

Memorandum

To: Chairman Dave Reichert and Vice Chairman John Lewis
Charitable/Exempt Organizations Working Group
Committee on Ways and Means
From: American Society of Appraisers
RE: Noncash Charitable Contributions
Date: April 8, 2013

I. Introduction and Background

The American Society of Appraisers (ASA) appreciates the opportunity to provide its comments on the issue of noncash charitable contributions – and the valuation of such contributions – to the Charitable/Exempt Organizations Working Group of the Ways and Means Committee. Many of our members provide tax-related appraisal services, which include valuations of noncash charitable contributions.

ASA is a nonprofit professional appraisal organization which teaches, tests and credentials highly qualified individuals in the valuation of businesses; commercial and residential real property and interests in real property¹; tangible and intangible personal property² and, in the principles of appraisal review. ASA, whose credentialed appraisers are engaged in valuation practice throughout the country, is the oldest multidiscipline professional appraisal organization in the United States.

The Ways and Means Committee, through its eleven tax reform Working Groups, is embarked on a comprehensive review of current federal income tax law for the purpose of determining the need for reform of those laws and the shape of such reforms. One area of particular interest to ASA and its members involves the Committee's consideration of possible changes to the tax laws that authorize taxpayers to deduct the fair market value of noncash property donated to eligible entities. Notwithstanding the popularity and, we believe, the success and importance of the noncash program, we recognize it has been criticized by some. We also understand that congressional review of the program necessarily and properly involves the effectiveness of the process utilized to establish the fair market value of noncash donations – the reliance on appraisals and the integrity and reliability of those appraisals.

¹ ASA designated real property appraisers also hold licenses or certifications from the real estate appraiser licensing boards of the 50 states and territories and the District of Columbia pursuant to the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Such licenses or certifications are mandated for the vast majority of federally-related transactions that require appraisals.

² Tangible personal property includes art, antiques, collectibles, gems and jewelry and machinery and equipment. Intangible personal property includes closely held stock, software, copyrights, trademarks, good will and artistic compositions.

II. Executive Summary of ASA's Views

- **NONCASH CHARITABLE CONTRIBUTIONS ARE AN ESSENTIAL COMPONENT OF OUR NATION'S SYSTEM OF CHARITABLE GIVING:** In tax year 2010, 22.5 million individual taxpayers who itemize deductions reported \$44.3 billion in noncash donations. These donations directly benefit many thousands of the approximately 1 million organizations eligible to receive deductible contributions; and, they indirectly benefit the millions of individuals these organizations serve.³ Any changes to the Tax Code which limit or disrupt the ability of taxpayers to make noncash donations would severely undermine the far-reaching public policy benefits of these donations; and,
- **APPRAISALS OF THE FAIR MARKET VALUE OF DONATED PROPERTY ARE RELIABLE AND THE PROGRAMS IN PLACE AT IRS TO ENSURE SUCH RELIABILITY ARE BASICALLY SUCCESSFUL AND COST-EFFECTIVE:** Public and congressional confidence in the reliability and integrity of appraisals of noncash property are an indispensable element of the noncash donation program. There is strong evidence that donated property appraisals are fundamentally sound and that IRS requirements designed to ensure such reliability – even though imperfectly enforced - are important and cost-effective. Much of the evidence for this conclusion can be found in the findings of recent GAO and TIGTA reports.⁴ Additionally, it is important to recognize that IRS's valuation substantiation regime is largely the product of the enactment by Congress of several important, sensible, and long-overdue tax-related appraisal reforms included in the Pension Protection Act of 2006.⁵ These reforms ensure that appraisers who value noncash contributions possess the education, training, experience and independence necessary to value the specific type of property being donated; that appraisals adhere to generally accepted appraisal standards;⁶ and, that individuals providing appraisal services are held accountable for the quality of their work.

III. Discussion of Issues Relating To Noncash Contributions

A. Criticisms of Noncash Property Valuations and of IRS's Substantiation Program, Which Is Designed to Ensure the Reliability of Noncash Appraisals, Are Contradicted By The Experiences of Our Members Who Provide Tax-Related Valuation Services and

³ IRS Statistics of Income studies list 9 major categories of eligible done organizations: Arts, culture, and humanities; Educational institutions; Environment and animal related organizations; Health and medical research; Large organizations; Public and societal benefit; Religious organizations; Donor-advised funds; Foundations and Others.

⁴ GAO-12, "Appraised Values On Tax Returns" June 2012; Treasury Inspector General For Tax Administration, 2013-40-009, December 20, 2012.

⁵ These provisions mandated greater valuation competency and adherence to generally accepted appraisal standards for a variety of tax-related purposes through the adoption of new definitions of the terms, "Qualified Appraiser" and "Qualified Appraisal"; established a new civil money penalty that can be imposed on appraisers for valuation misstatements and disqualification of appraisers from practice before the IRS for a pattern of misbehavior; and, narrowed the tolerances for such misstatements thereby making it easier for IRS to sanction appraisers.

⁶ The Uniform Standards of Professional Appraisal Practice (USPAP) or other generally-recognized appraisal standards that are consistent with the letter and spirit of USPAP.

By the Findings of Recent Reports by the Government Accountability Office (GAO) and the Treasury Tax IG (TIGTA)

ASA strongly but respectfully disagrees with the criticisms of one witness at the February 14th hearing⁷ about the appraisals of donated property and about the program in place at IRS to ensure the integrity of the valuation process. The witness testified that the system of rules governing noncash contributions is “broken,” “hard to administer” and “costly”. He expressed doubt that the benefits of noncash contributions exceed the costs and was particularly critical of what he described as an “anti-abuse regime for property contributions” which includes “separate reporting on IRS Form 8283, distinct substantiation [of value] rules and requirements for appraisals.” We believe these criticisms are unfounded.

Our disagreement with them is based on the following:

- The “anti-abuse” regime involving IRS’s appraisal requirements, which the witness characterized as “notoriously difficult,” is nothing more than several sensible, long overdue and interrelated IRS requirements designed to ensure the integrity of the appraisal process. These requirements ensure that individuals appraising noncash property are free of any conflicts-of-interest; that they possess the education, training and experience necessary to value the specific type of property being donated; that appraisals are performed in adherence to generally accepted appraisal standards; and, that appraisers are held accountable for valuation misstatements through the imposition of civil money penalties and, if there are repeated instances of misstatements, disqualification, by IRS’s Office of Professional Responsibility (OPR), from practice before the Service.⁸

We think it is important to point out that the essence of the anti-abuse regime in place at IRS was mandated by Congress when it enacted the tax-related appraisal reform provisions of the Pension Protection Act of 2006. Those reforms, which ASA strongly supported, were long overdue and have proven to be effective. Although Congress’s legislative judgments are not infallible, we believe the Congressional tax writing committees deserve great credit for enacting these due diligence safeguards.

- ASA’s members, many of whom provide a wide-range of tax-related appraisal services, including those involving noncash donations, believe that the Pension Protection Act’s appraisal reforms have been effective in ensuring the reliability and objectivity of valuations. Based on their considerable real-world experience, our members do not believe that IRS’s anti-abuse regime imposes unnecessary or irrelevant burdens on them or on taxpayers. To the contrary, they are convinced that the appraisal requirements in place at IRS are necessary to protect the integrity of the tax system itself.

More importantly, perhaps, is that two recent independent studies – one by GAO and another by TIGTA – indicate that IRS’s anti-abuse regime for appraisals actually promotes effective tax administration in at least two ways: First, by helping ensure the reliability of the appraised value of noncash property and, thereby, the legitimacy of the tax deduction; and, Second, by lessening

⁷ Roger Colivaux.

⁸ Although appraisers do not prepare or sign tax returns, OPR’s standards of care and penalties established for them are somewhat similar to those established for tax practitioners.

the need for IRS to devote audit resources to reviewing appraisals. Because appraisers who value noncash contributions are required to meet strict qualifications and related due diligence requirements before they are even eligible to provide valuation services and because they understand the penalties which await them if their appraisals are faulty, IRS examiners reviewing tax returns (which are accompanied by appraisals), need to focus less of their time at the back end of the tax administration process on whether the valuation result reported in the return is reliable. In short, a strong case can be made that the anti-abuse regime involving appraisals is actually cost-effective.

We acknowledge that there are occasions when two highly skilled appraisers will disagree on the fair market value of the same property; and other occasions when even a highly qualified professional appraiser gets careless or just gets it wrong. But, the volume of such instances has been greatly reduced by the Service's Qualified Appraiser/Qualified Appraisal requirements and by the specter of robust civil money penalties for valuation misstatements, and even disqualification from IRS practice, for a pattern of such misstatements. Importantly, the GAO and TIGTA reports suggest that the reduced incidents of such misstatements could be reduced even further if IRS effectively enforced its appraisal requirements.

B. The GAO and TIGTA Reports Clearly Suggest That Tax-Related Appraisals Are Fundamentally Reliable But That IRS Needs To Do A Better Job of Enforcing Its Appraisal Requirements

GAO's June 2012 report ("Appraised Values On Tax Returns"⁹) concludes that "The high no-change rate that we found through our data analysis and our file review indicates that IRS examiners find relatively little noncompliance relating to appraisals for noncash contributions." (emphasis added). While this finding forms the basis of a GAO recommendation that IRS may want to raise the current \$5,000 claimed-value threshold at which taxpayers are required to obtain a qualified appraisal, its central importance is that valuations of noncash property have been found to be reliable.¹⁰

⁹ GAO's report was in response to a request from Senators Baucus and Grassley for an analysis of how the tax-related appraisal reform provisions of the Pension Protection Act of 2006 (and the extension of the valuation misstatement provisions of those reforms to Estate and Gift taxes, as mandated by the Tax Technical Corrections Act of 2007) affected tax compliance.

¹⁰ It is worth noting that although IRS's Art Advisory Panel recommends adjustments in the claimed value of art in a significant number of cases, for three important reasons there is much less here than meets the eye: First, very few adjustments recommended by AAS involve noncash contributions (most involved Estate and Gift taxes). In the latest Panel report (FY 2011), only 2.5 percent of all adjustment cases involved charitable contributions. Second, the same GAO study which reported that "IRS examiners find little noncompliance relating to appraisals for noncash contributions" also is extremely critical of IRS's Art Advisory Services (AAS); and calls into serious question the reliability of its reviews of taxpayer appraisals of donated art. GAO found that AAS "may not be performing quality work" because its appraisal training and case review and management oversight are substandard. GAO reported that "the lack of appraisal training requirements for AAS appraisers and the lack of a comprehensive quality control process for AAS cases put the quality of potentially high-value appraisal cases involving art at risk"; and, Third, there are no professional appraisers on the Art Advisory Panel. Most are art dealers who are in the business of buying and selling art, often in the categories of art they review as part of their Panel work. Although GAO did not address the fact that not a single member of the Art Advisory Panel meets IRS's definition of a "Qualified Appraiser" and would be prohibited from providing most tax-related appraisal services, that fact is worth noting by Congress. While art dealers are generally knowledgeable about art markets, they have no education and training in the principles of professional appraisal practice. A useful analogy can be found with respect to real estate agents.

Whether raising the \$5,000 dollar threshold for purposes of triggering a professional appraisal requirement is justified is an entirely separate question. In this regard, Congress and Treasury need to decide whether donations of noncash property with a claimed value of \$5,000 is too insignificant a dollar number to trigger an appraisal requirement; and whether raising that dollar number – and thereby permitting taxpayers to assign their own dollar value to donated property below that new number – makes good tax enforcement sense.

TIGTA's recent report¹¹ is highly critical of IRS for its failure to adequately enforce its appraisal reporting requirements; and it concluded that as a result of this lack of enforcement, "an estimated 273,000 taxpayers claimed approximately \$3.8 billion in potentially erroneous noncash contributions in tax year 2010." (Emphasis added). This conclusion provides dramatic evidence of the importance of the need for effective IRS enforcement of its appraisal requirements. But, its larger meaning – in the context of the Working Group's mission – is that the Treasury IG believes that the Service's appraisal policies are not only worth enforcing in situations where an appraisal is required, but must be enforced if IRS is to collect the taxes properly due the Treasury.

In this regard, the TIGTA and GAO reports reach a fundamentally similar conclusion: That IRS's appraisal enforcement requirements are in the public interest and are necessary for effective tax administration. These conclusions point in an entirely different direction than the one described by the hearing witness who labeled IRS's appraisal enforcement regime (or, in his words, its "anti-abuse regime) as "hard to administer," "costly" and "broken". It is self-evident to us – and we hope to the Working Group – that GAO and the Treasury's Tax IG would not urge IRS to more aggressively enforce a regime that was costly or broken or dysfunctional in any other way.

It is also self-evident that the tax code, in its entirety, is complex and that compliance is rarely easy. While we all wish for a greatly simplified Code, we do not believe it is in any way unfair or inappropriate as a matter of public policy to ask taxpayers to substantiate the fair market values and the tax deductions they claim for donated noncash property by requiring reliance on an independent professional appraiser in situations where a donation has a meaningful dollar value. We also believe it is entirely appropriate to ask IRS to effectively enforce appraisal requirements largely mandated by Congress in response to its recognition that more rigorous standards are necessary.

C. Noncash Charitable Contributions Are An Indispensable Category of Our System of Charitable Giving

Although real estate agents are knowledgeable about residential housing markets, they are prohibited by law and regulation from valuing homes which serve as collateral for federally-related mortgage loans because they are not trained in professional appraisal practice and often are not independent of the transaction giving rise to a mortgage loan. Congress may want to consider requiring that at least some members of the Art Advisory Panel be credentialed as professional appraisers, as a way of improving the performance of IRS' Art Advisory Services.

¹¹ "Many Taxpayers Are Still Not Complying With Noncash Charitable Contribution Reporting Requirements" Ref Number 2013-40-009, December 20, 2012.

Donations of property are an important (many would say indispensable) component of charitable giving. For tax year 2010, 22.5 million individual taxpayers who itemized deductions reported \$44.3 billion in deductions for noncash charitable contributions. Of these taxpayers, 7.3 million reported \$34.9 billion in deductions on IRS Form 8283 (the form used to report “Noncash Charitable Contributions” and the value of such contributions). The number of taxpayers filing an 8283 form increased by 9.1 percent from 6.7 million for tax year 2009 and the amount claimed for noncash donations increased by 24.7 percent from \$28 billion in 2009. The largest category of donated property was corporate stock. Clothing and household items represented the next two largest categories. “Other investments” (conceivably stock in closely held companies and other types of investments), art and collectibles, real property and real estate, conservation and façade easements and electronics were also large categories of noncash donations.¹²

D. Hundreds of Tax Code Provisions Require Appraisals Of Tangible and Intangible Property As a Component of Determining Tax Liability For Income, Estate and Gift Tax Purposes

Reliable appraisals of tangible and intangible property are a lynchpin of the Tax Code for determining tax liability not only for noncash donations but also for other tax purposes involving millions of Income, Estate and Gift tax returns. We are convinced that the vast majority of appraisals, whether for noncash contributions or for other tax purposes, are reliable. Nevertheless, we also agree with TIGTA that the Service can and must do a better job of enforcing its appraisal requirements. ASA, which has worked with IRS and Congress over the years to ensure the quality of tax-related appraisals, would be pleased to continue that work with the Ways and Means Committee as it moves forward on its tax reform agenda.

The American Society of Appraisers hopes that the Charitable/Exempt Organizations Working Group and the Members of the Ways & Means Committee find our comments helpful. Thank you for considering our views. If you have any questions or need additional information, please contact our government relations consultant, [REDACTED]

¹² “IRS Statistics of Income Bulletin” Volume 32, Number 3, Winter 2013.