

## Taxpayer Victory over IRS: Even a Bad Appraisal Can Be a “Qualified Appraisal”

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Mr. and Mrs. Friedberg were just another couple of average married taxpayers like any other married taxpayers happily minding their own business until the IRS decided to wage a war of terror on them.

Just the type of average taxpayers who, after spending \$9,400,000 on a home, could afford to spend another \$4,000,000 to fix it up. This reminds us of President George W. Bush's October 20, 2000, speech at the AI Smith Dinner: "This is an impressive crowd: the haves and the have-mores. Some people call you the elite. I call you my base."

The Friedbergs bought in Manhattan's Upper East Side Historic District. The National Park Service designated the Friedberg home a "certified historic structure" for charitable contribution purposes. Almost immediately the National Architecture Trust contacted Mr. Friedberg about donating a façade and development rights easement. Not wanting to shirk his patriotic duty, Mr. Friedberg agreed and executed the papers necessary to transfer the rights to the NAT. The fact that the NAT's proposal showed a total estimated charitable contribution deduction of \$3,866,000 probably had nothing to do with Mr. Friedberg's decision.



When it came time to prepare their tax returns, the Friedbergs' accountant realized that certain formalities were required to document the charitable deduction. They took the NAT's advice and hired an appraiser expert in just this type of façade work. Curiously, this expert was located in Pittsburgh, Pa.

With the benefit of hindsight we must ask whether it is remotely possible that there might be someone with expertise in the valuation of Upper East Side Historic District façade and development rights who is located in metropolitan New York City (population 20,000,000)?

Pittsburgh is a great, vibrant and lovely city, of course.

However, with a population of a little over 300,000, we could drop Pittsburgh into the Upper East Side Historic District and it would get lost.

In any event, the IRS reviewed the Friedbergs' tax return filing and asserted a \$1,321,250 deficiency and a \$528,500 penalty. In a 2011 proceeding, both the taxpayers and the IRS moved for summary judgment. In response, the Tax Court sustained the IRS as to the façade deduction while harshly criticizing the appraisal: "Indeed, it appears that [the appraiser] arrived at 11%, the percentage of fair market value that NAT had told Mr. Friedberg was typical for façade easements, in spite of his research on comparable sales and not because of it." For the development part of the deduction the Tax Court held that there was enough substance to the appraisal as to warrant a trial on the merits.

After that case, the U.S. Court of Appeals for the Second Circuit overturned an earlier Tax Court decision on which the first *Friedberg* decision had relied. The Court of Appeals, in *Scheidelman II*, held that an appraisal can be “sloppy or inaccurate, or haphazardly applied” and still count for purposes of allowing the taxpayer to avoid the penalty. As a result, the Tax Court reviewed its earlier decision and issued *Friedberg II* on Sept. 23, 2013. In this second decision, the Tax Court held that even the harshly criticized appraisal was sufficient to make the Friedbergs penalty proof.

So this case is ripe for a “good news, bad news” joke. “I have good news, and bad news. Which would you like first?” “Give me the bad news first.” “The bad news is that you lost the income tax deduction and you owe the IRS \$1,321,520 because you had a lousy appraisal.” “What’s the good news?” “The good news is that the appraisal gave the IRS enough information to determine precisely how bad it was.”

This case also shows the difference between “logic” and “tax logic.” Only in Tax Court is a very bad appraisal a “Qualified Appraisal.”

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