Non-Cash Contributions: Qualified Appraisals and Valuation Penalties for Donors and Appraisers

Summary: Section 1219 of the Pension Protection Act of 2006 (H.R. 4) increases penalties on overvaluation (for income tax purposes) and undervaluation (for gift and estate tax purposes) of contributions of non-cash property on donors and appraisers, and imposes new requirements for what constitutes a "qualified appraisal" by a "qualified appraiser" for a gift of non-cash property worth more than $5,000.

Effective Date: Changes generally apply to returns filed and appraisals prepared after date of enactment, except for contributions of façade easements, which would be retroactive to returns filed and appraisals prepared after July 25, 2006.

Qualified Appraisals

Do the new rules apply to gifts of all non-cash property? Yes, a donor must obtain a "qualified appraisal" by a "qualified appraiser" for all gifts of non-cash property worth over $5,000, and must attach an appraisal summary to his or her tax return (Form 8283). The rules also apply to valuations of gifts for both income tax and gift and estate tax purposes.

What gifts require a donor to obtain a "qualified appraisal"? A donor must obtain a qualified appraisal for gifts of property worth more than $5,000, other than cash and publicly-traded securities.

What is a "qualified appraisal"? The current Treasury regulations define a qualified appraisal as an appraisal document that is:

- related to an appraisal made no earlier than 60 days prior to the date of gift or no later than the due date of the donor's tax return;
- prepared, signed and dated by a "qualified appraiser";
- includes all required information; and
- not involve a prohibited appraisal fee.

How does HR 4 change these requirements? The new legislation amends the definition of a qualified appraisal by (1) defining who is a "qualified appraiser" and (2) requiring that a qualified appraisal must be prepared in accordance with generally accepted appraisal standards (as defined by the Uniform Standards of Professional Appraisal Practice (USPAS) published by the Appraisal Foundation, www.appraisalfoundation.org).

Who is a "qualified appraiser"? The new legislation tightens the standards for qualified appraisers. The new law defines a qualified appraiser with respect to any specific appraisal as an individual who:

- has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements prescribed by Treasury regulations;
- regularly performs appraisals for which the individual receives compensation;
- can demonstrate verifiable education and experience in valuing the type of property subject to the appraisal;
- has not been prohibited from practicing before the IRS at any time during the three years preceding the appraisal; and
- meets any other requirements prescribed by Treasury regulations.

Who cannot be a "qualified appraiser"? Under existing regulations that remain in effect, a qualified appraiser cannot be:

- the donor;
- the donee;
- a party to the donor's acquisition of the property;
- employed by or related to any of the above; and
- someone used regularly by any of the above unless the majority of the work is performed for others.

What information must be included in a "qualified appraisal"? Under existing regulations that remain in effect, a qualified appraisal must include:

- description of the property, including its physical condition;
- date (or expected date) of gift;
- terms of gift, including any limitations;
- identity and qualifications of appraiser;
- statement that the appraisal was prepared for income tax purposes;
- preparation date;
- appraised fair market value;
- valuation method;
- specific basis for valuation; and
- appraiser's declaration.

What is an appraisal summary? IRS Form 8283 is the appraisal summary. An individual who claims a charitable contribution deduction of property worth more than $5,000, other than cash and publicly-traded securities, and that requires a "qualified appraisal," must attached an appraisal summary to his or her tax return. Among other things, the appraisal summary will include:

- identifying information about the donor and a brief description of the property;

- the date and how the donor acquired the property;
- the donor's cost or other basis in the property;
- the amount of consideration paid to the donor if the gift involved a bargain-sale;
- appraised fair market value;
- appraiser's declaration; and
- statement by the appraiser that fee charged is not prohibited and the appraisals prepared by the appraiser are not being disregarded by the IRS.

Is the charity required to sign the appraisal summary (Form 8283)? Yes, the charity is required to sign Form 8283 submitted by the donor with his or her tax return. The charity's signature serves as an acknowledgement affirming that the charity received the property. It does not certify the valuation of the property provided by the donor. However, a charity suspecting that the donor is substantially misstating the value of the property should generally not sign.

When must a charity file Form 8282? A charity must now file Form 8282 if it disposes of the property within three years of the date of the gift rather than two years as previously required. Form 8282 requires the charity to indicate the date the property was received, the date it was sold, and the amount received upon disposition. The charity's signature on Form 8283 serves as an acknowledgement of the charity's obligation to file Form 8282.

What are prohibited appraisal fees? An appraisal will not be a "qualified appraisal" if the fees charged are based on a percentage of the property's appraised value or what the IRS allows as a deduction.

Donors may not deduct the cost of appraisal fees as a charitable contribution, although they may be able to claim a deduction as a miscellaneous expense. If the charity pays the appraisal fee, the quid pro quo rules apply, reducing the donor's deduction by the amount of the fee. If the gift is to a donor-advised fund or a supporting organization, the charity may not pay the appraisal fee.

Valuation Penalties for Donors

How have the penalties changed for donors? The new legislation lowers the threshold for imposing accuracy-related penalties on donors for "substantial" and "gross" valuation misstatements of gifts of non-cash property. The actual penalty taxes imposed on donors remain the same – 20% of the underpayment for a substantial valuation misstatement and 40% for a gross misstatement.

What is the threshold for triggering penalty taxes for "substantial" valuation misstatements? For income tax purposes, the threshold for determining whether a penalty is imposed on donors for substantial valuation misstatements is reduced to 150% (from 200%) of the correct value as determined by the IRS. For example, a penalty will be triggered if the donor values a gift at $150,000, but the correct value is only $100,000. For estate and gift tax purposes, the threshold is increased to 65% (from 50%) of the correct

value. For example, a penalty will be triggered if the property is valued at $500,000, but the correct value is $769,231.

What is the threshold for triggering penalty taxes for "gross" valuation misstatements? For income tax purposes, the threshold for determining whether a penalty is imposed on donors for gross valuation misstatements is reduced to 200% (from 400%) of the correct value as determined by the IRS. For estate and gift tax purposes, the threshold is increased to 40% (from 25%) of the correct value.

In addition, the Act eliminates the "reasonable cause" defense in the case of gross valuation misstatements for either income tax or gift and estate tax purposes.

Valuation Penalties for Appraisers

How have the penalties changed for appraisers? Under prior law, appraisers were subject to penalties for aiding and abetting understatement of a donor's tax liability under section 6701 of the tax code. The penalty was generally $1,000. With the new legislation, appraisers will now be subject to penalties under a new section of the tax code, section 6695A.

What are the penalties for appraisers under new section 6695A? The penalty is equal to the greater of $1,000 or 10% of the amount of tax attributable to a substantial or gross valuation misstatement, up to a maximum of 125% of the gross income received by the appraiser.

The penalty is imposed if the appraiser knew or reasonably should have known that an appraisal would be used in connection with a tax return and the claimed value of the property which is based on the appraisal results in a substantial or gross valuation misstatement. There is a limited exception to the penalty if the Secretary of Treasury determines that the value established in the appraisal is "more likely than not" the correct value.

Are there additional disciplinary actions that can be imposed on appraisers? Yes, under prior law, appraisers could be barred from practice before the Department of Treasury or the IRS after notice and a hearing if they had been assessed a penalty for aiding and abetting the understatement of a taxpayer's tax liability (under section 6701). The new legislation eliminates the requirement that an appraiser has to be assessed a penalty under section 6701 before he or she can be barred from practice before the Treasury or the IRS.

The information provided here is based on our continuing analysis of the bill. Every effort has been made to ensure accuracy of these documents. However, due to the complexity of the bill and the fact that many of these provisions introduce issues that are new to the Internal Revenue Code, please understand that this information is subject to change. The information is not a substitute for expert legal, tax or other professional advice and we strongly encourage grantmakers and donors to work with their counsel to determine the impact of this legislation on their particular situations. This information may not be relied upon for the purposes of avoiding any penalties that may be imposed under the Internal Revenue Code.

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