



APPRAISALS - DO I REALLY HAVE TO SPEND THE MONEY?

When an asset is subject to a gift or is taxable as an asset in an estate at death, the fair market value of the asset must be determined. Under the tax laws, that fair market value is defined as the price a willing buyer/willing seller would pay, both reasonably aware of the facts. In other words, what would independent third parties pay for the asset?

Estate and Gift Taxes

Estate and gift tax rates are the highest in the Internal Revenue Code.¹ Accurately valuing assets subject to tax by taking into account all factors that may limit or diminish value is an important ingredient in prudent tax planning.

One must also understand the potential for close scrutiny of asset values upon audit by the Internal Revenue Service. Very small percentages of individual income tax returns are audited (less than 2 percent). While statistics are not available for gift tax audits, our experience indicates that few gift tax returns are subjected to full audit.² This should be contrasted with the examination that occurs at an individual's death. Every federal estate tax return is reviewed by the Internal Revenue Service. An estate may be closed only after receiving a "closing" letter from the Internal Revenue Service. The degree of review depends upon the size of an estate and nature and extent of its assets. Comprehensive, detailed audits are common whenever an estate includes interests in family or closely held businesses, unusual assets, or total asset values exceeding \$5 million. Penalties will be imposed when an asset is substantially undervalued. "Guessing" the value of an asset subject to estate or gift tax is not wise.

Do I Need an Appraisal?

If you are making a sizable gift or have a sizable estate, generally you need an appraisal of assets for which there is no ready market. Family or closely held business interests, family partnership interests, limited liability companies, real estate, gas and oil interests, artwork, antiques, jewelry, and even ordinary household goods and personal effects are all examples of items that should be appraised when gifted during lifetime or at death if a tax is to be paid.

What Role Should Your Attorney Play?

We do not appraise assets, but it is important that we work closely with the appraiser. Often, we should employ the appraiser for you. When we engage the appraiser, that work may be part of our work product for you. If, during the course of an appraisal, we determine that the appraisal may substantially differ from expectations, the services of that appraiser

¹ In 2022, the top marginal tax rate for estate assets and gifts is 40 percent.

² The Internal Revenue Service has indicated that more returns will be audited in the future since the Taxpayer Relief Act of 1997 changed the statute of limitations for gift tax returns. The value of gifts that are now properly disclosed on a return (proper disclosure requires careful attention to the IRS disclosure requirements) will bind the IRS. Previous law permitted the IRS to review at death the value of all of an individual's lifetime gifts.

may be discontinued, and we may be able to avoid disclosing that work to the Internal Revenue Service. We work closely with appraisers to be sure that they are using the latest valuation approaches as disclosed by the courts and Internal Revenue Service and consider all factors that impact upon an asset's value.

Who Should Do the Appraisal?

It is important to select an appraiser who is experienced and skilled at valuing the type of asset in question. The size and nature of your gift or estate, relationship of the appraiser to you or your company, and the cost of the appraisal are all factors that should be considered. In some small- to medium-size businesses, the accountant for the corporation may be entirely appropriate to appraise a minority interest in a closely held business; however, the IRS expresses that it gives less credibility to the accountant for the business than to an independent appraiser. When the appraisal involves very valuable assets, you have a very large estate, or the gift or estate tax is dependent upon a new and not fully tested technique, such as family limited partnerships, the skill of the appraiser should match the circumstances.

What Will an Appraisal Cost?

Several factors should be identified to assess the true cost of an appraisal. Certainly, one of those is the price of the initial appraisal report, but that alone should not control. Other factors include:

- (a) What follow-up services, if any, does the appraiser include in the cost of the initial report (for example, assistance with an Internal Revenue Service audit or appeals).
- (b) Does the appraiser have a reputation for successful results with the Internal Revenue Service or in litigated matters which might diminish the likelihood of Internal Revenue Service challenges to the appraisal report.
- (c) If annual or biannual follow-up appraisals are required, what price will be charged for the follow-up appraisals.
- (d) Does the appraiser have unique expertise to evaluate the asset or transaction that may result in a lower final tax value than would otherwise be obtained from a less skilled appraiser. (After all, if the appraiser's knowledge and creativity successfully results in a lower gift or estate tax value, the most expensive appraiser could be the "cheapest.").

Conclusion

Competent appraisals are an important component in wealth transfer planning. We are experienced in dealing with appraisers and would be happy to assist you in any number of ways including, where appropriate, employing the appraiser.

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