



## Pension Protection Act Discussion: Impact on Real Estate Appraisers

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On August 17, 2006, President Bush signed into law the Pension Protection Act (Public Law 109-280), which includes a series of reforms relating to charitable activities. Included in these reforms are new definitions relating to appraisers and appraisals of property for charitable deduction purposes, such as conservation and historic preservation easements and estate and gift taxes. On October 19, 2006, the Internal Revenue Code issued "Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions (Notice 2006-96).

The following is a discussion of the new law between Bill Garber, Director of Government Affairs and Don Kelly, Chief External Relations Officer of the Appraisal Institute.

*Notice: Nothing herein is to be considered the rendering of legal or tax advice, and readers are responsible for obtaining such advice from their own professional advisors.*

*Questions? Contact Don Kelly, Chief External Relations Officer, Appraisal Institute, 202-298-5583, [dkelly@appraisalinstitute](mailto:dkelly@appraisalinstitute) or Bill Garber, Director of Government Affairs, Appraisal Institute, 202-298-5586, [bgarber@appraisalinstitute.org](mailto:bgarber@appraisalinstitute.org) or*

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### **Garber: The Pension Protection Act (PPA) defines "qualified appraisers" working before the IRS -- Who is now eligible to perform appraisals for tax returns involving noncash charitable contributions?**

Kelly: The Pension Protection Act (PPA) specifies that such appraisals are to be performed by a "qualified appraiser," which is defined in the Act to mean a person who has earned an appraisal designation from a recognized professional organization or has met minimum education and experience requirements established by the Treasury Secretary through regulations. On October 19, 2006, the IRS issued *Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions* (Notice 2006-96). This transitional guidance states that the IRS accepts designations awarded on the basis of "demonstrated competency" in valuing the type of property for which the appraisal is performed. Designations conferred by professional appraisal organizations such as the American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and Appraisal Institute meet this definition, as they require education, testing, experience and demonstration of knowledge, understanding and ability.

The transitional guidance further requires the appraiser to make a declaration that, because of background, experience, education and membership in professional associations, the appraiser is qualified to appraise the type of property being valued. This declaration should be contained within the appraisal report.

Alternatively, and with respect to real property only, appraisers licensed or certified to appraise the type of property being appraised in the state in which the real property is located meet the

minimum education and experience requirements under the transitional guidance, and are also eligible to perform appraisals of charitable contributions of real property.

**Garber: The PPA also defines a “qualified appraisal” for appraisals of noncash charitable contributions – what appraisal standards now apply?**

Kelly: The transitional guidance defines a “qualified appraisal” as one that is conducted in accordance with generally accepted appraisal standards; it cites, as an example, an appraisal that is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice, as developed by the Appraisal Standards Board of The Appraisal Foundation.

Additionally, for appraisals of conservation or preservation easements (or similar restrictions), appraisers should follow the existing valuation guidance set out in Treasury Regulation 1.170A-14(h). Also, appraisers should avoid using a “rule of thumb” or other simplified valuation methodologies, which have been severely criticized in recent years by the IRS. Additional guidance is available from existing publications such as J. Reynolds, *Historic Properties: Preservation and the Valuation Process* (Appraisal Institute, 2006) and *Appraising Easements* (Land Trust Alliance/National Trust, 1999).

**Garber: When do the new “qualified appraiser” and “qualified appraisal” requirements take effect?**

Kelly: The new requirements are effective for appraisals prepared for returns or submissions filed after August 17, 2006. If an appraisal was prepared for a return filed on or before August 17, 2006, the old IRS appraisal and appraiser requirements apply.

**Garber: Do appraisers need to present verifiable education and experience to meet the “qualified appraiser” requirement?**

Kelly: Yes, pursuant to the PPA, an appraiser will not be treated as a “qualified appraiser” unless the appraiser demonstrates verifiable education and experience for valuing the type of property subject to the appraisal. Also, the appraiser must not have been prohibited from practicing before the IRS at any time during a three-year period prior to the date of the appraisal.

**Garber: Where can appraisers obtain education on the appraisal of conservation easements?**

Kelly: The American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and Appraisal Institute are developing a certificate program for real estate appraisers on the appraisal of conservation easements. The program will combine elements from past programs offered by these appraisal organizations on the appraisal of conservation easements into a stand-alone certificate program (with a test).

The program is the product of a memorandum of understanding between the three appraisal organizations and the Land Trust Alliance, and it is meant to help appraisers meet the new definition of “qualified appraiser” and to assist land trusts in identifying qualified appraisers in

compliance with the PPA. The program will be available to appraisers through each appraisal organization's education outlets in addition to the Land Trust Alliance Rally in 2007.

**Garber: Is a similar program also contemplated to assist qualified appraisers on the appraisal of historic preservation easements?**

Kelly: Yes, development of a similar educational program is scheduled for 2007. It will likely be developed in cooperation with the Congressionally-chartered National Trust for Historic Preservation.

**Garber: Do appraisers need to provide any additional statements or declarations in my appraisal report?**

Kelly: All appraisals performed for returns filed after February 16, 2007 should include the newest version of Form 8283, which was released by the IRS in December 2006. All appraisals performed for filings after this date must include an additional statement relating to substantial or gross valuation misstatements. The statement should acknowledge the appraiser's understanding that a substantial or gross valuation misstatement resulting from an appraisal of the value of property that the appraiser knows (or reasonably should have known) would be used in connection with a tax return or claim for tax refund may subject the appraiser to a civil penalty.

The new Form 8283 has been revised to include this statement.

**Garber: If an appraiser prepared an appraisal after August 17, 2006, for a return that will not be filed until after February 16, 2007, should he/she attach an additional statement relating to substantial or gross valuation misstatements to the Form 8283 already signed for the taxpayer?**

Kelly: Yes, if the appraiser has already signed the old Form 8283 and provided it to the taxpayer for a return to be filed after February 16, 2007, he or she should provide an additional statement relating to substantial or gross valuation misstatements as explained above. The appraiser should send the statement to the taxpayer so the taxpayer can attach the statement to the Form 8283.

A statement similar to the following should suffice in most instances: *"I understand that this appraisal will be used in connection with a tax return or claim for refund, and a substantial or gross valuation misstatement resulting from this appraisal may subject me to a civil penalty under Section 6695A of the Internal Revenue Code."*

**Garber: The PPA also provides for new penalties against appraisers – generally, how have the rules changed?**

Kelly: As a result of the PPA, the IRS now has the ability to suspend or disbar an appraiser from practicing before the IRS without the previous "aiding and abetting" standard. Additionally, the IRS now has the ability to enact civil money penalties against appraisers based on "substantial" or "gross" misvaluations, and the substantial and gross misvaluation thresholds have been lowered and also apply to estate and gift tax appraisals.

**Garber: What penalties are involved with a “gross” or “substantial” misstatement?**

Kelly: The penalty can range from \$1,000, up to a maximum of 125 percent of the gross income (the fee) received by the appraiser for preparing the appraisal.

**Garber: How does the PPA define “gross” and “substantial” misstatements?**

Kelly: The PPA lowers the percentages for gross and substantial misstatements to become applicable in a greater number of cases. A “substantial valuation misstatement” would now occur if the value used is 150 percent (or more) of the “correct value.” For estate or gift tax purposes, a substantial misstatement occurs if the value used is 65 percent (or more) off of the “correct value.”

A “gross valuation misstatement” would occur if the value used is 200 percent (or more) of the “correct value.” A “gross valuation misstatement” will be deemed to occur for gift or estate tax purposes if the value used is 40 percent (or more) off of the correct value.

**Garber: Who determines the “correct value?”**

Kelly: The PPA prohibits penalties on appraisers who have established that the value in the appraisal was “more likely than not the correct value” to the satisfaction of the IRS. However, the IRS, not a court, will make the determination of whether the appraised value is “more likely than not” the correct value. In other words, to avoid such penalties, the appraiser must establish the value is “more likely than not the correct value” to the satisfaction of the IRS.

For example, if an appraiser is engaged to perform an appraisal of a conservation easement for a noncash charitable contribution, and subsequently provides an appraised value of \$1,500,000 for a property the IRS determines the “correct value” be to only be \$750,000, than that appraiser would have made a “gross valuation misstatement.” Likewise, if the “correct value” were determined by the IRS to be \$1,000,000 or less, the appraiser would be subject “substantial valuation misstatement” penalties.

**Garber: Will the IRS use Standard 3 of USPAP as the basis for reviewing appraisals?**

Kelly: This issue was not clarified in the transitional guidance or in the PPA; thus, it is unknown at this point. The IRS defined “qualified appraisal” to mean appraisal performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP), but the transitional guidance does not say whether this standard would apply to IRS review appraisers and engineers. This issue is of paramount importance, as how the IRS determines the “correct value” becomes critical to the fairness and integrity of the appraisal review and appraiser sanctioning system.

The American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and Appraisal Institute believe appraisal reviews should be performed in accordance with Standard 3 of USPAP and that the IRS should clarify the review and appraiser sanctioning process. There are a variety of options available to the IRS that can help ensure fairness and transparency to this process, such as fielding peer review panel to help make the correct value determination. We have provided comments to the IRS on this issue in our comment letter on the

transitional guidance, and we look forward to working with the IRS to create a fair and understandable process for appraisers.

**Garber: If a taxpayer who obtained an appraisal that is subsequently deemed by the IRS to be incorrect opts not to contest the IRS determination of correct value, will the appraiser have the opportunity to defend his or her work, or would the taxpayer's decision not to contest seal the appraiser's fate?**

Kelly: The PPA prohibits penalties on appraisers who have established that the value in the appraisal was "more likely than not the correct value" to the satisfaction of the IRS. Because of this, we anticipate any attempt by the IRS to sanction an appraiser will involve a separate examination or case involving the appraiser, although this is not stipulated in the transitional guidance. The rules governing practice before the IRS, including disciplinary proceedings, are published in IRS Circular 230.

**Garber: Do the new appraisal and appraiser requirements apply to appraisals for estate or gift taxes?**

Kelly: Although the definitions of "qualified appraisal" and "qualified appraiser" are currently focused on noncash contributions (they appear in the section of the tax code relating to charitable contributions), we believe the IRS has the authority and may broaden the application to other tax code sections. Arguably, it may be the intent of Congress for the new definitions to apply to estate and gift tax appraisals as the Joint Committee on Taxation issued an interpretative statement at one time that suggested this.

For the time being and out of an abundance of caution, therefore, appraisers may want to interpret the new definitions as applying to tax-related appraisals in general. At the conclusion of the implementation process by Treasury and IRS, we should have a more definitive answer to this question.

**Garber: Where can appraisers find the transitional guidance, IRS Circular 230, the new Form 8283 and Treasury Regulation 1.170A-14(h)?**

Kelly: *The Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions* (Notice 2006-96) can be found at [http://www.irs.gov/irb/2006-46\\_IRB/ar13.html](http://www.irs.gov/irb/2006-46_IRB/ar13.html).

Copies of a Notice of Proposed Rulemaking on IRS Circular 230 can be found at <http://www.irs.gov/pub/irs-regs/122380002.pdf>, and the IRS Circular itself can be found at <http://www.irs.gov/pub/irs-pdf/pcir230.pdf>.

Treasury Regulation 1.170A-14(h) can be found at [http://www.lta.org/publicpolicy/treasury\\_regs\\_on\\_ce.pdf](http://www.lta.org/publicpolicy/treasury_regs_on_ce.pdf).

The new Form 8283 can be found at <http://www.irs.gov/pub/irs-pdf/f8283.pdf>