# The Qualified Appraisal Requirements Aren't That Complicated

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In this article, Sharkey and Paolillo criticize a recent analysis of qualified appraisal standards, explaining the correct standards and arguing for equitable application of an IRS settlement program.

In a recent article,[1] Russell Shay examined how the new IRS settlement initiative for some conservation easement cases docketed in the Tax Court, and the recent Tax Court opinion in *Savannah Shoals LLC*,[2] could result in the settlement of hundreds of those cases. Although it wasn't his main point, Shay's article does a disservice by wrongly suggesting that the Tax Court has been misapplying the requirements for a "qualified appraisal" in section 170(f)(11).

Shay is critical of the Tax Court for applying what he calls an "it's written on paper by a person who has an appraisal business" standard for "qualified" appraisals. But that is the essence of the law, crudely stated, bearing in mind that a person must be licensed under state law to have an appraisal business, and Shay is wrong to suggest that the Tax Court should be applying a more stringent standard.

Relatedly, Shay claims that it was ironic for the Tax Court in *Savannah Shoals* to hold that the petitioner's appraisal was a qualified appraisal while rejecting most of its conclusions. But there is no irony in that holding. Rather, it perfectly illustrates the difference between a substantiation requirement (an appraisal that enables the IRS to understand and evaluate the basis for a reporting position) and substance (presenting sufficient evidence to support the claimed valuation in court).

## The Qualified Appraisal Requirement

The requirement that taxpayers obtain a qualified appraisal to substantiate noncash charitable contribution deductions exceeding $5,000 (and attach a summary of the appraisal to their return) was established in section 155(a) of the Deficit Reduction Act of 1984. Congress enacted the provision off-code and directed Treasury to issue regulations implementing it.[3]

In 1988 Treasury finalized reg. section 1.170A-13(c), providing the requirements for an appraisal document to be considered a qualified appraisal. The requirements state that a qualified appraisal must be performed by a qualified appraiser, defined as an individual who executes a declaration stating that they regularly perform appraisals and have the qualifications to appraise the contributed property and who is not excluded

[1] Russell Shay, "Will Common Sense Clear the Tax Court's Conservation Easement Docket?" *Tax Notes Federal*, June 17, 2024, p. 2157.

[2] *Savannah Shoals LLC v. Commissioner*, T.C. Memo. 2024-35.

[3] Deficit Reduction Act section 155(a)(1); H.R. Conf. Rep. 98-861, 1984 U.S.C.C.A.N. 1445, 1683-85 (Jun. 23, 1984).

because of their relationship to the property or the parties to the donation.

In 2004 Congress codified the requirements of Deficit Reduction Act section 155(a) in section 170(f)(11) and added the requirement that taxpayers attach a copy of the appraisal to their return if the contributed property is valued in excess of $500,000.[4] New section 170(f)(11)(E) defined a qualified appraisal by reference to guidance prescribed by the Treasury secretary.

In 2006 Congress amended section 170(f)(11)(E) to provide a statutory definition of a qualified appraiser.[5] The amendment moved the existing definition of a qualified appraisal to section 170(f)(11)(E)(i)(I); added subclause (II), further providing that a qualified appraisal is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any guidance prescribed by the secretary under subclause (I); and added clauses (ii) and (iii), setting forth minimum education and experience requirements for qualified appraisers that were to be developed by the secretary.

In October 2006 the IRS issued Notice 2006-96, 2006-2 C.B. 902, providing transitional guidance on the new definitions in section 170(f)(11)(E). The notice provided that (1) an appraisal would be treated as a qualified appraisal if it complies with the requirements of reg. section 1.170A-13(c); (2) for real property, appraisers would be treated as having met the minimum education and experience requirements if they were licensed or certified appraisers in the state where the property is located; and (3) an appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards if, for example, the appraisal is consistent with the substance and principles of Uniform Standards of Professional Appraisal Practice (USPAP). Taxpayers could rely on Notice 2006-96 until Treasury finalized regulations under section 170(f)(11)(E).

In July 2018 Treasury finalized reg. section 1.170A-17. The new regulation expanded on the minimum education and experience requirements for qualified appraisers but largely retained the qualified appraisal requirements from Notice 2006-96, including the guidance on generally accepted appraisal standards. The regulation applies to contributions made on or after January 1, 2019.

### No 'Statutory Standards' in Amendments

Shay's criticism of the Tax Court's decisions on the qualified appraisal issue is premised on his erroneous assertion that the 2006 amendments to section 170(f)(11)(E) created substantive standards for qualified appraisals. Those amendments established new requirements for qualified appraisers. The definition of a qualified appraisal was modified to incorporate the new appraiser requirements, but there is no indication that Congress intended the modification in section 170(f)(11)(E)(i)(II) to create a new requirement that qualified appraisals satisfy substantive appraisal standards.

The nonspecific language used and the repeated delegations of authority to the secretary strongly suggest that Congress did not intend to create substantive statutory appraisal standards with the addition of the subclause. More fundamentally, the standards that Shay envisions would be out of place in section 170(f)(11), which provides substantiation and reporting requirements for all kinds of noncash charitable contributions.

The legislative history suggests that the "in accordance with generally accepted appraisal standards" language came from a proposal by the Joint Committee on Taxation warning that taxpayers were relying on "rule of thumb" appraisals to substantiate deductions for contributions of façade easements on their personal residences.[6] While a valuation based on a rule of thumb for which there is no support may violate all generally accepted appraisal standards, those are not the kinds of appraisals involved in cases like *Savannah Shoals*. There is plenty of support for discounted cash flow easement valuations in case law as well as the IRS's "Conservation Easement Audit Technique Guide."

[4]P.L. 108-357, section 883, 118 Stat. 1418, 1631-32.

[5]P.L. 109-280, section 1219(c), 120 Stat. 780, 1084-85.

[6]JCT, "Options to Improve Tax Compliance and Reform Tax Expenditures," JCS-02-05, at 283-285 (Jan. 27, 2005).

**Notable Easement Valuation Cases**

| Case | Notable Appraiser Value | IRS Value | Tax Court Value |
|---|---|---|---|
| *Kiva Dunes Conservation LLC v. Commissioner*, T.C. Memo. 2009-145 | $30,588,235 | $1,210,000 | $28,656,004 |
| *Champions Retreat Golf Founders LLC v. Commissioner*, T.C. Memo. 2022-106 | $10,427,435 | $20,000 | $7,834,091 |
| *Glade Creek Partners LLC v. Commissioner*, T.C. Memo. 2020-148 | $17,504,000 | $632,000 | $8,876,771 |

### USPAP Compliance Is Not Required

Shay incorrectly suggests that an appraisal must follow USPAP to be a qualified appraisal. The statute doesn't mention USPAP, and the regulations don't require USPAP compliance. In Notice 2006-96, consistency with the substance and principles of USPAP was given as an example of generally accepted appraisal standards. And when the IRS finalized regulations interpreting the statute a dozen years later, it declined recommendations to interpret "generally accepted appraisal standards" as requiring compliance with USPAP.[7]

An evaluation of every appraisal used to support a charitable contribution deduction for USPAP compliance is beyond the scope of section 170(f)(11) (and likely well beyond the IRS's capabilities). The qualified appraisal requirements are substantiation requirements designed to be helpful to the IRS in processing and auditing returns, but they are unrelated to the substance or essence of whether a charitable contribution was made, so they may be satisfied by substantial compliance.[8] Almost all IRS challenges to the appraisals in the cases before the Tax Court are challenges to valuation, and they should not be presented as challenges to the taxpayers' satisfaction of section 170(f)(11).

Notably, what Shay interprets as irony in *Savannah Shoals* is actually an example of the Tax Court following the purpose of substantiation requirements. It is clear from the Tax Court's opinion that a finding that an appraisal was qualified does not preclude a substantive evaluation of the contents of that appraisal in the context of valuation. The question is not whether the appraisal was conducted in such a way that the IRS or the court agrees with its method and inputs, but whether the taxpayer provided enough information for the IRS to determine if further investigation of the underlying return position is warranted. Taking the former view would make the qualified appraisal requirement an all-or-nothing proposition predicated on an extremely subjective standard, which is inconsistent with a substantiation requirement.

### The Notable Appraiser That 'We Know'

Shay bemoans what he sees as a lack of enforcement by the IRS Office of Professional Responsibility against "appraisers that the Tax Court has found, time and time again, to have vastly overvalued donations," and in the next sentence he references but doesn't name "a notable syndicated conservation easement appraiser" who surrendered his state license in lieu of facing a disciplinary proceeding. Although Shay doesn't expressly connect the two thoughts and provides no citations, the implication is that the notable appraiser is the one who the Tax Court has found to have vastly overvalued donations repeatedly.

The appraiser to whom Shay refers has not been repeatedly found by the Tax Court to have vastly overvalued donations, and his valuations have been substantially upheld in several notable cases, as shown in the table.

These cases demonstrate that some conserved properties can qualify for large deductions based on highest and best use valuations. They also

[7] T.D. 9836, 83 F.R. 36417-01, 36420 (July 30, 2018).

[8] *Bond v. Commissioner*, 100 T.C. 32, 41-42 (1993).

highlight the consistent assertion of vastly deflated easement values by the IRS, even when the extinguished development rights are demonstrably valuable. There appears to be no similar concern as to whether the IRS valuations were proffered in good faith.

### A Point of Agreement

We wholeheartedly agree that the Tax Court needs relief from the large number of conservation easement cases on its docket. Several recent trials have lasted multiple weeks, and the pretrial motion practice in many cases has consumed tremendous resources of the parties and the court without producing significant results.[9]

As litigation of those cases plays out, it is becoming clearer that nearly all of them will come down to valuation. While valuation disputes depend on the circumstances of each property, they are susceptible to settlement. We applaud the IRS's effort to offer a reasonable baseline settlement for easement cases.

Recently, the IRS announced that it is mailing time-limited settlement offers to taxpayers that participated in syndicated conservation easement transactions.[10] While that's an encouraging step, the IRS has indicated that the offers will be sent only to taxpayers with cases still under examination. It hasn't announced any intention to offer those settlement terms to partnerships that are in Tax Court litigation.

The announced offers reportedly provide for a more advantageous taxpayer settlement than the standard settlement that is being offered to syndicated conservation easement partnerships docketed in Tax Court. The standard settlement being offered in docketed cases provides that investors will: (1) receive an ordinary deduction equal to the amount of their contribution to the partnership; (2) have their charitable contribution deduction disallowed and the resulting income taxed at ordinary rates; and (3) be subject to a 10 percent accuracy-related penalty on the resulting liability.

The new settlement offer reportedly deviates favorably from that formula by: (1) imposing a flat 21 percent tax on the income from the disallowed deduction; and (2) applying a reduced 5 percent accuracy-related penalty to the deficiency. However, the offers are reportedly being extended for an extremely short time of only 30 days, and the partnerships will be required to fully pay the agreed settlement liability upfront.

Again, the new settlement offer is an encouraging development. However, while we recognize that the IRS has devoted significant resources to many long-docketed cases, questions must be raised: Why is this new settlement initiative so limited in scope and timing? Is it fair for some taxpayers who invested in easements more recently (well after IRS Notice 2017-10, 2017-4 IRB 544) to be treated more favorably than taxpayers who invested earlier and are more likely to be in Tax Court? Should this new offer not also be proffered to most easement partnership cases that are docketed in Tax Court?

If the IRS is truly committed to resolving the burden of these cases on the Tax Court, taxpayers, and its own personnel, we encourage it to extend the new settlement terms to all syndicated conservation easement partnerships and their investors. Further, we encourage the IRS to reasonably evaluate settlement offers in docketed cases that deviate from the baseline and accept them when warranted. ■

[9] In his concurring opinion in *Valley Park Ranch LLC v. Commissioner*, 162 T.C. No. 6, at 31-33 (Mar. 28, 2024), Judge Ronald L. Buch remarked on the flood of conservation easement cases facing the Tax Court and explained how, counterintuitively, the summary judgment practice in such cases has created uncertainty in the law and caused delay.

[10] IR-2024-174 (June 26, 2024).