CALIFORNIA CONTINUING EDUCATION, INC

PRESENTS

TAX VALUATION ETHICS STUDIES

by

Curtis L. Harrington
HARRINGTON & HARRINGTON
PATENTAX®

P.O. Box 91719, Long Beach, CA 90809-1719
(562) 594-9784, Fax: (562) 594-4414
http:/www.patentax.com E-mail: curt@patentax.com PATENTAX®

TEN VALUATION CASES FOR THE LESSONS THEREIN

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INTRODUCTION

Valuation entails the art and science of arriving at a monetary value across many disciplines. The static value of items of personal property including jewelry, art, machinery; real property and its improvements; and the value of going concern businesses are all contemplated using approaches developed over time. Ascertainment of value is important for many reasons:

Lenders need to know company value in order to more safely lend money;
Mortgage banks need to know real property value in order to more safely write mortgages;
Buyers need to know that value of their purchases meets or exceeds the price paid;
Sellers need to know that value of their for sale items meets or is less than the price paid;
Mergers need to be able to evaluate the ultimate value of the merged surviving entity; and
Casualty losses need to have a reliable value of destroyed property to measure insurance claims;

Most of the above instances involve two parties in a voluntary transaction and before the transaction occurs. If one party has a completely unreasonable view of value, an end result can occur in which the transaction might not be entered into, and not completed. The need for other valuations for past transactions are usually not voluntary and involve forcing functions such as court involvement. Tax related valuation often determines current consequence of tax events occurring earlier in time:

Value of an estate for gift & estate tax purposes;
Valuation of real and personal property for annual property tax assessments;
Valuation of entity fractions used as consideration for a taxable transaction;
Valuation of a going concern business for partnership for taxable dissolution purposes;
Value characterizations for entities undergoing merger under the Internal Revenue Code;
Valuation to support business succession planning which will result in a lesser tax assessed;;
Valuation for bankruptcy purposes, including cram down, redemption, and ;
Value of debt mechanisms including options and convertibility
Valuation of Taxable and Nontaxable Economic Damages

The majority of these valuations are initiated only after a triggering need.

Nothing is perfect, but a good valuation requires significant internal facts, significant external data, a complete analytical and computational treatment in approaches to value based upon the similarities and differences between the facts and data. A high-quality, complete and reliable valuation is time consuming, not inexpensive, and requires significant thought and expression of the factors, logic and reasoning in combining values to arrive at a valuation range.

If any aspect of the valuation report is missing, the arrived value will be challenged by an opposing expert. Communication between client and value expert and then between value expert and the tribunal in which value is to be established, is critical. An omitted element can adversely, and possibly irretrievably, affect the legitimacy of the value result.

Initial steps which can enable (but not guarantee) a quality evaluation include:
(1) an engagement letter that completely describes the appraisal task, requirements and reason that an appraisal is needed;

(2) A complete list of facts, documents supporting those facts and missing documentation needed for a high quality appraisal;

(3) A historical financial performance history within the context of the environment in which the appraisal value will operate;

(4) A site visit brief investigation into both direct physical aspects and interviews of individuals most familiar with the item / business being valued;

(5) Valuation method(s) and analysis and weighting of such method(s) and ultimately in conjunction with a review prior to finalization of a value opinion to insure and verify all bases for valuation;

(6) Embodiment of the value opinion into verbal and written communications including letters, summaries, and a full narrative appraisal report.

If all of these factors and timings are observed, and if the desire for a high quality appraisal remains a driver throughout the process, an opportunity for a high quality appraisal is possible. Omissions and shortcuts disable a high quality appraisal. Lack of quality creates a "tunnelling effect" which spreads to a taxpayer client position before a tribunal on matters other than value. The taxpayer client is often judged to be no more worthy than the completeness of that taxpayer client's appraisal report.

An incomplete, unreliable appraisal report can then be viewed as a bare feigned attempt destined for disaster. Its not like building a false structure for experimentation, there are others that are implicated, professionally. The tax professional representing the taxpayer has a duty to perform a complete effort, but might not be permitted to authorize an expenditure necessary for a "best" valuation effort. The valuational professional may quote a price commensurate with performance of a "best" effort, but the client may only have available an amount that is equivalent to 10% completion effort. In both cases the engagement should be avoided.

Circular 230 Ethics

The IRS has the ability to debar practitioners (disqualify appraisers) from involvement in IRS cases. "31 U.S.C. §330(c) (Circular 230) "After notice and opportunity for a hearing to any appraiser, the Secretary may —
(1) provide that appraisals by such appraiser shall not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service, and (2) bar such appraiser from presenting evidence or testimony in any such proceeding."

Other procedures applicable to appraisers include Circular 230 §10.50 Sanctions for gross misconduct. The latest instance I have been able to find was in 2014 where "facade easement appraisers" were suspended for 5 years for the use of a "a flat percentage diminution, generally 15 percent, to the fair market values of the underlying properties prior to the easement's donation." In essence, rather than having any approach, any comparables or any financial computations, the appraisers simply reduced value by an arbitrary pre-selected factor.

One reason that IRS does not spend many resources in disqualifying appraisers is that any form of logical approach, even if highly erroneous, can be defended. Defense in an inter-partes proceeding has a much greater chance of exposing substantive flaws than a unilateral attack on an appraisal in a disqualification contest.

The IRS, probably recognizing that its best conduct modifying tool would be achieved in a relationship to the amount of tax loss, had relied more heavily upon penalties:

IRC 6694, understatement of taxpayer's liability (greater of $1000 or 50% of the income derived by the preparer/appraiser);

IRC 6695A, Substantial and gross valuations (greater of 10% of the underpayment due to the misstatement or $1000 or 125% of the gross income received by the appraiser). A defense of "more likely than not" a good value is available to the appraiser, however if things have gotten to the penalty phase, it sort of eliminates the 51% value defense standard.

IRC 7517 causes IRS to furnish and explain (1) basis of IRS determination of value, (2) computation of such value, and (3) any expert appraisal (report) performed for IRS.

IRC 7602 enables IRS to examine books, papers, witnesses (by deposition) and such data can be used in connection with the Internal Revenue laws.

So, IRC 6694 and 6695A puts the appraiser to the same "type" of penalty risk as the taxpayer has. The general requirement that the appraiser know the purposes for valuation are doubled and reinforced. Not just the position for the appraisal, but the risk of inaccuracy.

IRC 7517 at least gives the appraiser and taxpayer a peek at the IRS position. However, IRC 7602 is a codification that enables IRS to examine books, papers, witnesses (by deposition) BEFORE appearing at trial.

It is well known that anyone that acts as a return preparer (and this includes the tax practitioner and the appraiser) has no privilege and can be made to testify against a taxpayer. However IRC 7602 gives the IRS an extra half step and enables data to be gathered from both the preparer and appraiser before trial. The data can be used later for criminal prosecution purposes.

This brings the topic to the conspiracy oriented IRC 6701 aiding and abetting an understatement of tax, which can correspond to the crimes of 18 U.S.C. §371, §286, and §287 loosely characterized as conspiracies to defraud the government. I usually encourage taxpayers to prepare their own tax returns as it forecloses the possibility of a conspiracy for one person.

However, the requirement for an outside appraiser supplies the second person that makes a conspiracy conviction possible. Further, the extra half step of 7602 enables the IRS to directly develop the evidence needed from the appraiser in a subsequent criminal conviction.

From the cases that follow, it is believed that a decision has been made to inflict a greater corrective action by punishing the taxpayer with failure of the transaction, rather than to expend far greater amounts of time bringing ethics actions against the appraiser.

A criminal conviction would automatically trigger, with some certainty, the disqualification outcome under Circular 230.

Given the generally accepted requirements of appraiser credentials, appraiser academic reputation, and appraiser monetary sanctions, the professional appraiser has a greater worry regarding loss of business from reputation compromise.

The Cases

I. TOTTEN .....(No Appraiser).....05

(1) When a case has significant magnitudes of audit adjustments in several areas a question of "fiction" or "audit lottery" can arise, and the strident taxpayer takes an un-settleable case to tax court.
(2) In the case of charitable deductions of in-kind property beyond a threshold limit, the appraisal rules are slightly more rigorous, and cannot be ignored.

CHRISTOPHER JOHN TOTTEN v. CIR (T.C. Summary Opinion 2019-1) Filed January 29, 2019. Docket No. 10691-14S.

Its not unusual for a taxpayer to be overly-creative and conjure a plethora of diverse, fanciful deductions to soak up income. Here, the reality of an un-agreed audit with an adjustment of $60,000+ in deductions, of which $18,000+ is a non-cash charitable deduction arose. Recurring opportunities such as this gives Tax Court a chance to again re-state the requirements for a required appraisal:

"There are also more rigorous substantiation requirements for contributions of property exceeding $5,000. Sec. 170(f)(11)(C). To substantiate a contribution exceeding $5,000 the taxpayer must also:

(1) obtain a "qualified appraisal" of the items (See Sec. 170(f)(11)(E)(i) and sec.1.170A-13(c)(3)(ii), Income Tax Regs. provide rules governing the requirements for a qualified appraisal.) and

(2) attach to his tax return a fully completed "appraisal summary" (Sec. 1.170A-13(c)(4), Income Tax Regs., provides the rules governing the requirements for an appraisal summary..), including IRS prescribed Form 8283 to be used as the appraisal summary.

"[S]imilar items of property" must be aggregated in determining whether gifts exceed the $500 or $5,000 (annual) thresholds. (Sec.170(f)(11)(F)). The term "similar items of property" is defined as "property of the same generic category or type", such as clothing, furniture, electronic equipment, household appliances, toys, and everyday kitchenware. Sec. 1.170A-13(c)(7)(iii), Income Tax Regs.

2009 donations included:

Date	FMV	Basis	Computation Method
March	$2,164	$10,478	Consignment Shop Method
December	$16,250	$16,250;	

By the time of trial, IRS conceded $3,709 of in-kind contribution, disallowing $14,570, of noncash contributions. At trial the taxpayer petitioner offered no records and no testimony to substantiate the value of the disallowed $14,570 of noncash contributions. Taxpayer loses on all items.

II. CHREM .....(Gaming The Value).....05

(1) Mechanism of a related company purchasing 13% of stock from a donee charity creates problems.
(2) Taxpayer neither prepared nor filed an actual Appraisal for charitable donation.
(3) The "assignment of income doctrine" loomed as the buy value became more certain.
(4) Related companies in an intertwined merger, and a comprehensive appraisal could have avoided cost and an unwanted raised profile.

MARC CHREM AND ESTHER CHREM, ET AL.,1 Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent; T.C. Memo. 2018-164

The facts of this case will be abbreviated in style to emphasize a number of interesting possibilities.

There were two related companies that had almost identical management: SDI (U.S. Corporation), an electronics manufacturer, and Comtrad a Hong Kong corporation that performed quality services and testing for three related companies that produced and marketed consumer electronic products (however SDI accounted for 83% of Comtrad's revenue and 76% of its gross profit in 2011).

Taxpayer - Petitioners (along with eight other individuals or couples) owned 100% of the stock of Comtrad Trading, Ltd.(Comtrad), a closely held Hong Kong corporation. A closely related company proposed to purchase 100% of Comtrad's stock for $4,500 per share.

After Comtrad's shareholders **agreed** to tender about 87% of their shares to buyer, petitioners donated the balance of their stock (13%) to a charitable organization. The acquiring company then completed a 100% acquisition, (a) by purchasing the donated stock from the charity for $4,500 per share & then (b) the acquisition of the JCF shares for $4,500 per share ($4.05 million in aggregate). ($526,000 passed to the charity.)

However, this case is limited to the charitable donation. On their 2012 Federal income tax returns, petitioners claimed charitable contribution deductions for their in-kind gifts, valuing the donated stock at $4,500 per share. Taxpayer, rather than follow the rules on appraisal, simply stated that the value of the charitable contribution was the same exact amount at which the $4,500 per share buyout was made. IRS determined that petitioners had failed to (where applicable) obtain & attach to their returns "qualified appraisals" of the donated property, See §170(f)(11)(C) & (D).

Using regulatory guidelines and professional standards that it deemed relevant, Empire provided its estimate (not an appraisal)of the fair market value (FMV) of "100% of the ordinary shares of Comtrad." It employed a market approach and a discounted cash flow approach, and it applied a 5% downward adjustment to reflect a discount for lack of marketability. It concluded that the FMV of Comtrad, "valued on a going concern basis," was between $29.5 million and $32.4 million, or $4,214 to $4,626 per share.

Detailed sequence of events:

(1) Comtrad Shareholders as a group sign contract to sell 87% of shares for $4,500 per share to a related company acquirer, SDI,

(2) Comtrad Shareholders DONATE 13% of shares to a charity, based upon a pre-arranged plan where the charity will agree to sell the shares to related company acquirer for $4,500 per share.

(3) SDI related company acquirer purchases the 13% donated shares from the charity for $4,500 per share.

(4) Donating shareholders of the 13% of Comtrad shares FAIL to follow required appraisal steps for the in-kind stock they donated, including a formal appraisal to should have been submitted with the tax return.

(5) Donating taxpayers urge that the $4,500 per share arranged purchase from the charity is (bootstrap) substantiation enough because it is a clear recognition of value. (It also mirrors the IRS donation

mechanism for IP donation based upon actual dollars derived from a donation.)

Possible abuses:

(1). What if the stock involved had an actual value of much more than $4,500 per share? What if it were double? Passing a 13% slip stream through a charity to support a depressed $4,500 per share price could have enabled the 87% of the shares to be valued low where the shares were bought for a low price and with other business benefitting the sellers to be paid later on?

(2) However, given the closeness of Comtrad to SDI, the transaction can be likened to a ruse to hide an inflated transfer of a disguised-dividend from a foreign company to be treated as capital gains. A partial redemption of combined Comtrad-SDI shares would have only resulted in a dividend treatment. SDI appears to control Comtrad, & comprises 76-83% of Comtrad's business. Dissolving Comtrad might have been not much more than dissolving a shell company. (The complete transaction was not before the court)

Possible objective: to spread a transfer price over 15 years to provide an even chance for offsetting gains with losses.

Possible learning point. If some other mechanism had been used other than an in-kind share transfer, the extreme appraisal rules may not have operated to "invade" the planned transactions. What if the in-kind gift of 3 shares in exchange for just under $15,000 per year annual gift exclusion had been performed in through an escrow for each donor? For husband and wife split gifts the original planned $202,500 could have been given over 7 years. I'm sure there could have been a myriad of ways to inject cash into the charity and provide a charitable deduction over a longer period.

There are much more details if the possible abuses and possible goals are explored, and no one may know the purpose of the transaction. The take-aways for this case include:

(1) Can a transaction that involves charitable donation be done in a way that avoids the need for an appraisal?

(2) Can the objectives of a transaction be served without involving a charitable donation?

(3) A cursory appraisal should be outlined on paper before a transaction so that the parties can at least know what is coming should value be challenged regardless of whether a charitable donation is involved.

III. SKOLNICK .....(Pretend Appraiser).....07

(1) An appraisal can be rejected where it is so bare as to be non-analyzable

MITCHEL SKOLNICK AND LESLIE SKOLNICK, ET AL.,1 Petitioners v. CIR (ustc 6-3-2019) Docket Nos. 24649-16, 24650-16, 24980-16.

A central question is whether petitioners' horse-related activity, undertaken through Bluestone Farms, LLC (Bluestone Farms), constituted an "activity not engaged in for profit" within the meaning of § 183. Taxpayer Petitioner proposed Mr. Reid as an expert to value their herd of horses. Mr. Reid is the owner of Preferred Equine Marketing, Inc. (Preferred Equine), a bloodstock agency for the standard bred horse industry. Mr. Reid avers that since 1986 his company has served as an agent for sellers (and occasionally for buyers) at numerous public auctions and private sales of standard bred horses.

Mr. Reid also avers that Preferred Equine is now a leading bloodstock agency in North America and has participated since 1989 in auction sales of 20,000 horses generating gross proceeds of over $500 million. Indicating some familiarity with our Rules, Mr. Reid disclosed that he has not authored a publication during the past 10 years and has not testified as an expert witness during the past 4 years. Mr. Reid produced a 3-1/2-page report with a pair of attached spreadsheets in which he opined that "the appraisal of horses is not an exact science and is greatly influenced by numerous economic and social factors."

The Report

Mr. Reid provided a first spreadsheet listing 93 horses allegedly owned by Bluestone Farms in August 2010. A second spreadsheet listing 60 horses allegedly owned by Bluestone Farms in August 2017. Spreadsheets were compiled along with the report in February 2019. Spreadsheets list horses by category (weanlings, yearlings, brood mares, stallions/stallion shares, racehorses, and retired horses). For each horse the spreadsheet shows the sex, year of birth, parents (sire and dam), and Bluestone Farms' ownership percentage. The final column of each spreadsheet shows an "appraised value of Bluestone Farms' interest" in each horse. Excluding retired horses the appraised values range from $2,500 to $1,900,000.

Not even an experienced Dealer is an Appraiser, Dealer tracking of individual items, each as an individualized unit with a specific history (which would be considered in detail as an individual unit of purchase) is insufficient to treat in spread sheet fashion, even by an experienced broker using a "cumulative" view and as assisted by a mere spread sheet of individual unit characteristics.

Mr. Reid does not explain, in his report or in the attached spreadsheets, (a) how he arrived at these values (other than simply stating his experience in the marketplace), (b) how he used data from the database to generate his assigned, nor (c) does he include the database as an exhibit coordinated with his report.

Testimony by expert is governed by Fed. R. Evid. 702 and 703. The former provides that a witness who is "qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion" if his testimony will help the trier of fact and the following conditions are met:
• the testimony is based on sufficient facts or data;
• the testimony is the product of reliable principles and methods; and
• the expert has reliably applied the principles and methods to the facts of the case.

In the Tax Court, a party who calls an expert witness must cause that witness to prepare a written report, which is served on the opposing party and lodged with the Court before trial (rule 143(g)(1))
Rule 143(g)(1) also requires that the report "shall contain:"
(a) a complete statement of all opinions the witness expresses and the basis and reasons for them;
(B) the facts or data considered by the witness in forming those opinions; &
(C) any exhibits used to summarize or support his opinions."

Held: Mr. Reid's report does not satisfy the requirements of the Federal Rules of Evidence or this Court's Rules, because:
(a) no based data was identified or provided;
(b) no valuation "principles and methods" were identified in performing his appraisal;
(c) although nine factors that he believes affect valuation were identified, he does not explain how he applied or weighted those factors when attaching a dollar figure to each horse;
and thus he failed to "reliably applied the principles and methods to the facts of the case."

Further Mr. Reid avers that the valuation of horses "can be affected in a volatile way" by external factors

such as "governmental actions," but does not cite any actions or results.

Mr. Reid does not indicate that he personally viewed any of the horses, nor identify data used to evaluate, in February 2019, the conformation, health conditions, breeding/pregnancy status, or fertility of the horses.

Testimony based on scientific, technical, or other specialized knowledge is subject to the Court's gate keeping function, which forecloses expert testimony that does not "rest on a reliable foundation" or is not "relevant to the task at hand." (And under court rules if this was not done by trial, you can't go back and supplement it now).

IRS' motion in limine to exclude from evidence the expert witness report of David Reid was granted.

IV. EXELON .....(Bad Bad Appraiser).....09

(1)Undue Influence over an Appraiser is not positive and not good.
(2) When a client requires parroting of such an extensive amount content, the negative consequences to the property's owner, professional consequences to the owner's attorney and to the owners appraiser could have been devastating.

Exelon Corporation, v. CIR, 147 TC 9 September 19, 2016 (Like kind exchange of power plants)

To mitigate 1.6 Billion in gains, P attempts to create a 1031 exchange. P loses with extreme prejudice, perhaps because of P's manipulation of P's appraiser? The court held:
(1) The agreements between P and C and M are not true leases, but loans.
(2) no transfer of the benefits and burdens of ownership to P.
(3) The substance of the transactions is not consistent with their form.
(4) P not satisfy I.R.C. §1031 by exchanging power plant interest for interest in financial instruments.
(5) P is not entitled to depreciation deductions with respect to its transactions with C and M.
(6) P may not deduct interest or include rental income since the transactions are not lease agreements under I.R.C. § 467.
(7) P must include in income for the 2001 tax year original issue discount income arising out of P's equity contribution, and is to be repaid with interest via cancellation options in P's agreements with C and M.
(8) P is not entitled to deduct transaction costs related to its transactions with C and M and must instead include them as an additional amount lent to C and M.
(9) P is liable for accuracy-related penalties under I.R.C. sec. 6662 on the grounds of negligence or disregard of rules or regulations. P did not show reasonable cause and good faith under I.R.C. sec. 6664(c) to meet the exception for those penalties.

Winston & Strawn LLP (Winston & Strawn) was responsible for advice regarding the legal aspects of the transaction, including its tax consequences.

Appraisal of Replacement Properties :
Deloitte prepared appraisal reports for all three replacement properties as well as for the fossil fuel power plants sold by Unicom under the EME agreement. In preparing the reports, Deloitte sought to address specific requirements set forth in Internal Revenue Service (IRS) published guidance on leasing transactions, such as the requirements articulated in Rev. Proc. 75-21, 1975-1 C.B. 715, and Rev. Proc. 75-28, 1975-1 C.B. 752. By letter dated December 29, 1999, Winston & Strawn provided Deloitte with a list of "appraisal conclusions we anticipate will be necessary to support our tax opinion issued in connection with any leasing transaction entered into by ComEd [Unicom's subsidiary]." That list was later

reproduced nearly verbatim in Deloitte appraisal reports. A table was provided in the opinion with a side by side table of seven from the Winston & Strawn letter and corresponding conclusions appearing in the Deloitte appraisal. Puppeteering the appraiser to obtain a tax result is sort of "circular fraud."

Result: 1031 exchange was disallowed in a prejudicially maximizing way, but the attorneys and appraisers appear not to have been made subject to discipline or IRS debarment.

V. DALGLEISH .....(Lack of Communication).....10

(1) Who hires the appraiser is important (single party or jointly hired), and a statement of who receives and approves the appraisal should be provided to create clearer understandings.
(2) When the appraiser has worked for one of the two parties in a joint appraisal, significant time should be spent making sure that all the parties are informed and understand how the appraisal will be used.

STACY DALGLEISH v. PIERO SELVAGGIO (In re the Marriage of Stacy Dalgleish and Piero Selvaggio) (Los Angeles County Super. Ct. No. BD430584) 11/1/17

Husband Selvaggio disputed whether an appraisal met the requirements of a 2009 STIPULATED JUDGMENT in a marital dissolution proceeding which set interest as beginning to accrue from a May 1, 2003 date of a Transmutation Agreement. Selvaggio did not dispute the amount of the appraisal, and the judgment gave him no right to do so. Having lost his argument that the appraisal was not a joint appraisal (which was required by the judgment), he then owed interest on the amount that the appraisal set from the date that his equalization payment to Dalgleish following a joint appraisal of certain real property.

A comprehensive judgment ordered a joint appraisal, but did not provide any right or describe any procedure to challenge the results. An increase in value of $2,192,103, triggered a right of Dalgleish to receive interest on 50% of the increase (on $1,096,051.50). Much of the argument between Selvaggio & the judge was the date when interest begins and whether a Selvaggio's challenges delayed that beginning date of interest accrual, based upon a stated fiction that since "interest must be computed on a 'sum certain' and until the increase was known, there was nothing to compute (but this was a judgment).

§ 685.020 provides that interest commences to accrue on a money judgment on the date of entry of the judgment (2009). Paragraph 1.C.iii of the Judgment required the payment of money by Selvaggio to Dalgleish. That portion of the Judgment was therefore a "money judgment" for purposes of § 685.020. Here, the trial court's March 11, 2015 order did not result in a new judgment, but simply enforced the already existing Judgment. For purposes of accruing interest, the date of entry of the judgment is the critical date, not the date when any postjudgment challenges might be resolved. (§ 685.020, subd. (a).)

Thus, the general rule is that "[a] judgment bears legal interest from the date of its entry in the trial court even though it is still subject to direct attack." Only if a judgment is reversed on appeal does the new award subsequently entered by the trial court bear interest from the date of the new judgment.

Much of the challenge by Selvaggio's counsel, involved (1) proposing hiring the appraiser, (2) wanting to speak with the appraiser to discuss cost & neutrality, even though Sommer had previously acted as Selvaggio's unilateral appraiser. Despite no math error in the appraisal, there should have been some understanding that the appraisal itself became part of the judgment, and some basis for challenge.

In this case much could have been remedied from the start, with:
(1) A written set of rules and understanding of the judgment and bases for challenge.

(2) Court should have been explained to Dalgleish that the interest to be applied was for a long starting period, from 5/1/2003, through 9/2/2008. All of the misunderstandings could have been avoided.
(3) This case shows a huge "failure to communicate" and much of the responsibility rests with the judge & attorneys. Court action after the appraisal was a useless waste for Selvaggio. Court & attorneys should have prepared a pre-printed statement of how the appraisal fits into an unchangeable judgment.

(1) For success, identify the "value responsible" from the non-value responsible.

Ruthven: **MILO H. SEGNER, JR, as Liquidating Trustee of the PR Liquidating Trust, Plaintiff, v. RUTHVEN OIL & GAS, LLC, ET AL**., § Defendants. (USDC NDTX) 2018. (Segner) seeks to recover about $21.7 million of fraudulently transferred money from Cianna Resources, Inc (Cianna). Cianna could avoid liability by showing that it received the money in exchange for value, in good faith, and without knowledge that the transfer was avoidable. Verdict was pronounced for Cianna.

Dallas-based Provident Royalties (an investment company) hired Ruthven Oil & Gas, LLC (Ruthven) to help it find and acquire mineral interests, and Ruthven approached Cianna to help it find mineral interests for Ruthven. Cianna contracted to receive $500 per acre as Cianna's compensation. Provident transferred $48,812,882.24 to Ruthven, of which Ruthven sent $21,117,572.79 to Cianna. Provident filed for bankruptcy in June 2009. Trustee Segner wants to recover money back from both Ruthven and Cianna. Oklahoma Documentary Stamp Act (ODSTA) tax records indicate that Cianna overstated on ODSTA documents the value of the interests it transferred. Court held that this alone does not establish as a matter of law that Cianna knew or should have known that Provident was defrauding its investors. Trustee Segner characterized Cianna's stamp-tax misrepresentations as evidence that Cianna was part of, knew of, or should have known of Provident's scheme, but the jury disagreed.

Action:
"the trustee may recover, for the benefit of the estate, the property transferred . . . from (1) the initial transferee of such transfer or . . . (2) any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a). But "[t]he trustee may not recover under § (a)(2) of this §550 from (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided." § 550(b)(1). Cianna bore the burden at trial of establishing the elements of § 550(b)(1).

(a) UCC (definition of good faith requires only honesty in fact and observance of reasonable commercial standards) versus a bankruptcy good faith which requires no knowledge of dishonesty no knowledge of voidability (even under a "could not have uncovered the fraud" standard). Do valuations consider this standard? Bankruptcy often involves a rule-of-thumb that receipt of 70% of value received is "good enough" to not be suspect for voidable transfer purposes. Is this the reason that Cianna wins because Cianna was not responsible for valuing the interests it was buying? Or that someone was guessing value?

(b) In Ruthven, it was alleged that Cianna overstated on ODSTA documents the value of the interests it transferred (probably inuring to a bonus for the state tax coffers) and does not establish as a matter of law that Cianna knew or should have known that Provident was defrauding its investors.
Money path & compensation moved from Provident to Ruthven to Cianna, to the mineral owner.

(c) Value proposition: The Court disagreed. Cianna needed to show only value sufficient to support a contract. (a not an unconscionable contract). The fact that Cianna was not a valuation expert meant that it

had no way of knowing if the value was correct nor that the stamp act value was incorrect.

Conclusion:
Value seems to affect rights in a case as to what it is, how it is presented by the parties, etc.
Value failure can potentially divest partners; its better to be certain if this applies to you, or to get others to indemnify you. In addition, ODSTA could have required an appraisal, but did not.

(1) Failure from incompetence can be more costly than failure from coma.
(2) Taxing authorities are known to make laws forcing an abusing agency to pay for causing expense, time, and rights of a taxpayer; but they are usually are narrowly drawn.
(3) Narrow circumspection is economically beneficial for government at the expense of taxpayers, but does little to correct the tax collection efficiency of assessment, nor system improvement.

Land Partners, LLC v. County of Orange, Court of Appeal of California, Fourth Appellate District, Division Three, January 10, 2018, Opinion Filed. 19 Cal. App. 5th 741 | 228 Cal. Rptr. 3d 617

Rev. & Tax. Code, § 5152, (attorney fees) does not apply whenever an assessor merely fails to apply a statute or regulation. Under Rev. & Tax. Code, §§ 5152 and 538, an award of fees require a cognitive decision on the part of the assessor that a particular provision, rule or regulation is unconstitutional or invalid either on its face or as applied to the circumstances in the case. Accordingly, a factual finding by the court that the reason the assessor did not apply a particular provision was that he or she believed it to be unconstitutional or invalid is a prerequisite to an attorney fee award under § 5152. A taxpayer's request for attorney fees was properly denied because there was no such finding.

(a) Omission by government assessor is not enough to get attorney fees and (b) an "Economic Unit" is an important consideration in determining whether assessment is correct. Assessor had overvalued the property by at least $22 million. Taxpayer appeals based upon 5 factors that the assessor "failed to consider" and won. However, attorney's fees for the appeal are not available for error or intrinsic incompetence. If the assessor failed to apply a particular law, rule or regulation because the Assessor subjectively believed it was unconstitutional or invalid, attorney fees could have been awarded.

My mathematical interpretation of this case is that if the assessor computes 2+2=5, the assessor may be mental step defective, but its up to the taxpayer to correct the assessor. However, if the assessor adopts as a "subjective belief" (like a religious belief?), the law, rule, or regulation is unconstitutional or invalid that caused the computation 2+2=5, the taxpayer can recover attorney fees for correcting the assessor. Will an assessor ever go "on record" regarding a belief of unconstitutionality or invalidity?

(1) "Disregarded for tax" does not mean "disregarded for valuation"

SUZANNE J. PIERRE, Petitioner v. CIR (ustc 133 T.C. No. 2; 2009)

Taxpayer transferred cash and publicly traded securities ($2.45 Million) to LLC, a New York limited liability company, in exchange for a 100-percent interest in LLC. Taxpayer subsequently made a number of transactions, including four transfers of her interest in LLC to trusts established for the benefit of her son and granddaughter:

(1)gift a 9.5-percent interest in LLC to each trust.
(2) then, a sale of 40.5% interest in LLC to each trust in exchange for a note having a face amount of $1,092,133, plus interest. In valuing the transfers for Federal gift tax purposes, P applied substantial discounts for lack of marketability and control**.**

IRS position is that because the LLC started as a single member LLC, it is disregarded as the same as personal ownership and gets no discount. Respondent IRS argues that, because petitioner elected to treat Pierre LLC as a disregarded entity, she is properly treated as transferring two 9.5-percent undivided interests in the LLC's assets rather than two 9.5-percent interests in the LLC itself.

Held: Nothing in the check-the-box regulations or in the cases cited by respondent persuades us that those regulations require us to disregard a single-owner LLC where, as is the case here, to do so would be "manifestly incompatible" with the intent of other provisions of the Internal Revenue Code.

If the check-the-box regulations are interpreted and applied as respondent contends, they go far beyond classifying the LLC for tax purposes. The court will not accept that the check-the-box regulations apply to define the property interest that is transferred for such purposes. Congress has not acted to eliminate entity related discounts in the case of LLCs, single-member LLCs or other entities generally.

The regulation does not provide that an entity will be disregarded "for all Federal tax purposes". Instead, the regulation implements a statute that, by its terms, applies except where "manifestly incompatible with the intent" of the Internal Revenue Code. Sec. 7701(a).

Held: petitioner's transfers to the trusts should be valued for Federal gift tax purposes as transfers of interests in Pierre LLC & not as transfers of a proportionate share of the underlying assets of Pierre LLC.

(1) a challenge to the appraisal procedure results in a fresh (holistic) look upon appeal (contrasted with an attack on conclusions, or discretion or other matters of law)
(2) For special equipment associated with real estate (principles of "appraisal unit") and a prior year error in approach combine to dictate a proper result.

Luz Solar Partner Ltd., III v. San Bernardino County Appraisal Unit
Court of Appeal of California, Fourth Appellate District, Division Two; September 27, 2017, Opinion Filed E064882 Reporter 15 Cal. App. 5th 962 | 223 Cal. Rptr. 3d 451 | 2017 Cal. App. LEXIS 849

Luz contends that defendants and respondents San Bernardino County (County) and the Assessment Appeals Board of San Bernardino County (Appeals Board) erroneously relied on the Board of Equalization's (Board) incorrect interpretation of the applicable statutes governing the method of assessing the value of the property. Rejecting their contention, we affirm.

In 1980, the Legislature acted to exclude construction of certain active solar energy generation systems (SEGS unit) from property tax assessment. (Cal. Const., art. XIIIA, § 2.) Revenue and Taxation Code 73 excludes newly constructed energy systems from the definition of "new construction" and were not considered, for property tax purposes, to be improvements that add value. Between 1986 and 1991, Luz Partners built seven utility SEGS units.

For each of the early SEGS units, non-solar (Conventional natural gas boilers & furnaces) comprised 3% of the cost of construction and solar component (mirrors, conduits, generators, & transformers, were 97%

of the cost a SEGS unit.

Until 2010, San Bernardino County was the only county in California with real property improved with SEGS units, and the County had to develop its own procedure from scratch. The assessor did this by splitting the personal property improvements into solar (exempt) and non-solar (not exempt) based on the then-current market values, and placing the non-solar value on the assessment rolls under the fixtures category. The Assessor found that from year to year, these assessed values of the non-solar components declined by depreciation.

"Decline In Value: Excluded New Construction" with instructions to include the solar component of the SEGS unit in an estimate of full cash value of the solar property. Full cash value of the solar property (including items exempted under § 73) is considered for fair market comparison purposes to the factored base year value. Assessment is on a basis of the lesser of (1) base year value (i.e., the value of the property at the time of acquisition), as adjusted for inflation since the base year, not to exceed 2 percent each year, to produce the "factored" base year value and (2) full cash, or market, value.

However, when a property with excluded new construction sells, the excluded solar component of new construction becomes assessable along with everything else on the property. If a taxpayer claims a valid valuation method was improperly applied, a trial court is limited to reviewing the administrative record. However, where the taxpayer challenges the validity of the valuation method, the court is faced with a question of law, deciding whether challenged valuation method is arbitrary, in excess of discretion, or in violation of standards.

Luz Partners argument was: new methodology (1) violates §51 and §73 because it does not use the same "appraisal unit" to compare with the factored base year value & the current full cash value, and (2) treats the non-solar component as if it were appreciating. The key to the updated procedure is that §51 (rather than §73) provides that an appraisal unit is that which persons in the marketplace commonly buy and sell as a unit, OR that is normally valued separately."

According to the Board's guidelines, once a base year value of the solar property is established, (ignoring the value of the non-solar component) § 73's job is complete, and the focus shifts to § 51 which, in accordance with Proposition 13 (limiting any increase of the value of real property except upon change of ownership or new construction) and Proposition 8 (providing for a reduction in real property assessments for declining market value), to addresses appreciation/depreciation of solar property value.

Pursuant to §51, the Assessor is to base the tax assessment on the lesser of the solar property's factored base year value (i.e., non-solar equipment only, pursuant to § 73) or the solar property's current full cash value (i.e., both non-solar and solar equipment). Here, the lesser was the property's factored base year value. The value of the excluded solar equipment was never enrolled; it was only considered for comparing the factored base year value to the current full cash value. There was no violation of § 73 or any internal contradiction.

Prior to 2011, the SEGS unit was wrongly considered as two bifurcated components. However, after receiving instructions from the Board, the Assessor began assessing the factored base year value of the solar property based on § 51's 2 percent maximum index rather than as a depreciating asset. An assessor or appraiser must consider the latest changes in legal holdings and tax administration. In this case, the difference under the new procedures resulted in a tax increase for Luz Partners. Likewise an appraisal of the property would show a reduction in value from the higher taxes payable since the change in policy and interpretation of SEGS units.

X. KOLLSMAN.....(Ignoring Comparables is Incredibly Wrong)..... 15

(1) Art value trends rise and fall, and such data is well known, and should not be blindly ignored.
(2) Case language comes close to using the "F" word for suppressive depression of value, but stops short.
(3) "Cleaning" costs or refurbishment should not be overstated as it is an indirect suppression mechanism.
Estate of Eva Franzen Kollsman, Deceased, Jeffrey Hyland, Executor, v. CIR (unpublished)(ustc June 5, 2019) No. 18-70565 Tax Ct. No. 26077-09

A valuation professional was called upon to value a painting for an estate. Appraiser value was too low, to the extent that the tax return position taken on the low valuation was adjudged higher resulted in a deficiency in estate tax due in the amount $585,836. After audit and tax appeals, this tax court stated that the appraiser "failed to explain the nearly fivefold increase in value between his (the appraiser's) valuation and the sale price"

Incredibly, the appraiser "did not support his valuations with comparable sales data." To compound a bad situation (a) the appraiser "downplayed the importance of comparables in assessing value and failed to include any in his expert report," (b) "testified that when he arrived at his valuations, he was not 'interested' in comparables, and that the appraiser had (c) reviewed comparables only after the IRS challenged his methodology."

I don't know of any text that states that for any valuation approach for any item that the valuation expert can "IGNORE" all the other approaches regardless of circumstances. Appraiser "lack of interests" in an approach is not an excuse for treating and providing some valuation statements and computations in a report. Even if other valuation approaches are "not favored," there are factors that have to be reasoned, stated, supported and at least valued for the sake of elimination.

An appraiser cannot by fiat simply "dismiss" a possibility without exploring and evaluating it. It is often painful to put value approach factors on the table, but engaging in argumentation is what the judges want to see. The late Judge Laro of the tax court developed a "bath-tubbing" technique in which experts were encouraged to debate in extreme detail their approaches, assumptions and conclusions with the judge acting as an "inquisitive mediator". It has generally been known to get to the truth faster in more complex cases.

Curtis L. Harrington

The PATENTAX 浪人 - УДАРНИК

Contact: **HARRINGTON & HARRINGTON - PATENTAX®**
P.O. Box No. 91719, Long Beach, CA 90809-1719 patentax.com
Tel. (562) 594-9784; Fax (562) 594-4414 curt@patentax.com

Specialty: High Technology Patent / Trademark / Intellectual Property Law & Taxation

Education: **B.S.** Chemistry - Auburn University (1974)
M.S. Electrical Engineering - California State University Long Beach (1990)
M.S. Chemical Engineering - Georgia Institute of Technology (1977)
J.D. - University of Houston School of Law (1983)
M.B.A. - University of Oklahoma (1985)
LL.M. *Taxation* - University of San Diego School of Law (1997)

Admitted to Practice: Supreme Courts of California, Arizona, Texas, & Nevada
U.S. Supreme Court; U.S. District Court, C.D. - CA & S.D. - TX
Internal Revenue Service U.S. Patent and Trademark Office
U.S. Court of Appeals for the Federal, Fifth & Ninth Circuits
California Dept.of Real Estate - Broker; Los Angeles County CA EMT-Basic
U.S. Tax Court FCC-Commercial & Amateur Extra
Certified by The State Bar of California Board of Legal Specialization: Taxation

Languages Japanese Language Proficiency Exam, (Japan Foundation), Level 4; Kanji Proficiency Exam (Kanji Aptitude Testing Foundation) Level 7, recognized by Japan Ministry of Education, mastery of 640 kanji; Russian reading ability.

Patents Issued Prepared & prosecuted patents, in electrical, chemical & mechanical technologies technical specialty: optics, fiber optics, cryogenics, electromagnetics, & computers.

Litigation Associate counsel in patent & trade secret litigation; Municipal Court Judge pro tem & Superior Court Mediation program Attorney-Client fee Dispute Arbitrator, Long Beach Bar Association; Patent Panel, American Arbitration Association.

Teaching Adjunct Law Professor, Golden Gate University School of Law, LL.M. Taxation Program; Georgia Institute of Technology - previously taught heat and mass transfer laboratories, and analog and digital computer laboratory.

Member: **Current Member**: State bars of California, Texas, Arizona & Nevada; California Lawyer's Association (Business & Tax Sections) Central District Consumer Bankruptcy Attorneys Association (2011-Pres); Texas Bar College (2018-pres); & Fellow, National Tax Practice Institute. **Past Member**: Member (2006-2016) of California State Bar Board of Legal Specialization, including Taxation Advisory Committee Chair (2010-11) and Chair of the California State Bar Board of Legal Specialization; Southern California Bankruptcy Inn of Court (2011-2012); Long Beach Bar Assn.(Bd. of Governors, 1994-95); Orange County Bar Association, (Co-Chair Technology Law Section 1996); CA Society of Enrolled Agents (Orange Co. Chapter President 2003-2004); Registered Parliamentarian - National Association of Parliamentarians; Sema Business Management Committee (1997-98); CEB committee (1999-2000); Taxation Section Executive Committee (2002-2005); Income & Other Tax subcommittee (Chair 2000-2002); Special Master, CA State Bar Association for Search Warrants under Penal Code 1524 (2001-2002).