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July 24, 2007

The Honorable Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury 1500
Pennsylvania Avenue, NW Room 3120
Washington, DC 20220

The Honorable Kevin M. Brown
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Assistant Secretary Solomon and Commissioner Brown:

On behalf of the American College of Trust and Estate Counsel ("ACTEC"), I write to express our concern about the current lack of guidance under the provisions in the Pension Protection Act of 2006 (the "Act") that relate to appraisers. These provisions, specifically §6695A of the Internal Revenue Code of 1986 and §330(c) of Title 31 of the United States Code, expose appraisers to penalties and give Treasury the authority to bar particular appraisers from presenting evidence or testimony in proceedings before Treasury. We ask that Treasury place these topics on its Guidance Priority List and, in the comments that accompany this letter, offer some suggestions as to what that guidance should provide. Our comments that are enclosed suggest that the guidance to be issued clarify the application of these sections in such a way as to reduce the possibility that they will discourage appraisers from providing taxpayers with the appraisals they need in order to comply with their reporting obligations under the Internal Revenue Code.

ACTEC is a non-profit professional association of approximately 2,600 lawyers who are selected on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to these fields through lecturing, writing, and teaching and bar activities. ACTEC offers technical comments about the law and practical comments about its effective administration. It does not take positions on matters of tax policy, such as whether additional penalties should or should not be imposed on appraisers.

We appreciate your consideration of our recommendations and would welcome the opportunity to discuss them further with you.

Respectfully submitted,

Daniel H. Markstein, III
President

AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL

REQUEST FOR GUIDANCE UNDER IRC SECTION 6695A
AND
SECTION 330(c) OF TITLE 31[1]

July 24, 2007

Introduction and Background

The appraisal of property is an integral part of the administration of the Internal Revenue Code.[2] When property other than cash is used to pay for property or services, is the subject of a gift, or is included in the gross estate of a decedent, the value of that property must be determined in order to calculate the amount that will be subject to income, gift, or estate tax.

As a general rule, the value that determines the taxes to be paid is fair market value, "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts"[3] Unless there is an established market in which identical items of property are regularly traded, the only practical way to determine the value is to obtain an appraisal.

Indeed, in some circumstances, a taxpayer is compelled by the Code or by Treasury regulations to obtain an appraisal. For example, section 170(f)(11), under certain circumstances, denies a charitable income tax deduction to a taxpayer unless he or she attaches a qualified appraisal summary to his or her income tax return. Treas. Reg. § 20.2031-6(b) requires that an appraisal of an expert or experts, under oath, must be filed with a decedent's estate tax return if his or her gross estate includes household and personal effects having marked artistic or intrinsic value of a total value in excess of $3,000.

Even when an appraisal is not compelled, it is strongly encouraged. For example, Treas. Reg. §301.6501(c)-(f)(3) provides that if the taxpayer submits an appraisal with her gift tax return that meets certain requirements, she will be considered to have adequately disclosed the gift. The statute of limitations on assessing a gift tax deficiency will begin to run only if the gift tax return adequately discloses the

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1 The principal drafters of these comments were Jonathan G. Blattmachr, Mitchell M. Gans, Ellen K. Harrison, Linda B. Hirschson, and Carlyn S. McCaffrey. Helpful comments were received from Ronald D. Aucutt, W. Birch Douglass, III, Christopher H. Gadsden, Edward F. Koren and Pam H. Schneider.

2 References to "Code" are to the Internal Revenue Code of 1986, as amended. References to "section," unless indicated to the contrary, are to sections of the Code. References to "Treas. Reg. §" are to the regulations promulgated by the Treasury under the Code.

3 Treas. Reg. §20.2031-1(b) and Treas. Reg. 25.2512-1.

gift. If an appropriate appraisal is not submitted, the statute of limitations will begin to run only if the taxpayer submits detailed financial information about the value of the gift and explains the method for determining value. Treas. Reg. §301.6501(c)-1(f)(2)(iv).

The failure to obtain an appraisal evidences a lack of reasonable cause and good faith for purposes of the accuracy related penalties imposed under section 6662.[4] The recently issued Appeals Coordinated Issue Settlement Guidelines regarding discounts for family limited partnerships states the IRS' position that the absence of an appraisal is a basis for asserting accuracy penalties under section 6662.[5]

The fair market value of any piece of property for which there is no objectively determinable value is ultimately a question of opinion. Market experience as well as case law over many years has established that the opinion of experienced appraisers as to a property's market value may vary widely even if each is acting in the best of faith. Consider, for example, the recent London art sales in which Monet's "Waterloo Bridges" sold for $31,700,000, twice the pre-sale estimated value, and in which Damien Hirt's "Lullaby Spring" sold for $19,000,000, about three times its pre-sale estimated value. Another example of the not uncommon disparity between good faith estimates and actual values established by arm's length sales is the recent sale in Fontainebleau of one of Napoleon's swords for $6,800,000, four times the pre-sale estimated value. The recent cases described in the schedule attached to these comments further illustrate just how wide the differences in opinion as to value often are.

Section 6701(a) has, since 1982, imposed a penalty on any person, including an appraiser, who advises with respect to the preparation of any portion of a tax return, who knows or has reason to know that such portion will be used in connection with any material matter arising under the internal revenue laws and who knows that such portion if so used would result in an understatement of tax liability. The section 6701(a) penalty applies regardless of the amount of the underpayment.

Section 330 of Title 31 of the United States Code has, since 1984, authorized the Treasury to discipline an appraiser against whom the penalty under section 6701(a) of the Code has been imposed by directing that no appraisal completed by the appraiser have any probative effect in any proceeding before Treasury or the Internal Revenue Service and by prohibiting the appraiser from testifying before Treasury or the Internal Revenue Service. In other words, any appraiser against whom a penalty under section 6701(a) has been imposed could have been

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[4] *See, Estate of True v. Commissioner*, T.C. Memo 2001-167, where a penalty was imposed on an understatement of tax attributable to substantially and grossly undervalued assets because the executors did not engage the services of an appraiser.

[5] UIL No. 2031.01-00 dated October 20, 2006.

"blacklisted" by the Secretary. Pursuant to this provision, Treasury has promulgated section 10.5(b) of Circular 230 which provides:

> (b) Authority to disqualify. The Secretary of the Treasury, or his or her delegate, after due notice and opportunity for hearing, may disqualify any appraiser with respect to whom a penalty has been assessed under section 6701(a).
>
> (1) If any appraiser is disqualified pursuant to this subpart C, such appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Director of Practice pursuant to section 10.81, regardless of whether such evidence or testimony would pertain to an appraisal made prior to or after such date.
>
> (2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

The Pension Protection Act of 2006

The Pension Protection Act of 2006 (the "Act") significantly increased both the penalties that can be imposed against appraisers and the ability of Treasury to blacklist them.

Appraiser Penalties

New section 6695A, as added by the Act, imposes a penalty on an appraiser who prepares an appraisal that he or she knows (or reasonably should have known) would be used in connection with a return or a claim for refund, if the appraiser's conclusion as to the value of a property results in either a substantial valuation misstatement of income tax within the meaning of section 6662(e) or a gross valuation misstatement of any tax within the meaning of section 6662(h).

A substantial valuation misstatement can occur only with respect to an income tax return. In general, it occurs if the value of any property claimed on such return is 150% or more of the amount determined to be the correct amount of such property. For example, if a taxpayer donates a painting to a museum, claims on his or her return that the value of the painting was $100X and the value is determined to be $66.66X, a substantial valuation misstatement will have occurred.[6]

A gross valuation misstatement can occur with respect to an estate, gift or generation-skipping transfer tax (a "transfer tax return") return as well as an income tax return. In general, it occurs with respect to an income tax return if the value of any property claimed on such return is 200% or more of the amount determined to be the correct amount of such property. For example, if a taxpayer donates a painting to a museum, claims on his or her return that the value of the painting was $100X and the value is ultimately determined to be $50X, a gross valuation misstatement will have occurred.[7]

In the case of a transfer tax return, it occurs if the value of any property claimed on such return is 50% or less than the value determined to be the correct value. For example, if a taxpayer makes a taxable gift of a painting, claims on his or her gift tax return that it was worth $100X and the value of the painting is determined to be $200X, a gross valuation misstatement will have occurred.[8]

Although a gross valuation misstatement may occur with respect to a transfer tax return, it is unclear that such misstatement can give rise to an appraiser penalty under section 6695A. This is so because section 6696 defines "return" and "claim for refund" for purposes of section 6695A as a return of any tax imposed by Subtitle A and a claim for refund of any tax imposed by Subtitle A. The transfer taxes are imposed by Subtitle B.[9]

The only method that an appraiser has to obtain relief from an appraiser's penalty section 6695A is to persuade Treasury that the value established in his or her appraisal "was more likely than not the proper value."[10]

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6 Section 6662(e).

7 Section 6662(h)(2)(A)(i).

8 Section 6662(h)(2)(C).

9 Section 6695A, by its terms, only applies to an appraiser who knew or reasonably should have known that the appraisal would be used in connection with a "return" or a "claim for refund." Section 6696, as amended by the Pension Protection Act of 2006, provides a definition of the terms "return" and "claim for refund" for purposes of sections 6694, 6695 and 6695A. Section 6696 defines these with reference exclusively to the income tax. Thus, based on this section, it is arguable that an appraisal secured for estate or gift tax purposes cannot trigger the section 6695A penalty.

It seems rather clear, however, that Congress intended to impose the section 6695A penalty in the estate-and-gift-tax context. After all, the section specifically cross-references section 6662(h), which unequivocally applies in the case of an estate or gift tax valuation error. It would seem that this specific provision in section 6695A should take precedence over the general definitional provision in section 6696. In short, the conflict between section 6696 and 6695A not be resolved by a reading that renders the specific provision in section 6695A meaningless. Nonetheless, it would be helpful if the ostensible conflict between section 6695A and section 6696 were addressed in published guidance.

10 Section 6695A(C).

Appraiser Blacklisting

Section 330(c) of Title 31 of the United States Code, as amended by the Act, permits Treasury to direct that no appraisal completed by the appraiser have any probative effect in any proceeding before Treasury or the IRS and to prohibit the appraiser from testifying before Treasury or the IRS without regard to whether a penalty has been imposed against him or her under Code §6701(a) or under any other section. Indeed, section 330(c) of Title 31 provides no standards for Treasury to use in determining whether to use section 330(c) of Title 31 against a particular appraiser. All that is required is notice and an opportunity for a hearing.

Recommendations

We are concerned that new section 6695A and the revision to the blacklisting provision of section 330(c) of Title 31 of the United States Code may inhibit appraisers from reasonably and correctly appraising property for tax purposes. We believe that would not serve the effective administration of the tax laws. We think that prompt guidance from the Treasury about these changes is important so that both taxpayers and appraisers know the circumstances in which appraisers may be penalized and blacklisted.

A. Regulations Under Section 6695A.

1. The More-Likely-Than-Not Standard

We believe that section 6695A should be construed to permit a waiver of the penalty if the Secretary determines that the appraiser reasonably and in good faith believed that the appraised value was more likely than not proper. A construction that required a factual determination that the appraised value was more likely than not proper would establish a standard that would be virtually impossible to meet.

In order for the penalty to apply, there must be a determination that the correct value is at least 33% less than (for income tax purposes) or at least 50% greater than (for estate or gift tax purposes) the appraiser's value. Once the correct value has been finally determined, it is difficult, if not impossible, for an appraiser to argue that a significantly different valuation was more likely than not the proper value. The value that was found to be correct was presumptively the value that was more likely than not to be found proper. After failing to win the valuation argument, the appraiser is unlikely to be able to establish that him or her valuation was more likely than not the proper valuation. Accordingly, we believe that, as with other parts of the Code, the "more-likely-than-not" standard in section 6695A means or should be construed to mean a belief that the appraised value was more-likely than not correct. (*See, e.g.*, section 6662(d)(2)(C)(i)(II) prior to amendments made by P.L. 108-357; Treas. Reg. § 1.6664-4(f)(2)(i)(B).)

If construed otherwise, section 6695A could interfere inappropriately with the judicial process. Consider an appraiser who believes that there is substantial support for a valuation method. He or she believes that it is more likely than not to be sustained by the courts. Even if he or she were to conclude that the probability of success was fifty-one percent, he or she might well refuse the engagement based on a fear of triggering the penalty. And if other appraisers were similarly intimidated, the taxpayer would be denied an opportunity to offer evidence of a method having a fifty-one percent probability of success. Whenever litigants are precluded from making a legal argument in court, serious constitutional, as well as policy, issues are implicated.[11] We suggest that it is important to avoid a construction of section 6695A that would tend to close the courthouse door on arguments having such a substantial probability of success.

Imposing a more-likely-than-not standard on appraisers without regard to their states of mind not only threatens the judicial process but is also inconsistent with provisions applicable to practitioners under Circular 230. The more-likely-than-not standard in section 6695A should be contrasted with the much less rigorous not-frivolous and reasonable-basis standards in section 10.34 of Circular 230. It should also be contrasted with the more-likely-than-not standard under section 10.35 of the Circular. Under section 10.35, the more-likely-than-not standard does not pose a threat to the judicial process. It does not, in other words, preclude a taxpayer from defending the taxpayer's substantive position in court. Rather, as a practical matter, it merely renders them unable to invoke the professional-advice defense under section 6664 to a section 6662 penalty should the argument on the substantive position fail.

For these reasons, we suggest that the more-likely-than-not standard in section 6695A be construed to apply only when the appraiser could not have reasonably and in good faith concluded that the position taken in the appraisal was more likely than not the correct result. Thus, in the example described above, assuming that the appraiser could not reasonably and in good faith conclude that the probability of success was greater than fifty percent, the penalty could apply. On the other hand, if he or she could reasonably reach a more-likely-than-not conclusion, the penalty should not apply even if the appraisal is rejected in court. Any interpretation of section 6695A that failed to consider the appraiser's state of mind would make no sense. Indeed, a more-likely-than standard is unintelligible if not tethered to the appraiser's state of mind. For, once the court rejects the appraiser's valuation, it is no longer possible to consider the likelihood of the success of such valuation unless one adopts a test that excludes the actual outcome and focuses instead on what a reasonable appraiser would have thought about the likelihood of success.

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11 *Cf. Legal Services Corporation v. Velazquez*, 532 U.S. 903 (2001) (holding that legislation that barred certain litigants from making arguments based on the constitution was an impermissible interference with the judicial process and a violation of the First Amendment).

Therefore, we think that the section 6695A penalty should be waived if the appraiser establishes that he or she reasonably and in good faith believed that the appraised value was more likely than not correct. Such a rule would mean that the appraiser would be subject to the penalty if the appraiser intentionally, recklessly, or incompetently determined the appraised value. For example, an appraiser who uses an obviously incorrect valuation method to value an asset (*e.g.*, values an operating business solely on the basis on the value of the assets of the company and without regard to the earnings or cash flow of the business) would be subject to the penalty.

If our recommendation that the penalty be imposed only when the appraiser fails to establish that she reasonably and in good faith believed the value was more likely than not correct is rejected, we respectfully request that you issue regulations that describe the kinds of factors that would need to be shown by an appraiser in order to establish to the satisfaction of Treasury that the appraised value was more-likely than not the proper value.

2. Reliance on Representations From Others

We also believe that Treasury regulations should specifically address the issue of the appraiser's reliance on representations of others. The three circumstances in which we think that guidance should be provided are described below.

a. The appraiser has relied on advice of legal counsel to the taxpayer that none of the special valuation rules of Chapter 14 of subtitle B of Title 26 applies. For example, the appraiser has been engaged to value for federal gift tax purposes common stock in a closely held business that has been transferred by the taxpayer to his or her child as a gift. Legal counsel to the taxpayer advises the appraiser that section 2701 of the Code (providing a statutory rule of valuation which differs from the "willing buyer-willing seller" valuation method normally used for federal gift tax purposes under Treas. Reg. § 25.2512-1) does not apply. Reliance on other legal advice, such as advice relating to title, and rights and obligations with respect to the property being appraised) presents the same kind of issue.

b. The appraiser has relied, in part, on an appraisal provided by another appraiser. For example, an appraiser is asked to appraise, for federal estate tax purposes, stock in a closely-held operating business which owns real estate. The appraiser determines that both the capitalization of income and net asset value approaches should be considered to determine the value of the stock. The appraiser of the stock is not an expert in appraising real estate. The appraiser asks taxpayer's attorney to obtain an appraisal of the land from a knowledgeable appraiser of real estate. The attorney engages a knowledgeable appraiser of real estate who provides a written estimate of the land's fair market value using willing buyer/willing seller valuation method normally used for federal gift tax purposes under Treas. Reg. § 25.2512-1. The appraiser of the stock relies on the estimate of fair market value of the real estate in determining the value of the business. It develops that the value of the stock, in fact, is 250% more than the appraised value in part because the value of the land was underestimated.

c. The appraiser, despite the exercise of reasonable due diligence, received inaccurate or incomplete information about the assets, income, liabilities or other relevant circumstances from the taxpayer or any employees or agents of the taxpayer.

In all of the situations described above, we suggest that so long as the appraiser had no reason to believe that the information that he or she received from the attorney, from the other appraiser or from the taxpayer or his agents was incorrect, she should not be subject to the penalty under section 6695A to the extent that he or she can show that the valuation misstatement would not have occurred if information that he or she had received from others had been correct.

B. Blacklisting of Appraisers

We also suggest that section 10.50(b) of Circular 230 be amended in one of the following two ways.

1. If you adopt our suggestion that the penalty under section 6695A of the Code should be imposed only if the appraiser does not establish that he or she reasonably and in good faith believed that the appraised value was more likely than not proper (the "reasonable and in good faith" test), we suggest the amendment of section 10.50(b) to provide that a proceeding to blacklist an appraiser pursuant to section 10.50(b) should be commenced only if that penalty under section 6695A was imposed against the appraiser.

2. If you do not adopt our suggestion that the penalty under section 6695A of the Code should be imposed only if the appraiser does not meet the reasonable and in good faith test, we suggest the amendment of section 10.50(b) to set forth the criteria that the Secretary will use to determine that an appraiser will be blacklisted.

We also think that an appraiser should be subject to blacklisting only if the Internal Revenue Service can establish that the appraiser has demonstrated a pattern of providing incorrect appraisals knowingly, recklessly or as a result of the appraiser's gross negligence. A requirement of such a showing, we believe, is consistent with the rules of disciplining a Practitioner (within the meaning of section 10.2(e) of Circular 230) for giving incorrect tax opinions under section 10.51(l) of the Circular. We believe this symmetry is desirable.

VALUATION DISPARITIES

Case	Type of Property	Value by TP	Value by IRS	Value Assigned by Court
Estate of Thompson, T.C. Memo 2004-174, 2004 WL 1658404	487,440 shares of voting common stock	$1,750,000 ($3.59/share)	$32,387,730 ($66.45/share)	$13,525,240 ($27.75/share)
Estate of Dunia, T.C. Memo 2004-123, 2004 WL 1119603 (Tax Ct. 2004)	92.91 acres undeveloped property for comm'l sale	$4.05 million	$16.3 million (reduced to $8.5 million at trial)	$5,463,666
Polack v. Comm'r, T.C. Memo 2002-145, 2002 WL 128477 (Tax Ct. 2002)	1,040,000 shares of nonvoting common stock	$0.50/share	$1.65/share (reduced to $0.88/share at trial)	$0.88/share
Estate of Mitchell, T.C. Memo 2002-98, 2002 WL 531148 (Tax Ct. 2002)	Trust's interest in 1,226 shares of common stock	$28.5 million	$105 million	$41,532,600
Davenport v. Comm'r, T.C. Memo 2006-215 2006 WL 2845690 (Tax Ct. 2006)	Allstate & Safeco annuities	$0	$1,514,572	$1,514,572
Kohler v. Comm'r, T.C. Memo 2006-152, 2006 WL 2059210 (Tax Ct. 2006)	FMV of Kohler Co. stock owned by Kohler estate	$47,009,625	$144.5 million	$47,009,625
Wortmann v. Comm'r, T.C. Memo 2005-227, 2005 WL 2387487 (Tax Ct. 2005)	FMV of 30-acre property for § 170 deduction	$475,000	$76,200	$76,200
Estate of Forbes, T.C. Memo 2001-72, 2001 WL 286907 (Tax Ct. 2001)	QTIP's undivided interest in property	$519,000 (w/o interest in timber & pecan trees)	$2,990,942(w/ interest in timber & pecan trees)	$519,000 (TP correct to exclude beneficial interest in trees)
Kellahan v. Comm'r, T.C. Memo 1999-210, 1999 WL 420790 (Tax Ct. 1999)	FMV of 4.7 acres of land & improvements	$111,750 (reduced to $72,500 at trial)	$5,950	$5,950
Estate of Rodgers, T.C. Memo 1999-129, 1999 WL 225893 (Tax Ct. 1999)	FMV of common stock interest	$2,400,000 (amended to between $3,486,167 & $3,933,412)	$13,100,000 (amended to $7,700,000)	$4,316,920