

## **Hilton Speaks on Behalf of AICPA at Meeting with IRS**

Thomas E. Hilton, MS, CPA/ABV/CFF, ASA, CVA, Partner at Anders Minkler & Diehl LLP (AMD), spoke on behalf of the AICPA last Thursday, February 19, 2010, when the group presented their perspectives to the IRS. He addressed the IRS on the process of implementing penalties on valuation professionals under Internal Revenue Code 6695A. The IRS is collecting the perspectives of various organizations as they draft proposed regulations implementing IRC 6695A, which was included in the 2009-2010 Priority Guidance Plan. In addition to the AICPA, there were seven other organizations invited to speak and there were several common themes among the diverse group. The most pressing concern from all of the presenters was the current form of the form 4477 letter, and the ramifications it could have on a person's career. Additional common themes were the lack of definition surrounding the term "correct value", the possibility of a mechanical imposition of a penalty because of a negotiated settlement even if the valuator was not involved in the settlement, the need for discourse between the field agent and the valuation expert prior to the issuance of a letter and concern over the lack of clarity around the "more likely than not" standard. The AICPA continues to monitor the progress of this and other legislative issues.

### **Complete text of Tom Hilton's Presentation to IRS Office of Service-Wide Penalties**

Members of the Internal Revenue Service Office of Service-Wide Penalties, distinguished colleagues representing other organizations within the valuation discipline, on behalf of the American Institute of Certified Public Accountants, I wish to thank you for this opportunity to share thoughts and ideas regarding IRC 6695A, and more particularly with respect to the practical issues surrounding penalty determination and assessment communication.

My name is Tom Hilton and I serve as Chair of the Forensic & Valuation Services Executive Committee of the American Institute of Certified Public Accountants. I am a practitioner and my background is tax, having grown up in the tax department of a Big Four firm before specializing in valuation some 23 years ago. I have dealt with estate and gift tax examiners at the field and appellate level and I hope to bring a practical perspective to these discussions.

Throughout the history of the Internal Revenue Code, civil penalties have been used to encourage voluntary compliance with the tax laws of the United States. When the 1954 Code was written, spearheaded by the legendary then-chair of the House Ways & Means Committee Wilbur Mills, it contained 14 civil penalty provisions. Today there are more than 130 civil penalty provisions in the Code. These penalties are designed to discourage intentional or reckless non-compliance with our nation's tax laws.

As the national organization representing some 360,000 Certified Public Accountants in the United States, the AICPA has implemented a specialized training and credentialing program for CPA's wishing to specialize in the valuation of a business, fractional interest in a business, security, or intangible asset. Several thousand of our members render opinions of value on either a full-time or part-time basis. Many of the national accounting firms have valuation services groups. The AICPA protects the public interest and ensures consistency in practice among its members through the adoption of professional standards (both technical and ethical) for those members expressing an opinion of value in tax or non-tax matters. As Certified Public Accountants, our members are

qualified to practice before the Internal Revenue Service and hence are bound by the rules set forth in Circular 230. Consequently, the IRS and the AICPA share the common goal of reasonableness and ethical behavior in the discharge of responsibilities in the valuation discipline.

The field of valuation has many subjective factors which require the judgment of the valuation analyst which leads to many differences of opinion, even among those who are very knowledgeable and experienced. The valuation of business enterprises and business assets is well founded in academic publications and empirical studies. The use of public company information has provided the foundation for the analysis in business valuation. The biggest difference between valuing investments in public companies and nonpublic (closely-held) businesses is lack of information. The application of recognized methodologies, the rigorous analysis of the closely-held business entity, and the application of professional judgment gleaned from data analysis and years of training and experience provide the foundation for an opinion of value. Reasonable and experienced professionals can and do disagree, and often with just cause, on the value of an interest in the same enterprise, thus making the mechanical application of penalties for valuation misstatement under Section 6695A difficult at best and in the worst case, inequitable and potentially the cause of irreparable damage to the practitioner's reputation. The foregoing should not be interpreted to infer that there does not exist in the marketplace valuation analysts whose behavior has breached the standards of their profession, are an embarrassment to their credentialing organizations, and in the rendering of an opinion of value for federal income tax purposes, should be reprimanded or otherwise punished by the IRS and/or the OPR. We believe however, that these practitioners are the minority. The vast majority of valuation analysts follow their professional standards; conduct proper due diligence, and exercise good judgment. We do not believe those practitioners should be unduly harmed by the perhaps mistaken imposition of the appraiser penalties under IRC 6695A.

The key question is whether or not a mechanical calculation is the appropriate way to distinguish a reasonable and supportable difference of opinion from intentional or reckless disregard of the tax laws or taxpayer advocacy. We think not. We believe, and we strongly encourage you to implement, a more subjective analysis that would serve as a system of checks and balances on the mechanical calculation and would better highlight a fundamental difference of valuation opinion from a poor valuation analysis that smacks of intentional or reckless disregard for the tax laws. For example, evidence of poor work might include such factors as: ignoring strong market evidence, purposefully excluding a valuation approach that produces credible results, assuming facts that do not exist, or failure to comply with professional standards. Viewed through this prism, the Service would have more justifiable cause to pursue penalty assertion than by simply applying the mechanical calculation in a vacuum.

Many CPA's earn their living entirely from the practice of valuation. Like many professionals, the most important attribute of the CPA is his/her reputation, which is fundamentally grounded in his/her integrity. The ability of the Service to impose penalties on any valuation professional is a powerful weapon with serious consequences. The simple receipt of a Letter 4477 informing a valuation analyst of the possibility of the imposition of an appraiser penalty is discoverable in litigation and could ruin the career of those who regularly testify before a trier of fact. Why? Because the fact of an IRS inquiry could be brought up in every subsequent matter in which the expert seeks to testify and it could tarnish the expert's credibility in the legal community even if a

penalty was subsequently not imposed. We want you to know there are real consequences to even the thought of the imposition of these penalty provisions....you are potentially impacting people's careers....please understand this fact and implement a more equitable process for penalty determination than mere mechanical calculation.

In the safe harbor provisions under 6695A which provide for exceptions to the penalty, no penalty will be imposed if the valuation analyst establishes that the appraised value was more likely than not the proper value. Proper value.....what does that mean? Who determines proper value? How is proper value similar to or differentiated from fair market value? Further, we note that the bar for valuation analysts is "more likely than not" when the bar for tax return preparers is ""substantial authority" Until these important issues are addressed, we do not believe the assertion of a penalty under Section 6695A is warranted.

We would like to make you aware of real life circumstances that perhaps may not have been considered in the drafting of this Code Section and perhaps could be addressed in the forthcoming proposed regulations, which we understand are scheduled to be issued in April of this year. The manner in which an estate or gift tax audit is played out, and the dynamics of involvement/exclusion in that process, allow for the potential for triangulation that could result in a situation where the valuation analyst could be the target of the imposition of an appraiser penalty and be completely unaware of the existence of an examination by an estate and gift field agent.

Generally speaking, a taxpayer retains an attorney specializing in estate planning to assist and counsel in the preparation of an estate plan. The attorney often refers or retains a valuation analyst to express an opinion of value on a closely-held business interest that is a line item on a Form 706 or 709 that is prepared by either the lawyer's firm or the client's CPA firm. If that tax return becomes the subject of an IRS examination, the client retains the lawyer to represent him/her before the IRS. If the attorney feels the input of the valuation analyst is necessary to argue the position taken by the Service, the valuation analyst will be made aware of the existence of the estate/gift tax examination. However, in a number of instances, the valuation analyst is not contacted by the client or his/her attorney, has no knowledge of the field examination, and yet could be the subject of IRS scrutiny with respect to penalty assessment. Since under certain circumstances, the law now treats a valuation analyst as a tax preparer for purposes of tax preparer penalties, we believe the valuation analyst should be notified of the existence of an examination if the opinion of value is one of the items under scrutiny. This form of communication would be purely a notice of the fact that an examination has begun without any details, which of course are appropriately reserved for a duly authorized Power of Attorney.

Once an examination has begun, the client and his/her attorney have one objective....to resolve the matter with minimum additional tax cost to the taxpayer. Savvy and experienced estate tax lawyers understand the fact that a negotiation process often leads to a settlement at either the field or appellate level, sometimes without the need for or knowledge of the valuation analyst. After reflecting on the costs of appeal or perhaps Tax Court, and upon the advice of counsel, the client and the IRS often settle the matter by agreeing to a higher value for the subject interest. Does this settlement represent the "amount determined to be the correct amount" for purposes of the mechanical application of the appraiser penalty? We certainly hope not as in our opinion that is not the definition of fair market value.....this is simply a value negotiated for tax resolution purposes. In

a negotiated settlement, there may not have been an analysis or evaluation of the reasoning or rationale behind the opinion expressed by the valuation analyst. The agreed upon value is simply the amount necessary to prevent two competing interests from incurring further costs. Further, if the valuation analyst has not been a party to this process, he/she has been the subject of triangulation by the client and client's legal counsel. We believe this is inequitable and not in the spirit of these penalty provisions. Once again, the application of a mechanical calculation to consider the imposition of a penalty that is predicated on a negotiated value and not fair market value ignores the facts and circumstances of each case and the fact that reasonable professionals can and do differ on the value of an interest in the same business enterprise. We request this area be revisited prior to the issuance of proposed regulations to require the IRS to inform the valuation analyst that an estate or gift examination is underway and provide that person the opportunity to explain the reasoning behind the conclusion of value prior to the issuance of a Letter 4477.

Once again, as the duly authorized representative of the American Institute of Certified Public Accountants, I thank you for this opportunity and hope this information has been of help to you. The AICPA stands ready to work with the IRS in addressing matters affecting the tax laws of the United States and looks forward to future opportunities to do the same.

Thank you.