

Build your business on solid ground.

- A clearing leader for 25+ years
- \$2.7 billion in net capital!
- Powered by Fidelity Investments

As of December 31, 2008. National Financial Services, LLC, Member NYSE, SIPC 599359.2.0

LEARN MORE NOW

or call
888-678-1608

NA
FIN

Fidelity
Investments

FINANCIAL
PLANNING

<http://www.financial-planning.com>

Back

FREE Site Registration

- ✓ Free newsletters - *Retirement Planning, Wealth Advisor* and More
- ✓ Earn Free CE Credits
- ✓ Free Seminars and Podcasts from Industry Experts
- ✓ Access our Discussion Boards

Enter Email Address

Sign Up

The Art of Appraisals

By Donald Jay Korn

September 1, 2008

For some assets, there is only one way to find a true value, notes Adriane Berg, an attorney in Lebanon, N.J. "That's the price a willing buyer pays a willing seller at the moment of sale," she says. "Any time before or after, value is a matter of opinion."

Assets subject to this uncertainty include real estate, business interests, collectibles and intellectual property. Most of your clients will own at least some of these items and may need to assign them a value for a variety of purposes, such as a potential sale, inheritance or gift.

More or Less

A smart advisor will fill in the appraiser about the purpose of the evaluation at the time of the engagement. "When an appraiser asks why you want an asset valued, the question is really whether you want the appraisal to be high or low," Berg explains. "There is nothing ethically wrong with indicating how the appraisal will be used."

Why is doing this so important? When appraising a gift or an inherited asset, the owner will probably benefit most from a valuation on the low side, which will reduce the tax consequences. If the asset involved is 20% of a family business, for example, then a generous discount for lack of control and marketability might be desirable.

A business owner evaluating a firm for sale, on the other hand, benefits from a high valuation. Take, for example, the case of an accountant or attorney negotiating a buy-sell agreement in case of disability. "You would not want your interest discounted," says Martin Shenkman, an estate attorney in Paramus, N.J. "You would want a full payment of what your 20% interest is worth." When seeking out an appraiser, then, you need to check out two types of qualifications: knowledge of the asset, plus familiarity with the particular purpose involved.

You might suggest the client's attorney be the one to hire the appraiser, to keep the process confidential under attorney-client privilege. This way, if one appraiser's report comes in too high or too low, the client can seek out another.

Trumping the IRS

A rock-solid appraisal can provide significant tax savings, as was evident in a case that came before the Tax Court in 2006. Frederic Kohler, grandson of the founder of the company that makes plumbing fixtures, died suddenly while the company was being reorganized to eliminate outside ownership. Kohler had owned 13% of the stock of this closely held business.

Valuing the shares—and therefore, calculating the estate tax due—came down to a dispute between appraisers. Kohler's estate hired appraisers who put the stock's value at \$47 million because of the various restrictions on stock sales that resulted from the reorganization. The IRS expert valued the shares at nearly \$145 million and said the reorganization—which was completed two months after Kohler's demise—should not affect the estate's value. The IRS wanted an additional \$54 million in estate tax plus an \$11 million penalty.

"The Tax Court thoroughly discredited the IRS' valuation expert," says Blanche Lark Christerson, managing director of Deutsche Bank Private Wealth Management in New York. According to the court, the government appraiser prepared his report incorrectly, used the wrong valuation methods and didn't really understand Kohler's business. By contrast, the Tax Court found the estate's valuation experts thoughtful and credible. "The estate didn't owe extra tax or a penalty," Christerson says.

That's not to say that the Tax Court always sides with taxpayers' appraisers. In the *Holman* case, decided by the Tax Court in May of this year, a married couple formed a family limited partnership (FLP) and contributed millions of dollars worth of Dell stock to it. Then they gave FLP interests to their children. The court considered several issues, including the valuation of the partnership.

The main valuation question was the size of the discount from the Dell shares' trading price because the shares were held in an FLP. The Holmans claimed a 35% discount because the partnership interests were not easily salable; the IRS appraiser conceded only a 12.5% discount. The difference amounted to hundreds of thousands of dollars in gift tax.

The Tax Court came down on the side of the IRS expert, finding some of the testimony of the taxpayers' appraiser to be unpersuasive, illogical and without sufficient analytical support. As Shenkman interprets this opinion, "Guesstimates without quantitative substantiation won't be acceptable."

Looking Ahead

Not every appraisal involves big-money gift or estate tax issues. In the case of inheritance, a client may want simply to document a step-up in basis in advance of a future sale, says Eva Rosenberg, an enrolled agent in Northridge, Calif., and creator of the website TaxMama.com. An appraisal also might be worthwhile for assets that have not been inherited. Collectibles, for instance, may come with little documentation. "A solid appraisal can give an object provenance when it's time to sell, even if it was bought at a flea market," says Berg, whose latest book is *How Not to*

If your clients are donating assets worth \$5,000 or more to charity and want to deduct the gift from their income taxes, they must get an appraisal, regardless of how they acquired the assets. The IRS has tightened up its requirements in this area, which has been abused in the past.

Star Search

Getting a valuation that will stand up to scrutiny is vital—but locating appraisers and evaluating their competence might not be easy. “A financial planner looking for an appraiser might start with a fairly large local CPA firm,” advises Bob Keebler, partner in the Green Bay, Wisc., office of the accounting firm Virchow, Krause & Co. “Such firms usually have one or two partners who can do appraisals, or the firm can recommend someone.”

Like all experts, appraisers have specialties. For business interests, seek out someone with a designation such as accredited in business valuations (ABV), certified valuation analyst (CVA), accredited senior appraiser (ASA) or certified business appraiser (CBA). For entity valuations (interests in FLPs, LLCs, etc.), ask the appraiser if any entities he or she appraised have been subject to gift or estate tax audits, Christerson says. “If so, find out whether there were any valuation adjustments.”

Real estate valuations require different expertise. Christerson says she would lean toward high-end real estate brokers. Real estate appraisers might hold designations such as independent fee appraiser (IFA) or Member Appraisal Institute (MAI). Berg adds that extremely local appraisals might be necessary for real estate. “In today’s market, values can change block by block,” she says.

Beyond business interests and real estate, it may take additional effort to track down specialty appraisers. “For tangible property, I would tend to gravitate toward the larger auction houses, making sure that the expertise you need resides in that shop,” Christerson says. Berg names Sotheby’s, Christie’s and Doyle New York as some possible sources of appraisals for collectibles.

Berg tells of a client who owns a dining room set signed by Eero Saarinen, the Finnish-born architect and furniture designer. “We had Doyle look at it and received an appraisal of \$15,000 for the table and \$4,000 per chair,” she says. “My client is not that attached to the set, so there’s no question it will be sold some day. With an appraisal, we were able to include those amounts in the client’s retirement plans.”

In today’s economy, Berg points out, some people are using gold, including gold jewelry, as a store of wealth, so tangible gold assets may have to be valued. In another relatively recent wrinkle, intellectual property appraisals might not be limited to copyrights and patents. “Someone who runs a website may have an asset with value,” Berg says. “Industry associations and national publications might provide leads to appraisers.”

Rosenberg recently went through the appraisal process herself. She inherited a motorized wheelchair and wanted to give it away. She needed an appraisal, but wheelchair vendors were reluctant to provide the necessary statements. “We discovered the California Probate Referees Association and through this group, we found someone,” she says. For \$100, the Rosenbergs received an appraisal report which they attached to their tax return to support the deduction.

Pricing Advice

Appraisals can involve either a flat fee, set in an advance, or an hourly rate. Flat fees might range from a few hundred dollars for a residence or a vacation home to \$15,000-plus for a business or an expensive real estate property. Hourly rates can go up to \$400, depending on the complexity of the engagement and the expertise of the appraiser. The expense must be weighed against the ultimate payoff. “You get what you pay for,” Keebler says. Hiring an expert who can out-duel the IRS in court could save huge amounts in tax.

Rosenberg suggests that planners go to a top estate tax attorney in their area and ask for referrals to appraisers whose valuations have held up. One such referral, she says, turned out very well for her clients. “I was working with a married couple who wanted to give an apartment building to their children,” Rosenberg says. “We had the building valued by an appraiser who understood valuation discounts.”

Here is a simplified example of a valuation discount: Assume a building is valued at \$1 million, so giving away a 5% interest would translate into a \$50,000 gift, at nominal value. However, if an appraiser says that a 30% discount is warranted, owing to the lack of control and marketability of the partial interest, then that gift would be valued at only \$35,000.

“Over 10 to 12 years, my clients gave the building to their children without paying gift tax or using up their gift-tax exemption,” Rosenberg says. “None of their gift-tax returns were audited. They had to get new appraisals each year, but the ongoing costs were reasonable.”

There is no guarantee that every valuation-based strategy will succeed, but financial advisors can improve the odds with a careful choice of experts. Before agreeing to an engagement, a planner might request a look at a recent valuation. Reading the appraisal can provide a realistic indication of that specialist’s powers of persuasion.

Senior Editor Donald Jay Korn’s mystery novel, *Payable on Death*, is available at Amazon and other online booksellers.

