

Appraisal Requirements in Complex Charitable Giving

By Elliot Rotstein, CAP®

Americans are stubbornly philanthropic. In 2012, we gave over \$300 billion¹ to causes that we are passionate about. Through recessions, wars, political stalemates, and continued economic uncertainty, charitable giving has continued to increase. There is no reason to think that the deeply rooted tradition of giving back will subside in the near future. With \$41 trillion of wealth expected to pass to the next generation's philanthropists by 2055², we are sure to see more gifts and more dollars given to charities with each passing year.

Philanthropy is ever-evolving. The practice has become increasingly more accessible over the years with the growth of awareness surrounding such giving vehicles as Donor Advised Funds (DAF's), Private Foundations, Support Organizations, Gift Annuities, and Charitable Lead and Remainder Trusts. In addition to the growth in awareness regarding the various charitable planning vehicles, which can be used to help organize and manage how we give, there has been a tremendous growth in awareness regarding what assets make the most sense to give. Historically, individuals have supported the causes they care about by donating cash or appreciated securities such as stocks, bonds, and mutual funds. More recently, donors are being well informed by their professional advisors and other charitable organizations that there may be a more tax efficient asset category from which to fund their philanthropic efforts; Illiquid, non-publicly traded assets. These interests include closely held C- and S-corporation stock, LP/LLC interests, restricted stock, interests in hedge/private equity funds, real estate, and other privately held assets.

¹ Giving USA Foundation

² The 2010 Bank of America Study of High Net Worth Philanthropy conducted by the Center on Philanthropy at Indiana University

With so much wealth tied up in these illiquid, privately-held assets, the notion of using these interests to fund philanthropic efforts not only allows the donor to take advantage of tremendous tax benefits associated with the donation, but more importantly enables them to take what has traditionally been a non-working asset and put it to work in support of a good cause.

There are many technical requirements to consider and often times the process surrounding these types of gifts can be quite complex. When contemplating a charitable gift of illiquid privately-held assets, it is important to engage a charitable organization that has experience facilitating these types of gifts. It is equally important to work closely with a professional advisor who is well informed regarding other important considerations, which can include timing, tax deductibility, and valuation.

The Fair Market Value (FMV) of an illiquid privately-held asset gifted to a charity is reported on IRS Form 8283. To meet IRS requirements, any contribution of property other than publicly traded securities worth more than \$5,000 must be substantiated by a “qualified appraisal”. If the value of the donation exceeds \$500,000, the complete appraisal report must be attached to IRS Form 8283. The appraisal must be done no earlier than 60 days before the date of the gift and no later than the filing date of the return for the year of the gift. In order to meet the requirements of a qualified appraisal, the following requirements must be met:

- Appraisal must be prepared, signed, and dated by a qualified appraiser
- Includes a statement that the appraisal was prepared for income tax purposes
- Includes the appraised FMV of the property on the date or expected date of the contribution
- Includes the specific basis and methodology used in determining FMV for the property
- Includes a description of the appraised property
- Includes the qualifications of the qualified appraiser

Americans are incentivized to make charitable contributions through the ability to claim generous income tax deductions. Failure to properly document and report charitable gifts, particularly when the donation consists of illiquid privately-held assets can result in penalties, reduction in value, and even complete disallowance of the gift.

The results of a few recent cases have proved that the tax court intends to be strict in supporting IRS substantiation requirements of Section 170. Section 170 of the Internal Revenue Code governs, amongst other items, reporting requirements for charitable organizations, contributions and gifts. Each of the cases listed below involve gifts of illiquid privately-held assets and serve to support this point:

Rothman v. Commissioner, T.C. Memo 2012-165: \$290,000 charitable deduction disallowed by the IRS and tax court. The deduction was denied because the donor failed to meet the requirements for a qualified appraisal even though a professional appraisal firm had been engaged. In this case, the appraisal failed to include both the method of valuation used to determine FMV as well as the specific basis for the valuation.

Mohamed v. Commissioner, T.C. Memo 2012-152: Charitable deduction of approximately \$19 million denied by the IRS and tax court. In this case, both the donor and the IRS agreed that the value of the donated property was likely understated. Unfortunately for the donor, the value of the property is not what was being questioned. The entire value of the deduction was disallowed because the donor performed the appraisal himself. To properly comply with Section 170 substantiation requirements, the donor should have engaged an independent qualified appraiser.

Evenchik v. Commissioner, T.C. Memo 2013-34: \$1,000,000 charitable deduction disallowed by the IRS and tax court. The Evenchik case is unique because, as in the Rothman case, the donor did engage a qualified appraiser. The Evenchik case involved the donation of illiquid privately-held shares to a charitable entity. The sole assets of the corporation were two apartment buildings. While a qualified appraisal was attached to the return, the appraisal was for the two underlying apartment buildings owned by the corporation and not of the actual shares of the corporation. The charitable deduction was denied in full since Section 170 requirements were not met as a result of the lack of appraisal for the shares, which were donated.

The above cases serve to further support our position that tax court fully intends to be strict in supporting IRS substantiation requirements of Section 170. Management Planning, Inc. (MPI) is a full service valuation firm uniquely positioned to work closely with this country's most sophisticated philanthropists and their professional advisors. Since 1939, MPI has specialized in the appraisal of business interests, for tax purposes as well as for many other reasons. We have prepared thousands of valuations of such interests in a wide variety of industries and for many purposes. Our valuation practice is national in scope, with clients in every state. To support this effort, MPI has offices in Princeton, New York City, Boston, Hartford, Chicago, Atlanta and Orlando. Our ability to defend our work is what distinguishes us most from the competition. As evidenced by hundreds of settlements reached by working with attorneys and other advisors, MPI has the necessary experience to defend its work and reach successful settlements with the IRS. For additional information pertaining to MPI and our appraisal activities, please refer to our website www.mpival.com. We also provide investment banking and related advisory services through our affiliate, MPI Securities, Inc., which is a registered FINRA broker dealer.

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