

# *Burkert Valuation Advisors, LLC*

VALUATION AND LITIGATION CONSULTANTS

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## **Spotlight on Value: IRS Adequate Disclosure Regulations**

*by Rod P. Burkert, CPA/ABV, CVA*

A gift tax return is not required for gifts that do not exceed the annual exclusion amount. Also, the Internal Revenue Service cannot revalue a gift after the expiration of the three-year statute of limitations if it is adequately disclosed in the gift tax return. However, the statute of limitations will not begin for any gift unless/until it is adequately disclosed on a gift tax return. Thus, *adequate disclosure* is the key to starting the statute of limitations, and in certain circumstances, it may be advisable to file a return even for gifts that do not exceed the annual exclusion.

The IRS regulations provide guidance as to what constitutes adequate disclosure. The regulations apply to gift tax returns filed after December 31, 1999. Under these regulations, a gift is adequately disclosed only if it is reported in a manner adequate to apprise the IRS of the nature of the gift and the basis for the value reported. This requirement will be satisfied if the return (or a statement attached to it) contains the following information:

- (i) A description of the transferred property and any consideration received by the transferor;
- (ii) The identity of, and the relationship between, the transferor and each transferee;
- (iii) If the property is transferred in trust, the trust's tax identification number and either a brief description of the terms of the trust or a copy of the trust instrument;
- (iv) A detailed description of the method used to determine the fair market value of the property transferred, including any financial data utilized, any restrictions on the property considered, and a description of any discounts claimed; and
- (v) A statement describing any position taken that is contrary to any proposed, temporary, or final regulations or revenue rulings published at the time of the transfer.

Item (iv) is shown above in highly abbreviated form, and in the actual regulation, goes into significant detail about specific items required. Additional issues discussed in (iv) include requirements for publicly-traded securities as well as a discussion about whether the disclosure of a 100% control value is required.

Interestingly, the background section of the regulations states that “the more complete and comprehensive the information filed with the return is, the more readily the IRS will be able to identify the returns that should not be examined, thus saving taxpayers needless expenditures of time and money.”

It is not a surprise then that the regulations allow for the submission of a valuation report in lieu of the information required under (iv) and that such a report will meet the adequate disclosure requirements IF it is prepared by an appraiser who satisfies all of the following:

- 1.** The appraiser is an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.
- 2.** Because of the appraiser's qualifications, as described in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations, the appraiser is qualified to make appraisals of the type of property being valued.
- 3.** The appraiser is not the donor or the donee of the property or a member of the family of the donor or donee, or any person employed by the donor, the donee, or a member of the family of either.

AND the report contains all of the following:

- 4.** The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.
- 5.** A description of the property.
- 6.** A description of the appraisal process employed.
- 7.** A description of the assumptions, hypothetical conditions, and restrictions on the transferred property that affect the analysis, opinions, and conclusions.
- 8.** The information considered in determining the appraised value, including in the case of an ownership interest in a business, all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.
- 9.** The appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions.
- 10.** The valuation method utilized, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.
- 11.** The specific basis for the valuation, such as specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc.

Any gift not adequately disclosed is subject to examination and challenge by the IRS at any time, including and especially at the death of the donor. If the gift tax valuation report provides adequate disclosure, a safe harbor is created for those gifts made more than three years ago.

The adequate disclosure rule applies to the estate tax computation as well. Thus, gift tax values adequately disclosed on gift tax returns will be binding on the IRS in connection with the addition of taxable gifts to determine a decedent's estate tax liability unless the IRS has challenged the gift tax return within the statutory period.

Simply put, the IRS has given business appraisers some specific rules to follow, and the burden is now on each appraiser to follow those rules. Fortunately, the new requirements are largely items that should already be contained in a high-quality and properly written business valuation report (see *Spotlight on Value: A Professionally Prepared Business Valuation Report*). Thus, cutting out vital areas of the valuation report to save money in the short run is doing a disservice to a client by subjecting the report to possible attack by the IRS. The cost of submitting such a report could be many times larger in the long run.

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Rod is a co-founder of Burkert Valuation Advisors, LLC. With over 25 years of combined experience in public accounting and private industry, he has provided business appraisal and litigation consulting services for companies operating in a wide variety of industries and for various purposes. He is also an instructor for the National Association of Certified Valuation Analysts and a past chairman of its Executive Advisory Board and its Education Board.

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