SELECTING AND WORKING WITH VALUATION FIRMS

Presentation for
Attorneys for Family Held Enterprises
Annual Meeting and Conference

May 20, 2004

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I. INTRODUCTION

Valuation issues are pervasive in representing family held businesses, for both tax and nontax reasons. The Federal tax laws rely extensively upon valuation issues in establishing tax liabilities. The court in *Estate of Eldon L. Auker v. Commissioner*[1] stated that 243 sections of the Code require a fair market value determination in connection with the proper determination of tax obligations. An estimated 15 million returns per year are filed in which valuation related events are reported. The ACTEC Business Planning Committee's "*Estate Planner's Manual for Evaluating Appraisals and Appraisers*"[2] estimates 215 sections of the Internal Revenue Code rely upon the concept or term "fair market value" or "value". The ACTEC Manual also noted that 865 sections in the Treasury Regulations and 4300 Tax Court decisions exist using the term.

For attorneys representing family business, valuation issues commonly arise in the following contexts:

- Gift, estate, and generation skipping transfer tax planning and compliance
- Preparing and implementing Buy and Sell Agreements
- ESOPs
- Equity based compensation planning for key employees
- Determining the step up in basis adjustment after death
- Supporting charitable deductions
- Administering estates
- Dividing assets in the context of divorce proceedings
- Minority shareholder disputes
- Mergers and acquisitions

As a result attorneys who represent family held businesses often are intimately involved in the selection of valuation firms, the preparation of reports, and the utilization of the final work product. These reasons alone are sufficient to justify developing a better understanding of the selection of valuation firms and how to work most effectively with them.

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[1] T.C.M. 1998-185.

[2] "*Estate Planner's Manual for Evaluating Appraisals and Appraisers*" (draft 2004) (hereinafter cited and referred to in the text as the *ACTEC Manual*).

Additional reasons exist, however, that make this topic even more important to attorneys representing family businesses. The prevalence of audits of estate tax returns and the amounts at stake in estate or gift tax litigation make valuation reports that are prepared to support gift plans, gift tax returns, and for estate tax compliance the first line of defense to the audit. A well prepared and documented valuation report can discourage the IRS from aggressively attacking the reported position, or improve the likelihood of sustaining the reported position or achieving a favorable settlement for the client.

Moreover, decisions over the past ten years from the Tax Court and other courts have provided numerous examples where the courts have criticized, rejected, disagreed, or disregarded the work of appraisers, often for avoidable reasons. Improving the valuation process can reduce the likelihood of our clients being the subject of similar criticism. If the report complies with the adequate disclosure regulations[3] a period of limitations will commence running that will ensure that valuation is not reopened in future years in connection with other gift tax audits or upon audit of the estate. A properly prepared valuation report also can shift to the IRS the burden of proof in litigation.[4] Finally, a proper valuation may avoid the accuracy penalty under Section 6662.[5]

II. SELECTION OF VALUATION FIRMS

Preliminary Considerations

If a client requires the services of a valuation firm for the first time, or is seeking to hire a new valuation firm, and time permits, the client should start the process early. Hastily prepared reports are more prone to mistakes. Valuation firms are frequently busiest during the final months of the year and during the first quarter of each year as they provide their clients with information for year end planning and for gift tax compliance. The summer months can be a good time to initiate a search for a valuation firm as workloads for the estate planning lawyer and the valuation firm can permit the search to take place at a more relaxed pace.

Kinds of valuation firms

In any given community clients and their advisors may have literally dozens of different valuation firms from which to select. In Western Michigan where our firm is located valuation firms break into three strata:

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[3] Treas. Regs. § 301.6501(c)-1(f)(3).

[4] I.R.C. § 7491. Historically the burden of proof on valuation matters rested with the taxpayer. *See Estate of Mitchell v Commissioner*, 250 F.3d 696, 701-02 (9th Cir. 2001); *Cohen v. Commissioner*, 266 F.2d 5, 11 (9th Cir. 1959); Tax Court Rule 142. Section 7491 shifts the burden of proof in tax cases to the IRS after the taxpayer produces *credible* evidence that it has complied with Section 7491's requirements. In addition to the credibility requirement, Section 7491 has four additional requirements that must each be satisfied in order to shift the burden of proof to the IRS: (1) the taxpayer must comply with the substantiation requirements of the Code and Regulations; (2) the taxpayer must maintain records as required by the Code and Regulations; (3) the taxpayer must cooperate with reasonable requests from the Service, including exhausting administrative appeals; and (4) taxpayers other than individuals and estates must meet certain net worth limitations applicable to awarding attorney's fees. I.R.C. § 7491(a)(2); Sen. Rep. 105-174. This provision applies to taxable periods or events beginning or occurring after July 22, 1998.

[5] See I.R.C. § 6664(c); Treas. Regs. § 1.6664-4(b).

Smaller accounting firms

Many small accounting firms offer valuation services. Frequently these valuations are done by individuals as an adjunct to their accounting practices. The persons doing the work have received some training, but may not have been accredited by the major accrediting organizations, such as the American Society of Appraisers. Their resources to prepare and support valuations are limited, they often rely upon "canned" programs to prepare the valuations, they have none or little experience defending valuations in Tax Court, and they may have a difficult time qualifying as an expert under the Federal Rules of Evidence. Their principal virtues, and attractions to clients, are often twofold: (1) The accountant knows the client and the business (most often the accounting firm also does the accounting work for the business), is a trusted advisor, and the client likes the one stop shopping aspect of using the accountant; and (2) the cost of valuation reports prepared by this kind of firm can be significantly less.

Regional Valuation Firms and the Valuation Arms of Larger Accounting Firms

These kinds of firms are more costly than the smaller accounting firms, but generally are less expensive than the national valuation firms. These valuation firms bring greater expertise and focus to their practices. The individuals preparing the valuation reports are almost always accredited, focus their practices almost exclusively on valuation work, and have experience testifying in court.

In many instances the valuation firms are "boutique" firms headed, owned, or run by individuals that once worked in larger, national firms. When selecting a small boutique firm, attention to the depth of the firm is important. For example, if the valuation firm is essentially a solo practitioner, it is important to recognize and consider the possibility of retirement, illness, or death of the appraiser.[6]

National Valuation Firms

National valuation firms such as Management Planning, Duff & Phelps, and Willamette Management Associates, come a higher cost, but bring considerable sophistication, experience, and credentials to the engagement. Their large valuation practices also bring depth to the engagement; unlike smaller firms or boutiques, these organizations are not dependent upon one or a small number of individuals. Their broad practices offer considerable experience across a wide variety of industries and they are able to maintain sophisticated databases and conduct their own studies. They will have experience defending valuations against challenges by private parties, the Internal Revenue Service and other governmental bodies. Finally, these firms' reputations for sophistication and quality may deter third parties, such as the IRS from challenging valuation issues.

Independence

The independence of the valuation firm has become an important consideration in selecting a valuation firm. In years past it was not uncommon for the valuation arm of a client's

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[6] The significance of this issue should not be overlooked by clients. This was reinforced in my own practice several years ago when the principal in a one person valuation firm used by a client became unexpectedly and seriously ill in February, was hospitalized in intensive care for several days, and unavailable for several weeks. I have had at least one client move from a small valuation firm that specialized in the client's industry to a large national firm in recognition of this risk.

accounting firm to prepare the valuation report. In recent years, however, this has become a less common occurrence. In part this is because of the perceived lack of independence that arises out of the fear that the accounting firm may slant their report in a manner beneficial to the client in order to ensure that the client continues to send their audit, tax, and consulting work to the accounting firm. This perceived lack of independence leaves the report prepared by the company's auditors subject to attack by the courts.

Although much of the Sarbanes Oxley legislation is not directly applicable to the typical family held company, many privately held businesses to which Sarbanes Oxley generally does not apply have chosen to incorporate its provisions as best practices. With respect to valuation work, Sarbanes Oxley requires that the appraisal of a public company cannot be done by the company's auditor in order to preserve auditor's independence.[7]

Finally, the Treasury Regulations also require independence of the valuation firm in order to comply with the adequate disclosure requirements associated with the rules respecting the statute of limitations for gift tax purposes.[8]

Qualifications, Experience and Credentials

In selecting an appraiser to value gifts, the valuation firm or appraiser under consideration should at a minimum meet the requirements of the Treasury Regulations.[9] These regulations include the following requirements:

- The appraiser must be an individual who holds himself out to the public as an appraiser or performs appraisals on a regular basis.
- Because of the appraiser's background, experience, education and membership, if any, in professional appraisal associations, the appraiser is qualified to appraise the type of property being valued.[10]
- The appraiser may not be the donor or donee of the property or a member of the family of the donor or donee (as defined in Section 2032A(e)(2)), or any person employed by the donor, donee, or a member of the family of either.

Rob Oliver of Management Planning, Inc. suggests[11] asking the prospective firm the following questions:

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[7] 15 U.S.C. § 78j-g(3).

[8] Treas. Regs. § 301.6501(c)-1(f)(3) requires that the appraiser:

(i) Must be independent of a donor and donee

(ii) Not be a member of the donor or donee's family

(iii) Cannot be employed by the donor, the donee, or be a member of the donor's or donee's family or married to a person who is the donor, donee, or a member of one of their families.

Similar requirements are set forth in Treas. Regs. § 1.170A-13(c)(5), which is applicable to charitable deductions.

[9] Treas. Regs. § 301.6501(c)-1(f)(3).

[10] *See Estate of Ford v. Commissioner*, T.C. Memo 1993-580 (criticizing an Associate Professor Finance as the appraiser because of his lack of membership in any appraisal society and because he was not a full time appraiser).

[11] Rob Oliver, *Valuation Techniques: Successful Utilization and Implementation*, Practicing Law Institute Tax Law and Estate Planning Course Handbook Series, 251 PLI/Est 181 (1997).

- How many appraisals have been prepared for ongoing, long term gifting programs?
- How many of these appraisals have been settled and at what overall level of discount?
- How many have been litigated and what result?[12]
- Does the appraiser have testimony experience before the U.S. Tax Court?
- Has the appraiser been retained by the IRS or served as a result of a court appointment?[13]
- How often is the appraiser's work relied on in real transactions, such as ESOPs, arbitrations, merger or sale transactions, or to raise capital?

Other considerations or questions one should ask regarding the prospective appraiser include:

- Have they been subjected to disciplinary sanctions under IRS Notice 85-18?
- Do they have experience or expertise with the particular industry in which the enterprise operates?[14]
- Does the firm have the right experience for the task at hand? (*e.g.*, commercial property appraisers and farmland appraisers all appraise real estate, but farmland real estate is a specialty unique and different from the typical commercial real estate and requires a specialist)
- What methodologies would the prospective appraiser consider appropriate for the particular assignment?[15]
- Because a valuation report often is the first step in a process that can lead to adversarial proceedings, the client should attempt to determine whether the appraiser will pass muster as an expert if called to testify.[16]

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[12] The widespread availability of computerized databases of legal and tax resources makes it easier than ever to search out a valuation firm's litigation experience.

[13] Working for taxpayers and the IRS can be a double edged sword. For an interesting example of this at work, see *Estate of Halas v. Commissioner*, 94 T.C. 570 (1990) (taxpayer unsuccessfully sought to disqualify the Service's valuation firm on the grounds that the valuation firm had previously been retained by the family of the estate's decedent).

[14] *See Estate of Cloutier v. Commissioner*, T.C. Memo 1996-49 (criticizing the work of an appraiser with little familiarity with the industry of which the business being valued was a part).

[15] A number of years ago a client of our firm interviewed several valuation firms to provide a valuation report for its ESOP. Two of the firms were nationally recognized investment banking firms, one was a national valuation firm, and the fourth was the valuation arm of a Big Six accounting firm. The differences in approach each firm suggested was appropriate for this operating company were striking. As this example illustrates, it can be illuminating and beneficial to discuss the methodologies that the prospective firm may employ, the reasons for its opinions on the subject, and to form a judgment whether this is appropriate for the company seeking to hire a valuation firm.

[16] The United States Supreme Court, in *Kumbo Tire Co. v. Carmichael*, 119 S. Ct. 1167 (1999), *General Electric v. Joiner*, 522 U.S. 136 (1997), and *Daubert v. Merrell Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), made clear that *all* experts must be qualified in the subject matter and their evidence be reliable and relevant. Failure to meet such a

- Besides technical qualifications, one should determine whether the person is going to make a good witness. Will he or she speak credibly and convincingly if called upon to defend the appraisal?
- If the firm is a boutique valuation firm, what kinds of resources support it? Does the firm have adequate access to the right kinds of databases? Is the firm essentially dependent upon the skills of a single individual?
- Is the appraiser's work going to be consistent with his past publications or testimony?[17]

Accreditations

Read the glossy brochures of several different valuation firms and you quickly become aware of an alphabet soup of credentials and designations, including ASA, MAI, AIBA, CBA, CVA, and more. What are these credentials and how does one attain them?

American Society of Appraisers

The American Society of Appraisers (www.appraisers.org) is the oldest association for appraisers. Its members must follow Uniform Standards of Professional Appraisal Practice (USPAP). ASA certifies appraisers in five distinct areas:

- Business valuation
- Gems and jewelry
- Machinery and technical specialties
- Personal property
- Real property (subspecialties of real estate include ad valorem (for property taxes); 1-4 family residential; rural; urban residential greater than 4 family; and timber)

The ASA offers the following accreditations:

- **Accredited Senior Appraiser** (**ASA**). To obtain the ASA designation, the appraiser must have a minimum of five years experience in the appraisal field, hold a baccalaureate degree or its equivalent, pass an exam, submit to an interview and background check, submit two appraisals to peer review by an examination board, and undergo recertification every five years.
- **Accredited Member** (**AM**). The American Society of Appraisers also offers the AM designation. This is available to individuals with two years experience. Accredited Members also must hold a baccalaureate degree or

standard can result in disqualification. *See Target Market Publishing, Inc. v. ADVO, Inc.*, 136 F.3d 1139 (7th Cir. 1998).

[17] *See Mandelbaum v. Commissioner*, 69 T.C.M. (CCH) 2851 (1995), *affirmed* 91 F.3d 124 (3d Cir. 1996) (in which court noted that the valuation firm retained by the taxpayer had taken a position inconsistent with the firm's position in a previous case in which testimony was offered).

its equivalent, pass a series of exams, and submit to an interview and peer review.

Institute of Business Appraisers

The Institute of Business Appraisers (www.go-iba.org) was formed in 1978 for the purpose providing education and certification to appraisers specializing in the appraisal of closely held companies. It offers several certifications in the appraisal field:

- **Master Certified Business Appraiser** (**MCBA**). Achieving the MCBA designation requires the following credentials: Hold the CBA accreditation for ten years, hold a four year baccalaureate degree and a graduate degree requiring two years of study, have fifteen years of full time appraisal experience, have received recognition by another professional business appraisal organization, and provide references.
- **Certified Business Appraiser** (**CBA**). The requirements for a CBA designation include a four year college or university degree, successful completion of 90 hours of appraisal coursework, passage of an exam, submission of two appraisals to peer review, and passage of a character and fitness screening.
- **Accredited by IBA** (**AIBA**). This designation is for individuals with the least experience in valuation. To attain this designation, the candidate must hold a four year degree, complete an eight day workshop, pass an exam, submit his work to a peer review process, and pass character and fitness screening. The accreditation is good for three years and then the individual must begin seeking CBA accreditation.
- **Business Valuation Accredited for Litigation** (**BVAL**). The Institute of Business Appraisers also offers a Business Valuation Accredited for Litigation accreditation. Achieving the BVAL designation requires completion of a five day IBA course, passage of a four hour exam, demonstrating one's competency in a clinical program, and references from two attorneys or completion of sixteen hours of education in the types of cases in which the candidate will be testifying. In addition, a BVAL candidate either must hold a business appraisal related designation from the IBA, the American Society of Appraisers, the American Institute of Certified Public Accountants, or the National Association of Certified Valuation Analysts, or alternatively be a candidate for the CBA accreditation if one has passed the CBA exam.

National Association of Certified Valuation Analysts

The National Association of Certified Valuation Analysts (www.nacva.com) offers four certifications or accreditations, of which two are relevant for purposes of this paper:

- **Certified Valuation Analyst** (**CVA**). The CVA designation is available to certified public accountants who have held CPA licenses for two years, participated in a five day training program, provided references, passed an exam, and submitted a case study or evidence of experience.

- **Accredited Valuation Analyst** (**AVA**). The AVA credential is for persons who hold a business degree from an accredited school, have a prerequisite understanding of accounting fundamentals as applied to business valuation theory and demonstrate prior experience. References are also required. In addition, the individual must be able to demonstrate with business references or attestations from previous employers and/or partners substantial experience in business valuation. The candidate is not required to be a CPA.

American Institute of Certified Public Accountants

The American Institute of Certified Public Accountants (www.aicpa.org) also offers accreditation for appraisers.

- **Accredited in Business Valuation** (**ABV**). The ABV designation means an individual holds a CPA license, passed an exam, provided evidence of ten engagements in which the person demonstrated substantial experience and competence, and obtained 75 hours of continuing education.

Chartered Financial Analyst

Although not technically an accreditation in the valuation field, individuals active in valuation often hold the Chartered Financial Analyst or CFA designation. The Association for Investment Management and Research (www.aimr.org) sponsors the CFA certification program. Achieving the CFA designation requires passage of a three part exam, each level of which requires approximately 250 hours of preparation. Level II of the exam focuses upon asset valuation.

Appraisal Institute

The Appraisal Institute (www.appraisalinstitute.org) offers three accreditations in real estate appraisals. These accreditations are:

- **Member Appraisal Institute** (**MAI**). Achieving the MAI designation requires experience in commercial, industrial, and residential appraisals, passage of eleven exams covering 380 hours of coursework; 6,000 hours of experience (3,000 of which must be in a specialized area); passage of a four module, two day exam; a four year degree; and submission of a demonstration report for peer review.

- **Senior Residential Appraiser** (**SRA**). The SRA designation is for appraisers of single family to four family residential properties. One must pass seven exams covering 181 hours of coursework, have 4,000 hours of experience (2,000 of which must involve residential property); pass peer review of a demonstration report, and possess a four year college or university degree.

- **Senior Real Property Appraiser** (**SRPA**). The SRPA accreditation is for less experienced appraisers of real estate. These individuals must have experience in commercial, industrial, residential and other property, possess a four year college or university degree, pass a series of exams, demonstrate experience and submit a demonstration report.

III. HIRING AN APPRAISER; THE ENGAGEMENT

Retaining the Appraiser

After determining the firm the client wishes to prepare the valuation, the next step is to enter into an engagement letter with the valuation firm. Many times the client enters into the engagement directly with the valuation firm. However, the client should understand that there is no appraiser client privilege and that the work of the appraiser is subject to subsequent discovery.[18]

In many cases the law firm will be the party engaging the services of the appraiser. In general the reason the law firm would engage the valuation firm is to position the attorney to argue that the attorney work product defense shields the work from discovery, at least during the early stages of the appraiser's work and perhaps up until the final report is issued. In order to qualify for the work product privilege, the law firm must retain the services of the valuation firm as an adjunct to the law firm's work for the client, and the legal work and the valuation firm's services must be provided in anticipation of litigation.[19]

Several examples of circumstances in which it might be appropriate for the law firm to retain the services of the valuation firm include:

- The client has an ESOP and has utilized the services of a valuation firm for several years, but is considering changing firms. Attorney and client are concerned whether the valuation reports will be consistent and about the potential problems, such as claims by former plan participants or existing plan participants, that might result if the new valuation firm's results are grossly inconsistent with the work done by the prior firm.
- The client implemented a gift plan several years ago, filed a gift tax return reporting the gift but without preparing and including a valuation report in the return. Now the client is involved in a valuation dispute with the IRS and needs to retain a valuation firm in connection with the defense, but wishes to ensure that the valuation firm's report and opinion will be consistent with the taxpayer's position in the dispute.

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[18] *Halas v. Commissioner*, 94 T.C. 570 (1990).

[19] See Fed. R. Civ. Proc. 26(b). In *United States v. Meyer*, 398 F.2d 66 (9th Cir. 1968), the court declined to shelter an appraiser's work product from discovery, and stated:

> Ordinarily, appraisers are not employed in condemnation matters to act as advisors to counsel; and the government does not contend that its appraisers were.[fn] Appraisers are usually employed to furnish expert opinions as to the value of the property taken. The appraisers' opinions and the data and analyses upon which they rest are interdependent elements which together constitute the product of the appraisers' expertise. They do not become the work product of the attorneys merely because the attorneys confer and counsel with the appraisers; they are not immunized from discovery merely because the appraisers may have set them out in reports to counsel.

However, the footnote contained important and interesting *dicta*:

> [fn]*A counseling relationship would undoubtedly be entitled to protection from unlimited discovery* (emphasis added).

- Following the death of a shareholder of a closely held corporation, an estate tax return is required and tax will be owed. Attorney preparing the estate tax return is concerned about the valuation that will be revealed.
- A corporation desires to redeem the shares of family members not active in the business. No Buy and Sell Agreement exists. The corporation desires to obtain a valuation to determine the price to offer to the inactive family members.

Obtaining the work product defense to disclosure of the valuation firm's work product is not assured and complacency about the availability of this defense should be resisted. In the family business context, valuation firms are most frequently retained in connection with gift planning, the preparation and filing of gift tax returns, and the preparation and filing of estate tax returns. In this context and with respect to the requirement that the report be prepared in anticipation of litigation in order to make the work product defense to disclosure potentially available, the Tax Court recently stated:

> We accept the general concept that, normally, the audit or examination process is not conducted in anticipation of litigation. If a particular matter has been singled out for litigation and Government lawyers become involved to begin formulating trial strategy, then it is possible that some part of the audit or examination process may be in anticipation of litigation, and documents prepared may also be protected under the work product doctrine.[20]

Moreover, the farther into the process the valuation firm proceeds, the more written communication that is generated and disseminated (especially if it is provided to the client, or even worse, to persons outside the litigation), the more likely that the work product defense will be unavailable.

The likelihood of protection is enhanced if the lawyer pays the valuation firm, coordinates all communication between the client and the valuation firm, and has entered into a confidentiality agreement with the valuation firm. Finally, the valuation firm should not provide a written report until it has completed its work and discussed it tentative conclusions with the attorney.[21]

Defining the Scope and Purpose of the Engagement

Regardless of whether the lawyer or the client retains the valuation firm, an engagement letter is appropriate. The following[22] should be included or addressed in the engagement letter:

(i) Client name

(ii) Business name

(iii) Type of entity being valued

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[20] *Bennett v. Commissioner*, T.C. Memo 1997-505.

[21] D. Zeydel and N. Benford, *Valuation Principles and Recent Developments: Practical Guidance for the Estate Planner*, 34 Real Prop. Prob. & Tr. J. 207, 282 (1999).

[22] ACTEC Manual at 29, citing *Defining a Valuation Engagement* by Z. Christopher Mercer, E-Law Business Valuation Perspective, Volume 2000-02.

(iv) State of incorporation or formation

(v) Principal business locations

(vi) Business interest being evaluated

(vii) Standard of value to be employed

(viii) Premise of value

(ix) Effective date of appraisal

(x) Purpose of intended use

(xi) Type of report

The engagement letter also should state for whom it is being prepared and who may use it and rely upon it.[23] Finally, the letter also should set forth the expected timetable for completion of the report.

Limitations of Liability and Indemnification

In reviewing the engagement letter, it is important to identify and in some cases resist limitations and indemnification provisions sought or imposed by the valuation firm. For example, some engagement letters may seek to limit the valuation firm's liability to the amount of its fees. Others may seek to limit liability only in the event of gross negligence or willful misconduct.

It is common to find in valuation firms engagement letters that the report cannot be disclosed to, used or relied upon by third parties. The scope of this provisions should be expanded to permit inclusion in and disclosure in estate and gift tax returns if appropriate. If the law firm engages the valuation firm, make certain the engagement letter makes clear that it can be disclosed to or the rights under the engagement letter assigned to the client immediately prior to the preparation and delivery of the written report.

Many, if not most, valuation firms require indemnification from the person retaining them. However, valuation firms differ in their approach to the question of indemnification. Sometimes the scope and extent of the duty to indemnify is negotiable. In our firm's experience, valuation firms that are arms of investment banking firms or originated with investment banking firms are the most insistent on broad indemnification clauses, and are the least willing to negotiate limitations upon the scope of the indemnity.

If the valuation firm requires indemnification from the client, there are several points or aspects of the indemnity to consider:

- Seek an exception to the obligation to indemnify the valuation firm to the extent the losses incurred by the valuation firm are attributable to the negligence, gross negligence, or willful misconduct of the valuation firm.[24]

[23] ACTEC Manual at 155.

[24] In 2002 one of our clients decided to hire a new valuation firm, and the firm it selected came from the investment banking community. Not only did the selected firm seek a broad indemnification from the client, it would create exceptions to the duty only in the cases of the valuation firm's gross negligence or willful misconduct. In checking

- If the law firm has retained the valuation firm, extra attention should be paid to any indemnification provisions to avoid the law firm taking on the duty to indemnify the valuation firm. Besides simply refusing to indemnify, the law firm could limit its duty to indemnify to the extent the client has reimbursed the law firm. Alternatively, the client could separately enter an indemnity agreement with the valuation firm.
- Finally, as with all indemnifications, consider the scope of the losses covered, and make certain the client understands it.

Representations

Engagement letters often contain representations or statements with respect to the information upon which the valuation firm will rely. In some cases the statement may be as simple as a statement that the valuation firm may rely on the information provided as being accurate and complete and is not required to independently verify it. This kind of statement limits the valuation firm's liability if the information is inaccurate. Unlike more affirmative promises this statement does not expose the client (or its attorneys if the law firm engages the valuation firm) to liability if the information is inaccurate.

Some letters include affirmative representations by the person retaining the valuation firm that the information provided will be accurate. It is unclear the full scope and extent of the obligation being undertaken by the engaging party if the information turns out to be inaccurate. However, if the law firm hires the valuation firm, it clearly should not agree to make these kinds of representations. If these representations are a condition to hiring the valuation firm, consider having the client make this representation separately or have the law firm state it is relying in turn on information furnished by the client.[25] One should consider the possibility that if the client makes these representations and/or provides indemnification, it might affect the ability of the attorney to assert the attorney work product defense to a request for production by the Service. At some level, as the client makes representations and assumes duties to indemnify, it appears less to be the case that the law firm is engaging the valuation firm and more like the client is doing so.

One appraiser or two?

A review of valuation cases will reveal a number of instances in which multiple valuation firms were engaged. In some cases it may be necessary or even advisable to retain more than one appraiser to handle different valuation tasks or to provide additional support on significant issues. For instance, in valuing family limited partnerships interests, a valuation of the partnership interests may depend upon the valuation work of a real estate appraiser if one of the assets of the FLP is real estate. However, one should take care in hiring multiple valuation firms

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with my partners on their experiences in negotiating broader exceptions, an interesting dichotomy was observed in their responses. Lawyers who deal frequently with investment banking firms find these firms often insist upon broad indemnification provisions and that it is difficult to negotiate reasonable modifications with them. On the other hand, lawyers working with firms outside the investment banking community almost never encounter indemnification agreements, and if they do, they are not laden with indemnification obligations that include indemnifying them for their negligence.

[25] ACTEC Manual at 160.

to value the same interest. Multiple appraisals invite opportunities for impeachment of the witness at trial.[26]

Compensating the Appraiser

It is important that the engagement letter clearly set forth how the firm will charge for its services, what out of pocket expenses are reimbursable, and what is not included in the fee. In our experience, valuation firms charge for their services in a variety of ways, although a fixed fee for a valuation report is most common. However, some firms charge on a per hour basis, with a range or cap provided. In almost all instances the valuation firm's fixed fee contains an exception for additional consulting outside the scope of the report (such as in conjunction with year end planning) or testimony, with this work being charged on an hourly basis.

In addition, valuation firms typically seek reimbursement for their out of pocket expenses incurred in connection with the engagement. In some instances these can be negotiated. Common out of pocket expenses that might be negotiated are local travel costs and access to databases.

Many times the client is engaging a valuation firm on an annual basis. Inquiring about the firm's approach to return engagements is appropriate also. My experience is that valuations often are more expensive the first year, and that subsequent valuations are less costly because the firm needs to spend less time getting to know the company being valued. In some cases it may be desirable and possible to include multiple valuations in the engagement to secure beneficial pricing.

IV. REVIEW OF VALUATION REPORTS

The purpose of hiring a valuation firm is to obtain an opinion of the value of the asset or assets being valued. As a general matter, the client's focus is on the numbers – Is the value reported "right"? In most cases the client has an intuitive sense whether the valuation provided is at least in the ballpark. Moreover, they often can look at the financial analysis and identify whether the assumptions and comparable companies are correct and appropriate.[27] However, beyond these areas, clients ordinarily are not skilled in reviewing the report and will look to the lawyer to tell them whether the report is acceptable. In fact, due to clients' inexperience, the lawyer may be the only one able to evaluate the quality of the report. As a result, the lawyer ordinarily will and should carefully review and comment on the report. Nevertheless, in doing so the lawyer must remember that he is not the appraiser, and in his review he should not write the report, and in general must be careful how much influence he exerts over the valuation process.

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[26] If there is a need to seek a second opinion, this is an additional reason for the lawyer to hire the valuation firm. If it appears the second firm will offer a materially different opinion, the lawyer can terminate the engagement and perhaps shield the preliminary conclusions from discovery.

[27] Another area in which the client can "judge" an appraisal report is by its weight. Although obviously volume is not determinative of quality, it is true that an properly prepared report will be of a certain length. A client, and its counsel should be suspicious of an appraisal report that is quite short. *Compare Estate of Simplot v. Commissioner*, 112 T.C. No. 13 (1999) (in which the court was critical of the estate for reliance upon a two page report) and *Estate of Cloutier v. Commissioner*, T.C. Memo 1996-49 (criticizing a report that was only three pages long) *with Estate of Gloeckner v. Commissioner*, 152 F.3d 208 (2d Cir. 1998), *rev'g and remanding* 71 T.C. Memo 1996-148 (commenting favorably upon the resulting 27 page report complete with appendices).

What should be in the report?

In addition to looking to case law for guidance in reviewing the report, the Uniform Standards of Professional Appraisal Practice (USPAP) published by the appraisal Standards Board of The Appraisal Foundation should be considered.[28] The USPAP Standards reflect the current standards of the profession. The Treasury Regulations also provide guidance regarding the contents of the report.[29] The USPAP standards and the Treasury Regulations, considered together, form a good framework for evaluating the report.

Client, Permitted User, Use, and Purpose for the Appraisal

The report should identify the client, and in the case of an Appraisal Report (as defined under USPAP), it also must state any intended users, by name or type.[30]

The appraisal should also state the intended use and purpose of the appraisal.[31]

The Date of the Transfer and the Date of the Appraisal

The appraisal report should include the effective date of the appraisal and the date of the report.[32]

Standard of Valuation

The standard of valuation should be included in the report as well, and attention should be paid to determine whether the correct standard is being employed.[33] In the estate and gift tax context, the correct standard to evaluate the fair market value of an asset is as follows:

> "Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[34]

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[28] For business appraisals USPAP Standard 10 applies. USPAP Standards Rule 10-2 provides for two different kinds of reports: an "Appraisal Report" and a "Restricted Use Appraisal Report". The Standards require that the report prominently state which kind it is. The difference is that if the intended users include parties other than the client, an Appraisal Report must be provided. When the only intended user is the client, a Restricted Use Appraisal Report may be provided. See Comment to USPAP Standards Rule 10-2. Simply receiving a copy does not make one an intended user of the report unless the client identifies the user as an intended user as part of the assignment. Although the Standards call for different reports, the requirements are substantially the same. The materials that follow note where differences exist under Standard 10 for the contents of Appraisal Reports and Restricted Use Appraisal Reports.

[29] Treasury Regulations Section 301.6501(c)-1(f)(3) sets forth certain requirements, which if met, provide a taxpayer with certainty that the statute of limitations will apply to the gift and prevent reopening the valuation at a future date, such as at the time of audit of another gift or at death in conjunction with an audit of the estate tax return. See I.R.C. § 6501(c)(9).

[30] See USPAP Standards Rule 10-2(a)(i).

[31] USPAP Standards Rule 10-2(a)(ii), (v); Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(A). Although it would seem to be a case of stating the obvious, using a report prepared for a different purpose should be avoided or done at one's own risk. In *Estate of Simplot v. Commissioner*, 112 T.C. No. 13 (1999), the court was critical of the use of areport prepared for ESOP purposes in connection with an estate tax return.

[32] USPAP Standards Rule 10-2(a)(vi); Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(A).

[33] USPAP Standards Rule 10-2(a)(v).

[34] Treas. Regs. §§ 20.2031-1(b), 25.2512-1. See also Rev. Rul. 59-60, 1959-1 C.B. 237 (fair market value is "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are

Although this seems obvious, the cases identify numerous examples in which the wrong standard is applied.[35]

A Description of the Property

The report should provide information sufficient to identify the business or intangible asset appraised.[36] For example, if the asset being valued is an assignee's rights in a limited partnership, the report should clearly indicate that this interest is being valued.[37] If relevant to the appraisal, the report should also state the extent to which the interest being appraised contains elements of ownership control, including the basis for that determination.[38]

Description of the Appraisal Process

The report should summarize with sufficient information to disclose to the client and any intended users of the appraisal the scope of work used to develop the appraisal. In the case of an Appraisal Report, this is required.[39]

Description of the Assumptions, Hypothetical Conditions and Any Limiting Conditions and Restrictions on the Transferred Property that Affect the Analyses, Opinions and Conclusions

Each of the USPAP Standards and the adequate disclosure regulations require that the report state all assumptions, hypothetical conditions, and limiting conditions that affected the analyses, opinions, and conclusions.[40] In addition, USPAP Standards Rule 9-2 contains various binding requirements that affect the content of the report. Standards Rule 9-2(d) states that in developing a business or intangible appraisal, the appraiser must identify any buy-sell agreements, investment letter stock restrictions, restrictive corporate charter or partnership agreement clauses, and any similar features or factors that may have an influence on value, and ascertain the extent to which the interest contains elements of ownership control.[41] This

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assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.")

[35] *See, e.g., Morrisey v. Commissioner*, 243 F.3d 1145 (9th Cir. 2001), rev'g *Estate of Alice Friedlander Kaufman*, 77 T.C.M. (CCH) 1779, TC Memo 1999-119 (1999) (hypothetical parties are the appropriate parties to consider in valuing the business; strategic buyers are not); *Mandelbaum v. Commissioner*, T.C. Memo 1995-255 (criticizing taxpayer's appraiser's report because it unduly focused on a hypothetical willing buyer and not the reviews of a hypothetical willing seller).

[36] USPAP Standards Rule 10-2(a)(iii); Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(B).

[37] *See Estate of Jones II v. Commissioner*, 116 T.C. 121 (2001).

[38] USPAP Standards Rule 10-2(a)(iv).

[39] USPAP Standards Rule 10-2(a)(vii); Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(C). For Restricted Use Appraisal Reports, the standard is slightly different. For this kind of report, it must state the extent of the process of collecting, confirming, and reporting data or refer to an assignment agreement retained in the appraiser's workfile that describes the scope of the work to be determined.

[40] USPAP Standards Rule 10-2(a)(viii); Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(D).

[41] In *Estate of Alice Friedlander Kaufman v. Commissioner*, T.C. Memo 1999-119, *rev'd and remanded Morrissey v.Commissioner*, 243 F.3d 1145 (9th Cir 2001), the Tax Court was critical of the appraiser for having failed to discuss the features of the classes of capital stock being valued and his failure to note the differences between the classes.

Although later overturned on appeal, the Tax Court in the *Kaufman* case provides an impressive list of how not to conduct an appraisal – or how to review it. And even though reversed on appeal, the appellate court based its decision on a different interpretation of the independence and significance of certain contemporaneous sales to third parties in determining the value of the shares held by the estate and by concluding that by abandoning during the litigation the valuation set forth in its notice of deficiency the Service had assumed the burden of proving whether any deficiency existed, and if so, what amount. Having failed in carrying its burden, and being satisfied that the

requirement highlights the importance of ensuring that the appraiser has the current articles or certificate of incorporation and bylaws, and the correct Buy and Sell Agreement restricting transfer of the shares.[42] It is advisable that the report also describe relevant documentation to indicate that the report is not generic and that the appraiser has undertaken to understand the entity and its governing documents. Doing so also will help support appropriate discounts.[43] Where there is a question about the meaning or effect of provisions in legal documents, the lawyer should offer assistance. Similarly, the attorney should carefully consider how the valuation firm has described the impact of legal documents to make certain the valuation firm has properly interpreted and understood them.

The lawyer and client should review carefully the assumptions, both documented and undocumented, and consider whether there is a convincing justification for reliance upon the information used. In addition, the lawyer and client should consider whether they agree with the assumptions and whether they are consistent with the facts and circumstances underlying the event giving rise to the valuation. For example, in *Knight v. Commissioner*[44] the valuation expert was criticized for failing to support his assumptions and to justify his conclusions. In addition, the court criticized the expert for identifying nineteen business reasons for the formation of the partnership he was valuing. However, the taxpayers only identified five of the nineteen reasons as its reasons for the formation of the partnership. In addition, the report referred to compensation paid by the partnership to the general partner when no compensation in fact was paid.[45]

Information Considered in Determining the Appraised Value

In the case of a report valuing an ownership interest in a business, the report should include all financial data used to determine the value, with sufficient detail so that another person can replicate the process and arrive at the appraised value. If the appraisal is an Appraisal Report under USPAP, this information must be considered.[46]

Examples of the kinds of additional information that should be considered and reflected in the report include:

- Financial and economic conditions affecting the business enterprise, its industry, and the general economy.[47]
- Past results, current operations, and future prospects of the business enterprise.[48]

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sales to third parties were good evidence of the fair market value of the stock held by the estate, the court of appeals reversed the Tax Court decision. However, except for one correction, the Tax Court's analysis of the deficiencies in the valuation firm's report went undiscussed in the court of appeals' opinion.

[42] *Id*. The Tax Court also was critical of the valuation firm's failure to examine the certificate of incorporation and bylaws of the company.

[43] ACTEC Manual, p. 145

[44] 115 T.C. 506 (2000).

[45] Ultimately a big part of the problem in *Knight* was that in the eyes of the court the expert had become the advocate. The factual errors made by the expert contributed to the court's conclusion on this point. As noted in *Martin Ice Cream Company v. Commissioner*, 110 T.C. 189 (1998), the lawyer is the advocate; the appraiser is the valuation expert.

[46] USPAP Standards Rule 10-2(a)(ix). See also Treas. Regs. § 301.6501(c)-1(f)(3)(ii)(E).

[47] USPAP Standards Rule 9-4(b)(ii).

[48] USPAP Standards Rule 9-4(b)(iii).

- The acquisition or disposition of product lines or divisions
- Changes in members of the management team

In addition, the valuation firm should have had access to the necessary people and the appropriate legal, financial, and tax documentation, and this access and use of this information should be reflected in the report.

An interesting question is the degree to which information that becomes available after the effective date of the valuation can or should be used to support the valuation report. In *Estate of Necastro v. Commissioner*,[49] the Tax Court considered this problem in connection with environmentally contaminated property. In that case serious contamination was discovered after the effective date of the valuation. The court determined that the effect this information should have on the valuation as of the effective data depended upon whether a reasonable buyer would have discovered the problem and discounted the price as a result. It is therefore not sufficient to conclude that if the information was unknown at the effective date, it has no effect on valuation.

A properly prepared report will provide a description of the company's capital structure, business and its history, and information about competitors and the industry in which the company operates.[50] In addition, the appraiser should have conducted a site inspection of the company's premises and interviewed management.[51] The results of the inspections and the interviews should be considered, reflected, and supported in the report.[52] In addition, information obtained from a variety of outside sources concerning the company should be included, including from sources such suppliers, customers, competitors, and financial institutions.[53]

Appraisal Procedures Followed and Valuation Methods

The heart of the valuation report is the description of the procedures followed and the appraiser's valuation method. Both the adequate disclosure regulations and USPAP require that the report include the reasoning supporting the analyses, opinions, and conclusions.[54] For Appraisal Reports, the report must describe appraisal procedures followed, and the reasoning that supports the analyses opinions, and conclusions. In addition, the report must include the valuation method utilized, the rationale for the valuation method and the procedure used to

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[49] T.C. Memo 1994-352. *See also Estate of Pillsbury v. Commissioner*, T.C. Memo 1992-425.

[50] See USPAP Standards Rule 9-4(b)(i); *Estate of Gloeckner v. Commissioner*, 71 T.C.M. (CCH) 2548 (1996), *rev'd and remanded*, 152 F.3d 208 (2d Cir. 1998).

[51] *Id*.

[52] In *Estate of Alice Friedlander Kaufman v. Commissioner,* T.C. Memo 1999-119, *rev'd and remanded Morrissey v.Commissioner*, 243 F.3d 1145 (9th Cir 2001), the Tax Court was critical of the valuation firm retained because of his reliance upon unverified representations of management and a lack of offered support that would allow the court to verify the accuracy or completeness of management representations.

[53] *Id*. In *Mandelbaum v. Commissioner*, T.C. Memo 1995-255, the court was critical of the taxpayer's expert for his emphasis on talking only to venture capitalists, leveraged buyout firms, and the like, who typically demand a higher rate of return, and not to other possible buyers, such as competitors or independent investors, who might not demand a higher rate of return, and would therefore agree to a higher value for the business.

[54] Treas. Regs. 301.6501(c)-1(f)(e)(ii)(F); USPAP Standards Rule 10-2(a)(ix). For Restricted Use Appraisal Reports, the report must state the appraisal procedures followed, state the value opinion(s) and conclusion(s) reached, and reference the workfile. The comments note that the appraiser's workfile must be sufficient to enable the appraiser to produce an Appraisal Report. *See also Estate of Cloutier v. Commissioner*, T.C. Memo 1996-49.

determine the fair market value of the asset transferred.[55] It is equally advisable that the valuation firm note why it excluded common valuation approaches that were not relied upon.[56]

USPAP Standard 9 addresses the development process the appraiser should follow in generating his work product, and the comment to Standards Rule 10-2 indicates that an Appraisal Report must include sufficient information to indicate that the appraiser complied with the requirements of Standard 9. If the appraiser makes any permitted departures from specific requirements or excludes any of the usual valuation approaches, the report must note these departures and explain them.[57] Moreover, if the "Departure Rule" is invoked, the assignment is considered a "Limited Appraisal" and the use of this term in the report makes clear that that the assignment involved something less than or different from the work that could have been and would have been completed if departure had not been invoked.[58]

The courts make clear that other, recent transactions are the preferred method of determining value.[59] It is only when there is no market for trading in a company's securities and no recent history of arms length trading is available to set the value of a business interest should a valuation firm's report be relied upon. Therefore, if recent sales of the capital stock or other interests have occurred, the valuation report should note their existence, and include a description of the prices, terms and conditions affecting past sales of similar equity interests.[60] In addition, the report should explain whether and why these transactions reflect or do not reflect the value of the interest being appraised.[61]

The report should include information concerning the specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger or acquisition transactions, as well as sales of similar businesses or capital stock of publicly held similar businesses.[62] In relying upon comparable sales the report should provide enough information to enable the court to determine if the comparable companies cited were sufficiently similar to the company being valued. Specifically the valuation firm should explain why the firms selected were chosen, particularly when there are significant differences in size, and the basis for concluding the firms were truly comparable.[63]

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[55] Treas. Regs. § 301.6501(c)-1(f)(e)(ii)(G); *Estate of Davis v. Commissioner*, 110 T.C. 530 (1998) (in which the court criticized the work of Shannon Pratt for not explaining how a blockage and/or Rule 144 discount was arrived at); *Estate of Alice Friedlander Kaufman v. Commissioner*, T.C. Memo 1999-119, *rev'd and remanded Morrissey v.Commissioner*, 243 F.3d 1145 (9th Cir 2001). *See also Estate of Ford v. Commissioner*, T.C. Memo 1993-580.

[56] *Estate of Alice Friedlander Kaufman v. Commissioner*, T.C. Memo 1999-119, *rev'd and remanded Morrissey v.Commissioner*, 243 F.3d 1145 (9th Cir 2001). *See also Estate of Ford v. Commissioner*, T.C. Memo 1993-580.

[57] In a Restricted Use Appraisal Report, the appraisal also must include a prominent use restriction that limits use of the report to the cient and warns that the appraisers opinions and conclusions set forth in the report cannot be understood properly without additional information in the appraiser's work file.

[58] USPAP Standards Rule 10-2(a)(x).

[59] *See Wall v. Commissioner*, T.C. Memo 2001-75; *Estate of Alice Friedlander Kaufman v. Commissioner*, T.C. Memo 1999-119, *rev'd and remanded Morrissey v. Commissioner*, 243 F.3d 1145 (9th Cir 2001); *Estate of Gloeckner*, 71 T.C.M. (CCH) 2548 (1996), *rev'd and remanded*, 152 F.3d 208 (2d Cir. 1998)

[60] USPAP Standards Rule 9-4(b)(vi).

[61] USPAP Standards Rule 9-4(b)(iv)

[62] USPAP Standards Rule 9-4(b)(v); *Estate of Gloeckner*, 71 T.C.M. (CCH) 2548 (1996), *rev'd and remanded*, 152 F.3d 208 (2d Cir. 1998).

[63] *Estate of Alice Friedlander Kaufman v. Commissioner*, T.C. Memo 1999-119, *rev'd and remanded Morrissey v.Commissioner*, 243 F.3d 1145 (9th Cir 2001).

In reviewing the methodology, the attorney and client should consider whether the methodology "fits" the company and industry and determine if the valuation methodology is commonly used for similarly situated companies and produces values consistent with norms in the industry. For example, in *Mandelbaum* the court criticized the taxpayer's valuation consultant for suggesting a 70% discount was appropriate. The court stated "We find incredible the proposition that any shareholder of Big M would be willing to sell his or her stock at such a large discount."[64]

In addition, if valuation firms have been employed in the past, the report should be reviewed to determine if the methodology is consistent with the methodology used in prior reports. If there has been a change in methodology, or a change in the size of adjustments, or other meaningful changes in the approach to the report, the appraiser should provide a convincing explanation for the change and be prepared to defend it on audit and in litigation.[65]

Care should also be taken that if the report refers to studies, that the studies are current and that studies and the subjects of them are comparable.[66]

Certification

Finally, the report must contain a signed certification in accordance with Standards Rule 10-3.[67] The certification required by Standards Rule 10-3 is a familiar one seen in reports, which is similar in content to the following:

"I certify that, to the best of my knowledge and belief:

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, impartial, and unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon developing or reporting predetermined results
- My compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.

[64] *Estate of Mandelbaum v. Commissioner*, 69 T.C.M. (CCH) 2852 (1995), *aff'd* 91 F.3d 124 (3rd Cir. 1996).
[65] See also *Mandelbaum v. Commissioner*, 69 T.C.M. (CCH) 2852 (1995), *aff'd* 91 F.3d 124 (3rd Cir. 1996) (court criticized the taxpayer expert for having taken contrary positions in other cases).
[66] *Knight v. Commissioner*, 115 T.C. 506 (2000).
[67] USPAP Standards Rule 10-2(a)(xi).

- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the *Uniform Standards of Professional Appraisal Practice*.
- No one provided significant business valuation assistance to the person signing this certification. (If there are exceptions, the name of each and the significant business valuation assistance must be stated.)"

Statement of Qualifications

The report also should include a statement of the qualifications of the appraiser, including his background, experience, education and membership, if any, in professional appraisal associations.[68]

Miscellaneous

One must assume that the report will be an exhibit in litigation. The courts have commented on a number factors that undermine the credibility of the report. Therefore, care should be taken to ensure that these factors do not adversely affect the report.

As an initial matter and reflecting the court's criticism of sloppy reports, a draft of the report should be reviewed for factual accuracy and to identify typographical errors. For instance, references to incorrect dates undermined the credibility of the report in *Peracchio v. Commissioner*[69] valuing a gift of interests in a family limited partnership holding marketable securities. The gift was made on November 25, 1997. The valuation report for the partnership was based on the values of the underlying assets on November 30, 1997, some five days after the date of the gift.[70] In *Alice Friedlander Kaufman v. Commissioner*,[71] the court was critical because of the numerous factual errors. For instance, the valuation report stated that certain individuals owned the largest blocks of stock, when the Service and the valuation firm's client had stipulated that others had larger blocks of stock.

Because of the potential breadth of the discovery process, and the possibility or even likelihood that the valuation firm's work is discoverable, copies of draft reports should be destroyed so they cannot be discovered and used as the basis for attacking the valuation firm's work.

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[68] See Treas. Regs § 301..6501(c)-1(f)(3); Tax Court Rule 143(f).

[69] T.C. Memo 2003-280.

[70] In that case the government's expert also was criticized for including in the valuation of the partnership approximately $640 of interest earned by the partnership in December 1997.

[71] T.C. Memo 1999-119. *See also Estate of Ford v. Commissioner*, T.C. Memo 1993-580.