



# Los Angeles Chapter Newsletter American Society of Appraisers

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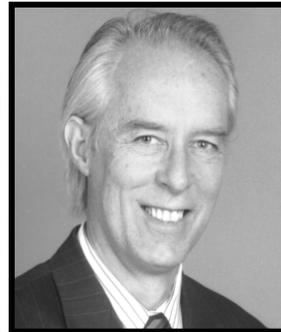
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- Business Valuations
- **Gems & Jewelry**
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## President's Message

You have probably already read the popular view of the appraisal profession (good news): CNN Money is reporting that real estate appraiser is eighth on the list of the 10 best jobs in America. Their reasoning is focused largely on the lending market, and a theory that work is steady, there are self-employment opportunities; see <http://money.cnn.com/magazines/moneymag/bestjobs/> This segment of the appraisal profession is no doubt singled out because of its visibility, but there is probably more at work. Technically sophisticated business services, such as appraisal, accounting and the like, have grown at a greater rate than all other occupational groups in high-income industrialized countries over at least the past 10 years. In the current labor environment, being part of a growing sector is good.



Dennis Webb, President

One of the most important attributes of knowledge-intensive occupations is that their advanced educational qualifications require constant upgrading. Also, career patterns are becoming increasingly individualized, and professionals need to continue to acquire a *wider array* of skills. The ASA offers resources to keep on top of current developments in its disciplines, and to broaden your skills through *interdisciplinary* education—it is more and more important to staying on top!

So there is a good reason for optimism regarding the appraisal profession. However, I'd like to suggest a perhaps even more hopeful indicator: The role of appraisers in society. On one hand, the news is filled with various allegations of larceny and malfeasance from civic and corporate leadership. Many folks in high places seem to be out to get theirs...to the detriment of everyone else. There are suggestions that the trend is generational, or maybe it's just what we've come to as a society. The body politic has devolved into a strictly us versus them game (you can substitute any us/them you like, but the game's the same).

On the other hand, our profession is very much about public service. We provide a neutral voice in matters having to do with lending, business and asset litigation, eminent domain, insurance, regulatory compliance, and other areas. And...can you think of another profession that puts so much time and energy into agonizing over its own standards? Especially while, all around us, standards of behavior are being dumped on a regular basis?

It is truly wonderful that the appraisal profession is now something to aspire to in the public's view. However, I am also pleased to be a member of a profession that has a role in the solution to what ails us as a society. We have an opportunity to make a difference. At least I see it that way, and I hope you do, too.

Best Regards,

Dennis Webb ASA, President

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The May 9 event was sold out a month before the conference. General comments indicate the program was extremely valuable. Special recognition goes to Raymond Rath-ASA, Adam Smith, and PricewaterhouseCoopers LLP for bringing this conference to Los Angeles.

Look for a summary of the proceedings in the June issue.

## The First Annual National IRS Symposium ~ Continued

This all-day event was held at the Sheraton Cerritos on February 22, 2006, and was reported in the April issue of this newsletter. The two morning sessions were also summarized in that issue: An overview of current topics and details of the penalty referral process. This issue is Part II, which begins with the last morning session, an estate & gift taxation update. It also includes the afternoon's four discipline-specific breakout sessions, and the wrap-up on practice before the IRS.

The summaries are slightly redacted (in light of the informal nature of the presentations), and no doubt incomplete as to some of its content. You may find some of the papers posted on our website. The most complete experience will be for you to plan to attend the Second Annual IRS Symposium, to be held in early 2007.

### Summary of IRS Symposium Proceedings – Part II

#### Estate & Gift Session

The third morning session was presented by Chuck Morris (J.D.), the Western States Territory Manager for the IRS Estate & Gift Tax program, with panelist John Thomson (ASA, MAI).

#### Chuck Morris

Mr. Morris began by recounting the enforcement disposition of his boss, Mark W. Everson, in testimony before the U.S. Senate Committee on Finance (March 8, 2003): "A substantive element of a proper enforcement posture will be closer work with practitioners. There are clear indications that professional standards have eroded in some corners of the practitioner community. [Practitioners] should be pillars of our system of taxation, not the architects of its

circumvention." He offered this quote as his plea to the audience, the lawyers, accountants and especially appraisers, whose role is to support the law.

He characterized appraisal and valuation services as: a growth industry, an art or a science, and relying on licensing and other credentials. He noted that the industry is looking to IRS to regulate & define what is a "qualified" appraisal, and who is a "qualified" appraiser.

**Undivided real estate interests are really "where the action is."**

**Some estate tax facts:** The exclusion for 2006-2008 is \$2,000,000, then in 2009 increases to \$3,500,000, in 2010 drops to zero, and increases in 2011 to \$1,000,000. The maximum rate in 2006 is 46%, and in 2007-2009 is 45%. Setting the estate tax rate high drives taxpayers and tax professionals to seek avoidance. The estate tax represents 1.2 percent of gross tax revenue—is that significant to the national budget?

Is it a "good" tax? Currently, the estate tax has vertical equity—it is progressive, the more you have the more it taxes you. It does not always have horizontal equity: On the same size gross estate, some people pay tax, some people avoid tax—this creates a compliance burden.

Is death the right time to tax, because it prevents a windfall? Does it have an impact on savings rate? Does

it represent double taxation; on untaxed capital gains? Is the idea of meritocracy important? The estate tax tries to implant the American spirit to have everyone start at the same place [zero?] instead of inheriting accumulated fortunes.

In **any** case, given the current tax structure, the game then begins. We have a voluntary tax system, so clients ask professionals: "how do I opt out?" Estate tax planning objectives are to reduce tax but still retain control. It also assumes "life without attribution" (e.g. a hypothetical transferee, not the actual heir. To wit: If dad cedes "control" of the family enterprise to son who heads the general partner entity, son is independent, right? Sure. And if dad decides to use inheritance as a lever, is son still independent? Does the hypothetical buyer/seller requirement of the fair market value (FMV) standard (which is objective, not subjective), contradict reality?

The differences between gift and estate tax create an incentive to make gifts, since gift tax reduces the gross estate, but estate tax does not. How are we to measure the value of a gift? What data are appropriate/make sense: Restricted stock studies and IPO studies? Is this stuff usable data?

The IRS' issues and appraiser challenges are: Discounts for lack of marketability and lack of control, blockage, and absorption. Undivided real estate interests are really "where the action is."

The appraiser's emphasis should be on **facts** and common sense. This alone will cure many of the difficulties encountered by IRS in determining whether taxpayers are, indeed, conforming to the law.



## Summary of IRS Symposium Proceedings – Part II continued from page 2

The lottery and marketability discounts; options for action could include eliminating the Estate and Gift Tax. But...What about basis? What about the gift tax? (Income shifting). Other solutions might include raising the exemption, lowering the rates, and eliminating the “loopholes” and broadening the tax base. Need to deal with attribution, life insurance and eliminate the “Crummey” trusts.

### John Thomson

John not only provided his perspectives on this area of appraisal, but also sought to stimulate thought and discussion and challenge all appraisers to further examine and explain their thought processes that support their opinions as to discounts. A summary of John’s comments relating to various cases follows:

### Re: Undivided interests in real estate and valuations thereof

Several notable cases, including Propstra, Moneyham, Williams and Stevens, might suggest that an acceptable or conventional range of cumulative discount relating to a 50% owner’s undivided interest might be on the order of 15% to 45% from Net Asset Value (NAV) based on appraisals and Court decisions. However, eliminating the Williams case the more likely range of discount appears to be 15% to 25%, based on the facts and circumstances, John’s analysis of cases, and his own appraisal experience.

He posited the question relating to a 1% undivided interest: Should its market value reflect a premium or a discount from Net Asset Value?

### Re: Family Limited Partnerships (FLPs) and valuations of interests therein

Views and appraisal opinions as to

the cumulative, or overall, discount from Net Asset Value have varied widely among taxpayers’ experts and the IRS’s experts. Based on decisions in various cases, including Knight, Strangi, Harper, McCord, Perrachio and Lappo, the cumulative discount for a fractional interest in an FLP determined by the Court has also varied widely due to not only facts and circumstances, but also the appraisal evidence and thought process presented to the Court.

### Re: 2036 Issues

In effect, Section 2036 removes the partnership veil and allows for examination of the business-like manner, or lack thereof, in which the business (or economic) purpose of the entity is conducted. Often a GP interest and various LP interests operate as a unit. At issue is whether the parties adhere to the partnership agreement in conducting the partnership’s business. In John’s experience, the IRS looks at 2036 issues first, then at appraisal issues. His experience implies that appraisers should also look more closely at the conduct of the partnership’s business when appraising fractional interests.

### Re: S Corporations—To tax or not to tax?

Sometime “Yes,” sometimes “No” was John’s response. When analysts estimate expected income or conduct a discounted cash flow analysis as part of the valuation process, they regularly consider to what extent expected income should reflect tax considerations at the corporate level or the individual ownership level. Inherently in the analysis, there is the general problem or consideration of losing or keeping S Corporation benefits.

### Re: Charitable Donations—What, No Discounts?

**...appraisers should also look more closely at the conduct of the partnership’s-business when appraising fractional interests.**

If illiquid interests in assets are the subjects of appraisal for charitable donation purposes, then does at least a discount for lack of marketability apply in the valuation process? Often discounts are overlooked or apparently ignored by appraisers in these situations. John simply raised the issue as a “common sense” question that appraisers need to consider in the valuation process.

### Re: Attributes of a Quality Appraisal Report

John identified several qualities of a quality work product, including:

- 1) Organized;
- 2) free of obscure jargon;
- 3) written clearly and coherently;
- 4) content easily comprehended by the reader; and
- 5) report leads the reader to a logical and supportable conclusion.

Referring to Judge David Laro, John reminded the audience of appraisers responsibility to educate the Court—help and instruct. An ongoing challenge remains: Integrate case law, and what cases stand for, into the thought process. In summing up, John noted that judges want guidance when appraisers and other experts address

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complex valuation issues.

**Art Panel – Common Valuation Issues and Best Practices**

This breakout session was presented by Karen E. Carolan, Chief of Art Appraisal Services and Chair of the Commissioner's Art Advisory Panel for the IRS, with panelists, Nancy Escher, ASA and Joy Berus, Attorney. The session was facilitated by Holly Mitchem, M.A., ASA.

**Karen E. Carolan**

Ms. Carolan provided a thorough outline of the work carried out by her department. Her office reviews all \$20,000 and higher appraisals for antiques, fine art, decorative arts (not gems, coins, or stamps). The office has a staff of 5. The cases are divided among them by area of expertise. They research comparable sales in house. Interestingly, the reviewer does not know if the appraisal is for estate of charitable contribution (does not need to know, *because there is only one FMV*).

The Art Advisory Panel is made up of dealers, museum scholars, appraisers. Appraisers cannot appraise for the IRS during their tenure on the panel. Membership is for 2 year period, and is unpaid. There are two sections of the Panel: Paintings & Sculpture (15 members) and Decorative Arts (6 members). The panel meets in Washington

**Reports should accurately reflect fair market value, not intrinsic value.**

D.C., and reviews cases item by item. It determines the most reasonable value based on facts that support it at that time. The Panel will reconsider their decision if there is additional information submitted. Unfortunately, the workload is so great that the Advisory Panel is stretched to the limit.

The Panel does not typically view the objects—paperwork and photographs are paramount in supporting the evidence of objects for review. Thus the appraiser's input is the most important role in presentation. They want supporting information and good quality photos with a submitted appraisal. The IRS now accepts digital photos on CD, but also wants 8 x 10 professional quality photos, labeled on the back with title, description, measurements and medium.

Reports should accurately reflect fair market value, not intrinsic value. Focusing on facts with sale of property most relevant (as all other views are only estimates) and appraisers are required to come to a logical conclusion. A broad range values are accepted, but a leeway of about 10% is usually agreeable.

Form 8283 was just updated by the IRS in December 2005; some check boxes on the 2nd page were changed but the threshold for attaching an appraisal are still \$20,000 and above.

**Q: What price level triggers an audit?**

A: Every line on a return has parameters; if any line falls outside of those parameters an audit can be triggered.

**Q: Who does gems and coins?**

A: One agent with GIA background does the gems (and cases are infrequent).

**Q: What about a collection of items each worth over \$20,000?**

A: Call the IRS if you have an unusual situation.

**Q: Please discuss 96-15 reviews**

A: Review Procedure 96-15 applies when the IRS issues a statement of value before the matter becomes a tax case. It is a fast track process based on a hypothetical donation scenario, and provides an early resolution to a potential audit situation. Only some areas of art are considered (based on the expertise of the Art Advisory Panel). They do approximately 170 of these per year, and about 50% are accepted. Submission cost is \$2,500, and must be accompanied by a qualified appraisal. Reviews are not undertaken for values of single objects under \$50,000. Karen said that 9615 is not binding and fees are refundable.

**Q: What percentage of returns get audited?**

A: Form 8283 is not "Coded", so non-cash contributions are not tracked.

**Q: What kinds of items are most frequently viewed on the panel?**

A: Painting, sculpture, decorative arts.

**Q: More Estate or Charitable Contribution cases?**

A: Estates (approximately 80% of the cases reviewed)

**Q: How do we handle fractional interests?**

A: Joy Berus – This is a business valuation issue.

A: Carolan – The IRS uses a 1957 ruling on Fractional Interest donation. Value at ratio to the whole.



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**Q:** Client does not want to give me access to property again, it is in storage.

**A:** An appraiser must confirm condition, authenticity, age, and witness ownership must see items in person and recently (not years ago), to be able to do this properly.

**Q:** What is the status of Senate Bill SB2020?

**A:** 1) To give artists same FMV as owner. Passed by the Senate, waiting in the House.

2) Long Term Capital Gains tax rate at 15%, art is the exception right now at 28% . This was an oversight by the authors of the original measure. Still waiting to be rectified.

**Q:** What about residential contents or art part of an estate not shown to the appraiser at the onsite inspection?

**A:** Not your responsibility.

**Q:** Glamour Market, does the IRS recognize value in provenance?

**A:** Absolutely, must be factored into the intrinsic value of an item.

**Q:** Does the IRS opinion of an institution count? (e.g., donating to small regional museum as opposed to the Met)

**A:** Only if the institution is unrelated to use of the item (Related Use issue).

**Q:** Do Art Advisory Panel experts ever disagree, and if so, what happens?

**A:** They have to go examine the item in person.

**Q:** ASA requires submission on an FMV appraisal for membership. Is this fair?

**A:** Yes.

**Q:** Any tips for good arguments?

**A:** Logical arguments that are supported by FACTS. Show how you based your value conclusion. Quantify how you arrived at your value conclusion.

Blockage concerns how the market would respond to large volume of items made available at one time; Personal Property and Business Valuation appraisers work jointly on these cases. Ms. Carolan briefly quoted three major cases, namely O'Keefe, Calder and Smith plus other cases were mentioned as being examples of isolated incidents. Notes on cases appear in symposium manual. New rulings on 8283 Non-Cash Charitable Contributions are imminent as of December 2005.

Support your case with facts, not opinion. Focus on comparables most similar to the subject property. Condition is important. Use the most relevant market data; a sale of the actual item, if possible. Consider all relevant data; ignore none. If data is excluded, state in the report that you considered [X] issue but discounted it for [Y] reason.

In summarizing, Karen quoted the Department's delight in working with bona fide appraisers, especially ASA. She stressed the continuance of honesty and integrity by valuers in preparing reports. Emphasis to be on reality not trend, future value could not be an acceptable determination. Taxpayer, professional, preparer, appraiser and the IRS must work as a team. Compatibility is commendable; reliability is memorable.

**Support your case with facts, not opinion.**

### Partial Interest Discounts – Real Property Fractions and Controversies

This breakout session was presented by Harry J. Fuhrman, IRS Financial Analyst, with panelists Dennis A. Webb, ASA, MAI, MRICS, and Eric Nath, ASA. The session was facilitated by Vanita Spaulding, ASA, CFA.

#### Harry Fuhrman

Mr. Fuhrman began with an overview of how a valuation is selected, reviewed & challenged by the IRS. All valuations go to the IRS Cincinnati Service Center. Excessive or overstated values, often related to charitable contributions, are kicked out. Agents and IRS engineers from around the country now rotate to the Service Center for one or two weeks and literally go through appraisal reports by hand. Underlying real property valuation is handled by a real property appraiser.

Are appropriate discounts included? Did the appraiser apply inappropriate discounts (i.e. "blockage" discount applied to insubstantial block of marketable securities)? Does the discount pass the 'smell' test—does the assumptions and conclusion make sense? Would the hypothetical seller actually sell the interest at this price? IRS Valuator will even *add* a missing discount (in the taxpayer's favor) if it is appropriate. The speaker emphasized a need to link the transaction data used and the property in question.

If your Valuation is challenged: The IRS now emphasizes early resolution of the points of disagreement. First, schedules are prepared by the IRS Valuator. If no resolution is reached, then the valuator prepares a formal report, and the matter is referred to Appeals. If the points can-

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not be negotiated in the appeal, then the next stop is the Tax Court.

Amount of discount for a fractional interest holder is governed by “the record in the instant case, and not on what a court found reasonable in another case” (*LeFrak v. Commissioner*).

Courts have concluded discounts for undivided real property interests that have ranged from 5% (*Estate of Scull v. Commissioner*) to 60% (*Estate of Sels v. Commissioner*).

In *Sels*, the greater discount resulting from fractional interest in timberland was based in part on evidence concerning an actual sale of an undivided interest in other timberland, which was related to the property at issue and which occurred a month before the valuation date.

Amount of discount for a fractional interest holder is governed by “the record in the instant case, and not on what a court found reasonable in another case” (*LeFrak v. Commissioner*). “...The amount of this discount would depend on various factors such as the type of property, the size of the divided interest owned, and the number of co-owners” (*Estate of Smith v. United States*).

Undivided interest transactions are usable data so long as their confirma-

tion/comparability is established, and the transaction data are linked to the subject interest with respect to:

- Time frame
- Property type
- Size of interest transacted
- Number of co-tenants
- Size of tract / ability to partition (if applicable)

There are very few documented transactions where fractional interests change hands leading to a dearth of specific data.

Partition analysis is state-specific. In California, an owner has an absolute right of partition, and the only barrier to liquidity is the cost of partition and the time value of money until the property can be sold. Further, California is a “fast-track” state, with a one-year expected time horizon for a partition/forced sale proceeding. It is necessary to meet tests to show the court why “fast track” is necessary. (Here the speaker from the IRS and the panel disagreed about a realistic time horizon even with the so-called fast track approach. A panelist noted that a minority holder cannot get out without some considerable difficulty.) One should look at the county court’s backlog and the circumstances. It is important to find (and document) the duration of partition cases. IRS doesn’t want to see averages.

Partition analysis should address time to sell or opportunity costs, costs to sell, condition of the sale, and must look at current economic climate.

Appraisal reports for this purpose must be self contained and not summary reports. Otherwise, there may be an issue as to whether taxpayers, who have relied on an appraisers’

reports, have met their burden of proof in supporting claims of fair market value relating to properties and any relevant discounts applied.

Reviewers look at the dollar amount of discounts, as well as the percentage amount. They also seek to examine the linkage between discounts applied by appraisers and the discount data considered, analyzed and used to estimate the appraisers’ discounts.

Q. To Mr. Furhman - How often do you see an income approach rather than a partition analysis?

A. Not often.

Q. What about vacant land held for development: Can you take its ultimate sale price and discount it back to present value?

A. Tough to do.

Eric Nath

Nath has reviewed partition actions in 13 California counties and several adjoining states. Each county may be different. In California, fast track partition cases, if qualified, can be finished in a year or faster, but if not qualified then they will take longer. For instance, Sonoma County takes up to five years.

Banks often limit the ability of properties to be split into partial interests.

There is “an emerging market for fractional interests” generally known as Tenants in Common or “TICs,” which are used as vehicles in 1031 exchanges. This syndicated market in “partial interests” aka “fractional interests” each person ends up with a partial interest (see 1031exchangeoptions.com). In the TIC market, property interests



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are not bought based on discount from a fee simple appraised value or Net Asset Value, but rather based on historic and prospective investor returns, prospects for market growth and the exit strategy for the property if known.

Property interests in secondary market transactions may trade at discounts to original property prices, but can trade at a premium from value of interests in rent control areas. For example, interests in condo conversions often trade at premiums in the San Francisco market area. One economic reason for premiums is that TIC agreements generally prohibit partitioning.

Investors are really looking at real questions of fact, various criteria—they don't focus on fractional interest discounts. Partition costs cannot be the basis of FMV, since they do not represent a willing seller. A partition action is a required sale, forcing other owners to buy you out.

Neither comparable transactions nor partition analysis are right. The appraiser should be looking at the investor's economic reasons for the transaction: return on investment, liquidity, etc.

**Q. From Nath to the audience – Has anyone ever served as a partition referee?**

**A.** When nobody responded “Yes,” Nath gave an example from his experience as a court appointed partition referee. His example resulted in a 36% discount and the discount was without adjustment for the time value of the dollar amount (between the original date of value and the transaction date) or the “time cost” of persons involved in the proceedings.

### Dennis Webb

Cases were cited, and IRS is certainly entitled to reference cases to make a legal point. However, making conclusions based on cases requires intimate knowledge of the case, from the appraisal side. Does offering a case analysis as an expert constitute the practice of law? Few appraisers are admitted to the Bar. The comment offered from *LeFrak*—focus on the instant case, not what the court found in another case, is good advice. Much of the commentary gleaned from cases is interesting and instructive, though.

Points of comparison offered from *Caldwell* include time frame, property type, size of interest, number of cotenants, and size of tract/ability to partition. It may be helpful to refine this point's concept in a way that allows conventional appraisal techniques to be applied:

**Partition as an approach assumes it to be a likely/probable outcome. But, do the facts always support reliance on partition?**

Time expectation—easily ties to facts & circumstances of the case. It can be guided by property circumstances; lease rollover, balloon payment, remaining life of principal.

Property type would only be usable if it could be shown that type made a difference in the discount. To the extent

that risk varies based on property type and characteristics, measures of risk (capitalization/yield rates) are a good connection with this element.

Size of the interest can be related to the economic feasibility of partition; if the result were a pro rata share worth \$50,000, would partition be feasible? \$100,000? \$500,000? The answer to this question can determine the entire valuation process.

Size of tract/ability to partition is often a highest & best use problem. Use can be changed if the site is divided—is this a beneficial result?

Partition as an approach assumes it to be a likely/probable outcome. But, do the facts always support reliance on partition? First, there is always some sort of going-in scenario, agreement on expectations (or, how would a deal ever be made under FMV?). The issue of partition right becomes important when something changes—would a buyer go in specifically to force sale? Then, could misrepresentation/fraud (going-in) be charged by the offended cotenants? Would bringing a lawsuit really work? Would the fact of high net-worth cotenants change the hypothetical buyer's thinking on this? It is the feasibility of getting out that guides partition. Selecting the valuation process can be an issue of probabilities.

An interview with two lawyers produced an interesting result. Both are well-experienced in real property litigation and partition. The sole practitioner stated that “partition is the only lawsuit you always win.” The lawyer with the large firm stated “don't even try it if the interest is worth less than \$1,000,000.”

Webb agreed with Nath—most of the time, the analysis comes down to return on investment: How risky

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(compared to alternatives), what is expected cash flow and reversion, and how long will it be held?

Whether an income model, or partition analysis, of risk to cash flows is always related to an investment position in the underlying real estate, adjusted for various impairments. The risk-adjusted discount rate bears no resemblance to the ridiculously low rates used in notable cases.

Webb generally does not rely or recommend using LP trades as evidence of fractional interest discounts for several reasons, including the challenges of comparing the property in the subject LP to those held for example by registered RELPs, for which thin trading markets may exist.

It would be nice if data were aggregated and analyzed using statistical tools...only then would direct comparison make sense, according to Webb.

Fine points of agreement – Thankfully, the IRS recognizes that the facts of the case should drive the value analysis!!!

**Further Q&A for the Panel:**

**Q. For Nath – What method do you use for partial interests?**

A. Use discounted cash flow. If no Cash Flow, then it becomes a single-period cash flow at the probable sale of the property.

**Q. What data to use?**

A. 1031 Exchange data and Time Share data is not preferred by Nath.

**Q. For Nath – Is it necessary to provide a complete appraisal report?**

A. In tax court, you have no evidence supporting your conclusions if the backup is not in your report.

**Q. For Nath – How do you deal with debt in a partial interest situation?**

A. Real transaction would dictate—if the debt would follow the property, then it would be discounted in the valuation. The other approach, not to discount the debt, could be contested by the IRS and result in a major hassle. Nath recommends avoiding the hassle.

A. Webb – Obtain and review *all* the debt instruments! This is a hazardous area with lots of pitfalls.

**Machinery & Equipment – Criteria for IRS Appraisal Review**

This breakout session was presented by Gary D. Brown, P.E., Supervisory General Engineer of the Large and Midsized Business Department of the IRS with panelist Melvin I. Fineberg, ASA. The session was facilitated by Richard Hodges, ASA.

**Gary Brown**

Mr. Brown emphasized shared objectives of the appraisal societies and the IRS, focusing on an improved culture, resolution, and short cycle times for taxpayers, effective use of valuation resources, and the need for professional valuations. Complying with our codes and standards, USPAP, ASA, AAA and others will greatly facilitate compliance with (very similar) IRS standards.

Areas that he and his staff routinely look for in appraisal reports include clear descriptions, conditions of the subject assets, a brief history of the property, any leases or agreements that may affect value, and the pertinent marketplace. Limiting Conditions contained in reports should be compatible with IRS procedures.

Concerning agreements and resolutions, Mr. Brown and his staff always try to find agreement with the appraiser as

to the facts of a case. His department is very proactive with regard to resolving issues before they become a burden to the taxpayer. The IRS has recently implemented programs to achieve this goal. Included in their “toolbox” are programs such as Prefiling. The Compliance Assurance Process (CAPS) and Fast Track-all designed to avoid and/or resolve issues in a timely manner. His department would appreciate appraisers being more proactive in noting and mentioning potential environmental issues that may require further investigation. Remember that any assumptions that are made by appraisers are subject to challenge if they do not seem reasonable.

He also covered some specific examples of areas that need to be addressed within the three approaches to value.

In conclusion, he reminded us that we are not advocates and we should avoid giving that impression. Above all he and his staff are looking for reports that are detailed and reasonable. They are appraisers and/or appraisal minded people.

**Mel Fineberg**

Among his observations, Mr. Fineberg noted that M&E appraisers rarely include their comparable sales and adjustments in their summary reports. Mr. Brown countered that he would like to see them included but at a minimum the appraiser’s work file should be available for review.

Mr. Fineberg discussed forthcoming changes in USPAP regarding Standards 7 and 8 that may effect the reporting of comparable sales and highest and best use.

**Conservation Easements & Façades – Non-cash Charitable Donations**



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This breakout session was presented by Wayne G. Couto, MSA, and Alexandra Nicholaides, Senior Counsel, Office of Chief Counsel, SBSE, with panelist Robert P. Caringella, MAI

[Alexandra Nicholaides/ Wayne Couto](#)

All easements are not created equally! Question for appraisers: Have you valued conservation easements? Too-common answer – If you've valued one kind you've valued all. An easement is an easement. That prospective appraiser is crossed off the list.

Considerations that make cases unique are revealed by:

**All easements are not created equally!**

Analyzing documents – easement, baseline report (donee organization), chain of title, other property restrictions, insurance, surveys, plat map, aerial topography maps, biological studies etc. Don't take what is provided at face value

Retained rights/uses – analyze the restrictions and retained rights in a meaningful way; make clear what the restrictions are and what the landowner may still do on the property. If you don't understand, don't guess, you may need to consult other experts.

Amendments and modifications – Changes that further restrict the property may be ok. Changes that allow restrictions to be removed are not, and violate the perpetuity provision.

Perpetuity provision – does mean forever and ever and ever.

Analyze comparable easements with existing encumbrances.

All easements are not treated the

same, e.g. the comparable's easement may completely encumber the entire property, but subject's may only limit development on a portion.

Analyze easement with existing zoning restrictions – zoning rules must be in file, e.g. considering whether a variance to zoning to allow 20 homes can be obtained needs to be documented.

Analyze easement vis à vis other restrictions – county, state, historic. If the easement's restrictions are the same as the county restrictions, say, the valuation impact of the easement may be negligible.

IRC section 170(h)(5) – Donee holds easement in perpetuity, exclusively for one of four conservation purposes: a) Education, recreation, utility of public, b) Natural habitat, c) Open space/scenic, or d) Historic. If donee retains rights inconsistent with the purpose of the conservation easement, IRC §170(h) (5) is not satisfied. The donation is still a gift, but not one for which a tax deduction is allowed.

### Recent Tax Court Decisions

*Wortmann v. Commissioner*, T. C. Memo. 2005-227: Other evidence which corroborates expert's determination.

*Kendrix v. Commissioner*, T.C. Memo 2006-9: Importance of IRC §170(f) (8) and contemporaneous written acknowledgement.

What to do when there is no empirical data; how to use a recognized valuation methodology. Whatever method you use must be defensible regardless of whether the client will win in the audit lottery.

- Court case "methodology" is not acceptable. Each case litigation

stands on its own facts, and the government has not accepted a methodology based upon prior court cases.

- Percentage diminution methodology does not exist; there is no approved or accepted % diminution for any case. There has been talk about the IRS having provided a range of value diminution, but that is incorrect—a statement from IRS guidance to employees was taken out of context. The legislative history makes it clear that Congress did not expect that each and every donation would result in a diminution in value.
- Unsupported methodology; must demonstrate that the owner has actually given up something!

### Other Factors:

Water Rights – an example where a property, that otherwise may have development potential, can't be developed because there is no water available (or the water rights were sold). Such a restriction may also be negligible; this goes to HABU consideration.

Enhancements – get missed a lot. It is part of an appraiser's job to know about other property the donor has that is located adjacent or near the subject property. E.g. A landowner has 1000 acres that are split up in five different parcels. An easement restricting use is placed on one of the five—does enhancement of the other properties result from the restriction to the subject? Also, a restriction is on a portion of a property may the remaining part of the property more valuable.

Impartiality – there is a sentiment that appraisers are hired guns (just like attorneys) to advocate the position of their client. Do all you can to erase the

**Summary of IRS Symposium Proceedings—Part II** continued from page 9

perception! One way to do that is refrain from considering how your outcome will impact your client's position, case, and deduction. Do work for both sides of the table. Reputation is all we have and once your reputation is blemished it is hard to erase.

Appraisal for tax purposes – values should be the same for tax purposes as they would for any other purpose. Appraisers have stated that the value for

**Resources for valuing conservation easements include:**

- *Appraising Easements*, Land Trust Alliance
- *The Conservation Easement Handbook*, Land Trust Alliance and Trust for Public Land
- California Farmland Conservancy Program, Department of Conservation
- *Uniform Standards of Professional Appraisal Practice*
- *Uniform Appraisal Standards for Federal Land Acquisitions*
- *Appraisal Specifications*, California Department of General Services
- *Winning the Development Lottery*, American Farmland Trust
- Various published articles, Appraisal Institute and International Right of Way Association
- Preservation groups including The Nature Conservancy and Trust for Public Land
- California Civil Code Section 815
- Various IRS and California publications relating to historic preservation and facade easements
- General information: 26 US Code 170 (h)
- Definition of value: US Treasury Reg 1.170A-1(c) (2)

tax purposes is different than for other purposes, i.e. financing, sale, etc. Not so; the after value of the property MUST equal its FMV for all purposes. E.g. if the property was sold right after the easement was placed on it, the sales price would equal the after value of the property arrived at for tax purposes. If not, then something is wrong with the appraiser's tax-purpose analysis.

[Robert Caringella](#)

A very thorough before and after analysis of highest and best use must be performed and reported.

Watch out for zoning restrictions or exactions that would restrict use of the property anyway, even absent the conservation easement.

Keep in mind that some restrictions may actually benefit the remainder of the property (view shed, open space next to future homes, etc.) and must be taken into account.

[Multidisciplinary Panel – Practice before the IRS](#)

This breakout session was presented by Brenda Woolbert, CPA, CVA, Team Manager, Engineers & Appraisers, with the facilitators from the breakout sessions. The session was facilitated by Nancy Alison Martin, ASA.

This session focused on professional responsibility, tips and techniques from the field, and included a summary of the proceedings of the breakout sessions (not repeated here).

[Brenda Woolbert](#)

Is your report complete? Does it answer the questions that you or they would have? Does it make sense? Has

it been filed in a timely way?

**Q: Authenticating is a liability for personal property appraisers, how does the IRS deal with this?**

A: IRS requires that appraisers authenticate as per USPAP competency rule. Don't take the assignment if you can't authenticate the work.

A: Results of scientific testing has not been tested in court.

**Q: Are IRS Appraisal Standards official now?**

A: I do not know. The standards represent a compilation of the standards of other appraisal organizations for BV.

**Q: Are IRS Standards available?**

A: I do not know.

**Q: Do IRS Auditors use "judgment" in difficult situations?**

A: They respect the need for judgment.

**Q: What about assumptions?**

A: State them in Assumptions and Limiting Conditions section of the report.

**Q: What about related use...estate attorneys and accountants don't seem to know much about this.**

A: Read tab 7 of the symposium booklet regarding donations to 501c3 organizations...the donation must be related to the organization. Or reduced by basis or FMV if item will be sold vs. kept.

**Q: What about site-specific art; e.g. developers putting sculpture on property in a business park?**

A: Market accepts it. Is there a bonus or incentive?



## Continued from page 10

A: Level of specificity makes it hard to prove but evidence of other easements can be used. Subjectivity comes into play.

A: Support your conclusion with data from the marketplace.

A: Should PP appraiser work with RP or BV appraiser too?

A: There are rulings that art is part of a building in CA, but not in Arizona

A: Many cities require developments to put in public art in order to build a new structure.

A: Check pre-existing ordinances. There are layers of municipal jurisdictional red tape to navigate.

Discussion of historic easements and a case about a taxpayer wanting to give a room of his occupied house to a historical society while still living in the house.

#### Acknowledgments

The Los Angeles Chapter is grateful to IRS for providing their top managers and specialists and to chapter members that participated as panelists and facilitators; their names are listed in the foregoing Proceedings, and their biographic information is available on the Chapter website. Contributions to these Proceedings were made by Raymond Bernadout, Stan Deakin, Mike Lacey, Rebecca Markman, Richard Reece, Jim Ryan, Roger Wilde and Elizabeth Yochim. The LA Chapter is also fortunate to have DeborahAnn Marshall, the Executive Administrator that makes such programs possible. Many thanks to you all.

Be sure to stay tuned for the Second Annual IRS Symposium in 2007. ■

## CCA Legislative Update

AS REPORTED BY:

**Abel Morales, for the CA Coalition of Appraisers.**

Our lobbyist Don Reisner has alerted us to a new pending bill, SB 1210 by Senator Torlakson which makes certain changes in the process that relates to the taking of property by eminent domain. The bill would require the acquiring entity to offer to pay the owner's reasonable cost in ordering their own appraisal. It declares that a final offer of compensation is "unreasonable" for purposes of seeking litigation expenses if the offer is less than the final court-ordered compensation by 10% or more. It also defines litigation expenses to include attorney's fees, witness fees and appraisal fees. The bill also would change certain laws that relate to redevelopment plans. It makes certain appraisal requirements that appraisal be performed by a licensed appraiser.

Don indicates that there is a lot of opposition to the bill. He wants to get input from ASA, or members who want to take some action so that he can discuss the issues. The link for a complete synopsis is:

[http://leginfo.ca.gov/pub/bill/sen/sb\\_1201-1250sb](http://leginfo.ca.gov/pub/bill/sen/sb_1201-1250sb)

### Upcoming Events:

**June—Officer Installation Dinner**  
Date/Location to be announced

**July— 2006 ASA International Appraisal Conference - July 30 to August 2, 2006, Brooklyn, New York**

**Fall—More Thinking Beyond the Box - Value Additives in Real Estate**  
\* A Guided Tour of The Workman Temple & Homestead Museum

**Keep your eye on the website for additional programs.**

**Candidate**

Even before they are accepted into ASA as Candidates, the first rung on ASA's accreditation ladder, appraisers must

- Complete an interview with and receive approval from their local chapters;
- Pass both ASA's ethics examination and an examination on the Uniform Standards of Professional Appraisal Practice (USPAP); and
- Pass intensive written and oral examinations covering general valuation theory and technical expertise.

**Accredited Member (AM)**

Candidates may apply for the Accredited Member designation once they

- Possess at least two years—or roughly 4,000 hours—of full-time-equivalent appraisal experience;
- Possess a college degree or its equivalent;
- Complete ASA's four-level Principles of Valuation course series, passing intensive written and oral examinations and a peer review; and
- Submit two actual appraisal reports for thorough review and approval by a committee of their accredited peers.

**Accredited Senior Appraisers (ASA)**

- Five years' appraisal experience
- Valuation courses and peer review
- College degree or equivalent
- Report review
- Mandatory reaccreditation

**Master Gemologist Appraisers**

- Accredited Senior Appraiser status
- Graduate Gemologist, GIA, or Fellow, FGA
- Own or employed by ASA registered lab
- Written and hands-on examinations

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*Note: Correction from February issue, Miss Lee is an applicant.*

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