been adopted by some IRS examiners as a cudgel to beat up taxpayer discounts, particularly on fractional interests in vacation homes. Judge Halpern discarded the expert evidence and constructed his own model, concluding a discount of 17%. However, the Judge did not see the decision as taxpayer-unfriendly. He said he must be persuaded in each case, and in this one, partition analysis was the only method left since the experts failed to support any other method.

This should be a relief to Chuck Morris, JD, former IRS Western States E&G Territory Manager, who is now in private practice in Irvine, California. Chuck said he is now involved in quite a few examinations (on behalf of the taxpayer), and said that IRS examiners are indeed throwing the concluded 17% at him. Primus has consulted on such a challenge, with highly favorable results reported [here](#).

**Discount premium bombshell to foul some gifting schemes.** Neil Mills-Mazer, AVA, JD, IRS Engineer Team Manager, introduced a potentially catastrophic method for capping fractional interest discounts – the minority “premium.” Please note that the views and opinions expressed are those of the presenters and do not necessarily reflect the views and opinions of the IRS. What if the discount attributed to a very large, say 99% share, were enough to buy out the minority position at 5x its pro rata value? The existence of such a premium suggests a natural cap on large interest discounts, but Mazer says it should also apply all the way to 50/50 ownership, in which case the maximum discount to consider would be 30%.

When Judge Halpern was asked for his thoughts on the model, he recommended reading his decision in Holman[v] (in which partnership buyout provisions placed an effective cap on marketability discounts). He asked whether a 99% holder would ever be willing to sell at a large (say 30%) discount? Not if he can buy out the 1% owner at what would amount to a 1%-2% discount. I have been addressing such questions for a long time, and once the full fact pattern is considered, such a simplistic notion doesn't always hold up. But I agree that such issues must be considered by the valuer.

I don't think this is anything new, in the sense that hypothetical buyer and seller options must be considered in detail, and a 99% owner would at least

consider buying out the 1% and perfecting its interests as compared with selling at a large discount. Neil said that this should be considered, not that it necessarily determines the discount. The presentation emphatically suggests that a 99/1 structure is not a very good idea at a minimum and that appraisers ignore such fact patterns at their (and your) peril.

**Motions in limine to increase, risk to attorneys.** Please note that the views and opinions expressed are those of the presenters and do not necessarily reflect the views and opinions of the IRS. Miles Friedman, SBSE Area Counsel, began a colorful panel discussion with the decision in Boltar,[\[ii\]](#) emphasizing the Court's role in keeping out junk science. Judge Halpern was very clear that the Court is not bound by expert opinions, and that he may pick and choose among the evidence offered, suggesting Trout Ranch[\[iii\]](#) as an example. Guy Glaser, JD, Area Counsel LB&I agreed that motions in limine will increase. When asked about responsibility for excluded reports, Judge Halpern said that the taxpayer attorney bears the risk. There will be no time for a new report, and no grounds for continuance. Attorneys should have confidence in expert reports.

**Privilege and appraiser work file protection lost.** Distinctions between appraisal advice and legal advice were explored in the context of U. S. v. Richey,[\[iv\]](#) where the appraiser's workfile could not be withheld under attorney client privilege and work product protection, because "...communication related to the preparation and drafting of the appraisal for submission to the IRS was not made for the purpose of providing legal advice, but, instead, for the purpose of determining the value of the easement." This case does not address the situation where value consultation is made for the purpose of providing legal advice, such as determining value effects of either estate plans or litigation, only if the appraisal is prepared for another use.

**A common appraisal blunder that lawyers can head off.** Appraisers often toss around statistical terms without understanding their implications. This could prove fatal if the report is headed for Judge Halpern's courtroom.[\[vi\]](#) The Judge gave a detailed presentation on why, in Peracchio,[\[vii\]](#) he was not happy with appraisers' lack of understanding of simple statistical measures they used in their reports (in this case, mean and median). He made a very careful presentation of statistical issues that he contends were built into the evidence by the appraisers' selection between mean and median discounts indicated by a population of closed-end fund

data. He was not happy at the appraisers' lack of understanding of statistical measures, and went on to describe what he wanted to see. Experts would be well-advised to keep such ignorance out of Judge Halpern's courtroom (and lawyers should be able to see such problems coming).

The takeaway for appraisers (and for lawyers reading appraisal documents) is that use of statistical terms and analysis in valuation had better be accompanied by an understanding of what the data mean, and why the appraiser is relying on it. Casual use of means and medians in Judge Halpern's courtroom can be a hazardous activity for an expert. He offered concrete steps that the appraiser and counsel can take to prepare for a specific judge and avoid such calamities.

**There's always an elephant in the room.** In my view the discussion was sorely needed, since this Symposium came with an elephant in the room. In my opening comments, I identified the elephant, and suggested that the next go-round of congressional action to help IRS counter a persistent problem could crush portions of the valuation profession out of existence. Enforcement does not have to continue to escalate, but obviously something needs to change.

What if the appraisals sent to IRS all made sense? What if attorneys and accountants were able to count on values being accepted as their clients are led to expect? What if, when it comes to it, the Court gets to work with nice clear, persuasive evidence from both sides? My own observation is that tax benefits don't have to be sacrificed for the system to work. It's not a matter of the taxpayer having to cave. It's about the valuation profession offering good evidence for value, and lawyers insisting on it. That's all.

The Symposium offered a chance to become more aware of what IRS and the Court is looking for. They were there to tell us. They didn't have to be there, but they were. This is a very good sign... It will take many steps to move to a different level of thinking than the one that created the problem. IRS included.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

*Dennis Webb*

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## CITATIONS:

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[i] Andrew K. Ludwick, et al v. Commissioner, TC Memo 2010-104. See the coverage of Ludwick in Estate Planning Newsletters #1642, 1652, 1653 and 1687] for the commentary and analysis by **Paul Hood, Owen Fiore, Steve Akers and Dennis Webb**.

[ii] Boltar, L.L.C. v. Comm., 136 TC No. 14 (4/5/2011); Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993). Comments on this case may be found in Estate Planning Newsletters #1804 by **Paul Hood**, and #1807 by **Chuck Rubin**.

[iii] Trout Ranch LLC et al v. Commissioner, TC Memo 2010-283

[iv] United States v. Richey, 2011 WL 182312 (C.A.9 (Idaho)), Jan. 21, 2011

[v] Thomas H. Holman, Jr. And Kim D.L. Holman v. Commissioner, 130 T.C. No. 12, May 27, 2008

[vi] Revisions to Circular 230 in 2004 empowered the government to censure CPAs, attorneys and others, and to impose monetary penalties. A new civil penalty for appraisers, §6695A, which allows sanction of appraisers whose conclusions amount to substantial and gross misstatements of value, was added in 2006. In Estate Planning Newsletter #1031, **Zeydel, Gans and Blattmachr** shared their views on the §6695A penalty "...which they point out is a problem for all of us, not just for appraisers." §6695A and gross value misstatements is discussed more recently in Estate Planning Newsletter #1580, along with §6701, which provides a penalty for aiding and abetting understatements.

[vii] Peter S. Peracchio v. Commissioner; T.C. Memo. 2003-280; No. 10470-01, Sept. 25, 2003. See also Estate Planning Newsletter #590, "Peracchio – Valuation of Gifts of FLP Units, by **Owen Fiore**.