

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Luanne M. Parker
Appeals Team Case Leader
(Office of Appeals)

from: Blaise G. Dusenberry
Senior Technical Reviewer
(Procedure & Administration)

subject: Additional Information for Gross and Substantial Valuation Misstatement Penalties

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether _____ (taxpayer) is subject to the accuracy-related penalty, based on an underpayment attributable to a substantial or gross valuation misstatement, for taxable year _____, _____, or both, when the Service calculated the penalty by valuing only a limited number of the items of property claimed by taxpayer on the returns.

CONCLUSION

FACTS

Taxpayer is an S corporation which operates retail stores in multiple states, selling a wide variety of products and supplies related to _____ . Taxpayer's products include _____ and related supplies. The taxpayer also distributes _____, including _____

. Taxpayer makes charitable donations to certain

During through , taxpayer purchased for \$.
Near the end of taxpayer donated the to the . When
the taxpayer filed its tax return for taxable year , it claimed an itemized deduction
for a charitable contribution in the amount of \$, based on the claimed
combined fair market values of the . To document the fair market
values, taxpayer included with its return a completed *Noncash Charitable
Contributions* (Form 8283) and an appraisal, which was earlier prepared by
 . did not create a separate appraisal report for each donated
by the taxpayer during . Rather, he created one appraisal report for all of the
donated during . The report listed, appraised and valued each
individually and then added the values of the individual items together to calculate the
total fair market value for all of the items contributed to the .

From December through August taxpayer purchased and
for the total purchase price of \$. Near the end
of taxpayer donated the to
 . When the taxpayer filed its tax return for taxable year , it claimed an
itemized deduction for a charitable contribution in the amount of \$, based on
the claimed combined fair market values of these items. To document the fair market
values, taxpayer included with its return a completed *Noncash Charitable Contributions*
(Form 8283) and an appraisal, which had been prepared by . He did not
create a separate appraisal report for each donated by the
taxpayer during . Rather, created one appraisal report for all of the
articles of property donated. The report listed, appraised and valued each
and individually and then added the values of the individual items together
to calculate the total fair market value for all of the items contributed to the

The Service examined taxpayer's returns for taxable years and and sought
to determine whether taxpayer complied with the appraisal requirements of Code
section 170 respecting non-cash charitable contributions. Specifically, the Service
examined the taxpayer's records and those of in order to determine if the
latter is a not a qualified appraiser because he was regularly used by taxpayer for
appraisal services. To accomplish this, the Service considered the number of reports
prepared for the taxpayer in comparison to the number prepared for all
other individuals and entities during and . The examination also took
into account the total time devoted to furnishing appraisals to the taxpayer
and income received from the taxpayer in comparison to those variables for all other
individuals and entities for which performed appraisals.

The Service determined that _____ is not a qualified appraiser respecting the charitable contribution deductions for non-cash donations claimed by the taxpayer and that, consequently, the deductions should be denied for taxable years _____ and _____.

The Service's examination also focused on whether taxpayer is liable for accuracy-related penalties for taxable years _____ and _____ based on underpayments reflected in the taxpayer's returns that are attributable to the alternative causes listed in Code section 6662(b). The Service concluded that because the values of the _____ claimed by the taxpayer when calculating the charitable contribution deduction for taxable year _____ exceeded the correct values by more than 200 percent, the taxpayer is liable for the 40% gross valuation misstatement penalty under section 6662(h). The Service determined that the underpayment reflected on the taxpayer's _____ return is, alternatively, due to a substantial valuation misstatement and thus subject to a 20% penalty pursuant to Code section 6662(b)(3) and (e).

In reaching these conclusions, however, the Service's Office of Art Appraisal Service did not perform an appraisal of each of the _____ the taxpayer donated to the _____. Rather, the Service selected _____, based on a random statistical sampling, and appraised only these selected _____. Because the Service's appraisal of the _____ randomly selected for review concluded that the values were overstated by at least 200 percent, the Service concluded that all of the donated _____ had values overstated by at least 200 percent.

The Service used the same methodology to determine the correct fair market values of the _____ the taxpayer donated to the _____ in taxable year _____.¹ The Service selected for review by a random statistical sample _____ out of the _____ the taxpayer donated to the _____, which was the foundation for the charitable contribution deduction claimed by the taxpayer. The Service accordingly determined the accuracy-related penalty based on a gross valuation misstatement or, alternatively, a substantial valuation misstatement.

You requested our views on whether the Service may calculate the values of multiple articles of property through reliance on a random sample of some of the properties in determining the taxpayer's liability for the gross valuation or substantial valuation misstatement penalty under section 6662.

LAW AND ANALYSIS

Section 6662 imposes a penalty of 20% of the portion of an underpayment of tax reflected in a taxpayer's return attributable to a substantial valuation misstatement. I.R.C. § 6662(b)(3). A substantial valuation misstatement exists if the value or adjusted

¹ The Service concluded that \$ _____, the fair market value the taxpayer used in calculating the portion of its deduction for the donation of _____ to the _____, was correct.

basis of property claimed on a return is 150 percent or more of the amount determined to be the correct value or adjusted basis. I.R.C. § 6662(e). If the reported value or adjusted basis exceeds the correct amount by at least 200 percent, the valuation misstatement is considered “gross” and the penalty increases to 40%. I.R.C. § 6662(h); *see e.g. United States v. Woods*, 134 S.Ct. 557 (2013); *Gustashaw v. Commissioner*, 696 F.3d 1124 (11th Cir. 2012). No penalty may be imposed under section 6662(b)(3) for a taxable year unless the portion of the underpayment attributable to a substantial or gross valuation misstatement exceeds \$5,000. I.R.C. § 6662(e)(2); Treas. Reg. § 1.6662-5(b). The determination of whether there is a substantial or gross valuation misstatement in the case of the return of a pass-through entity is made at the entity level. Treas. Reg. § 1.6662-5(h). However, the \$5,000 limitation is applied at the taxpayer level. *Id.*

The regulation implementing the substantial and gross valuation misstatement penalties under Code section 6662 includes the following rule for determining the penalty in the case of multiple properties:

(f) Multiple valuation misstatements on a return. –(1) Determination of whether valuation misstatements are substantial or gross.– The determination of whether there is a substantial or gross valuation misstatement on a return *is made on a property-by-property basis*. Assume, for example, that property A has a value of 60 but a taxpayer claims a value of 110, and that property B has a value of 40 but the taxpayer claims a value of 100. Because the claimed and correct values are compared on a property-by-property basis, there is a substantial valuation misstatement with respect to property B, but not with respect to property A, even though the claimed values (210) are 200 percent or more of the correct values (100) when compared on an aggregate basis.²

Treas. Reg. § 1.6662-5(f)(1)(emphasis added).

When the Service determines a taxpayer has misstated the value or adjusted basis of more than one property on his return, Treas. Reg. § 1.6662-5(f)(1) requires the Service to calculate the correct value or adjusted basis of each property individually. The example included within Treas. Reg. § 1.6662-5(f)(1) takes into account that when a taxpayer misstates the values of multiple articles of property on his return, some of the

² The example under section 1.6662-5(f)(1) is outdated because it reflects the misstatement percentage threshold for a substantial valuation misstatement under Code section 6662(e)(1)(A) prior to the effective date of the provision in the Pension Protection Act of 2006, P.L. 109-280, § 1219(a)(1)(A), 120 Stat. 1083 (“PPA 2006”) by which Congress lowered the thresholds for substantial and gross valuation misstatements to 150 percent and 200 percent, respectively, for tax returns filed after August 17, 2006. For returns filed before the effective date of PPA 2006, the threshold for a substantial valuation misstatement was 200 percent and for the gross valuation misstatement penalty to apply, the taxpayer had to misstate the property’s value or adjusted basis by 400 percent or more.

valuation misstatements may be sufficient to meet the 150 percent threshold under Code section 6662(e)(1)(A) while other misstatements may not. [REDACTED]

There are reported cases in which a taxpayer misstated the value or adjusted basis of more than one article of property for a single taxable period. *Woods* (outside basis of multiple pass-through entities), *American Boat Co., LLC v. United States*, 583 F.3d 471 (7th Cir. 2009)(in Son-of-Boss transaction, misvaluation of tugboat fleet). Our research did not, however, disclose a reported case in which a court addressed whether the Service may determine the substantial or gross valuation misstatement penalty under Code section 6662 based on an appraisal of some, but not all, of the properties claimed on the taxpayer's return. Here, it appears that the Service did not appraise each individually for taxable year or because the large number of made appraisal of all of them impractical.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

[REDACTED]

3 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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Please call (202) 317-6845 if you have any further questions.