

FCG VALUATION CASE E-FLASH

**Authored by John Walker and Chris D. Treharne, ASA, MCBA, BVAL
of Gibraltar Business Appraisals, Inc. a member firm of FCG
Issue 13:5**

Boltar, L.L.C., Joseph Calabria, Jr., Tax Matters Partner, Petitioner, v. Commissioner of Internal Revenue, Respondent
136 T.C. No. 14, Docket No. 25954-08, April 5, 2011

In a case involving a conservation easement and a related charitable deduction, the Tax Court determined that standards of reliability and relevance apply to non-jury trials. Under a challenge by the Respondent under the [Federal Rules of Evidence § 702](#) and [Daubert v. Merrell Dow Pharm., Inc. 509 US 579 \(1993\)](#), the court dismissed the report provided by the Petitioner's expert.

TAKEAWAY

The Petitioner's expert failed a Daubert challenge and failed its client for the following reasons:

- 1) failed to apply common methodology,
- 2) valued the subject easement after relying on a draft of the easement (rather than the final version),
- 3) assumed that the subject property had been annexed by the city when it had not, and
- 4) valued the subject interest using a development plan that could not possibly fit on the subject parcel.

THE FACTS

On October 1, 1999, Boltar, LLC ("Boltar" or "Petitioner") acquired two contiguous parcels of real estate ("Northern Parcel" and "Southern Parcel") via quitclaim deed. On November 8, 2002, Boltar received by quitclaim deed another parcel of land ("Eastern Parcel"), although the deed was never recorded. Individually, each of the parcels consisted of approximately 10 acres.

The Southern Parcel was encumbered by a pipeline utility easement of fifty feet, and both the Northern and Southern Parcels had golf cart easements. On December 29, 2003, the Petitioner granted to the Shirley Heinze Land Trust, Inc., (from which Boltar had received the Eastern Parcel) an easement that restricted the use of approximately eight acres on the eastern part of the Southern Parcel (the "Eased Area"). The easement disallowed any activity or use of the property which would impair conservation values.

Approximately 2.82 acres of the Eased Area, 8.5 acres on the Northern Parcel, and all of the Eastern Parcel were forested wetlands. As a result, a developer would be required to go through permitting processes with both the US Army Corps of Engineers and the Indiana Department of Environmental Management.

As of December 29, 2003, all of the Parcels were under the jurisdiction of Hobart, Indiana. The Northern and Southern Parcels were zoned for single-family residential, while the Eastern Parcel was zoned as a Planned Unit Development (PUD), part of the Deep River Pointe PUD ("DRP"). Phase II of the DRP never had a final plat approved by the City of Hobart, while the property for Phase III of the DRP was never annexed into Hobart and was never zoned as a PUD.

On its 2003 Form 1065, Boltar claimed a \$3,270,000 deduction for the donation of the conservation easement. Attached to the Form 1065 was Form 8283 and an appraisal report, both of which were signed by members of the same real estate appraisal firm. The appraisal report was based upon a draft copy of the conservation easement; the analyst and principal in the appraisal firm did not rely on the final version of the easement for their valuation purposes. In preparing their appraisal report, the appraisal firm assumed the Eased Area was under the jurisdiction of Hobart and that it was part of the DRP.

The IRS disagreed with the Petitioners' determination of fair market value. In particular, the valuation engineer faulted the Petitioner's expert for failing to consider the before and after method of valuing real estate. The IRS engineer's value was \$42,400, much lower than the Petitioner-expert's value, in part because the Eased Area was landlocked and had no direct access to a public road. As a result, development of the property would be difficult to impossible until the surrounding properties were developed.

The Respondent's motion in limine asserted that the Petitioner's appraisal report departed from the legal standard in determining the highest and best use by failing to apply the before and after methodology, did not value all of the contiguous Parcels and included a valuation which was physically impossible on the Eased Area. As a result, the IRS maintained that the Petitioner-expert's report was neither reliable nor relevant.

Boltar argued that Daubert factors were not relevant because there was no jury in this case, that the IRS had accepted the methodology in the Petitioner-expert's report and stipulated the version attached to the tax return was a qualified appraisal, and the issues raised by the Respondent did not affect the admissibility of the report.

DISCUSSION

The Tax Court determined that the Federal Rules of Evidence § 702 and Daubert analysis both apply to bench trials as well as jury trials. Additionally, § 702 sets forth the standards of reliability for evidence admitted at trial.

The court noted that "the cottage industry of experts who function in the market for tax benefits should be discouraged." The court further determined that experts' "willingness to use their resumes and their skills to advocate the position of the party who employs them without regard to objective and relevant facts, contrary to their professional obligations" was a problem.

With the preceding as background, the Tax Court found the Petitioner-expert's "report is so far beyond the realm of usefulness that admission is inappropriate and exclusion serves salutary purposes."

In particular, the court faulted the Petitioner's expert for failure to determine the highest and best use of the property after the easement was granted. The Tax Court further noted the Petitioner's expert failed to consider the effect of the easement on contiguous property owned by the Petitioner. Petitioner asserted that its expert addressed the effect in a three-page letter from to Boltar. The court, however, indicated the authors of the letter "were unaware of the extent of Boltar's ownership. That letter, moreover, is not a part of the report submitted in accordance with...the Court's standing pretrial order." Because the letter was not admitted with the expert report, it was not included in the evidence at trial.

The Tax Court also sided with the Respondent when the IRS noted that the Petitioner-expert's site plan was for ten acres even though the subject area was only eight acres. Additionally, Petitioner's expert ignored the effect of the fifty foot easement for the gas pipeline that ran across the property. Petitioner-expert's only response to the preceding was that the project "will fit, it just won't fit as drawn on the site plan," which was found unpersuasive by the court.

Finally, the court found the Petitioner-expert's assumption that the Eased Parcel had been annexed by the City of Hobart and was zoned PUD was fatal. The Tax Court faulted the Petitioner's expert for failure to include appropriate analysis, to correct factual errors, to adjust calculations based on additional evidence, and to abandon an unreasonable position as it related to the submitted report. As such, the court determined the Petitioner-expert's value "defies reason and common sense" and its report was "too speculative and unreliable to be useful."

CONCLUSION

The Tax Court was clear in the Boltar ruling: Unreasonable valuation reports will be rejected, regardless of the qualifications of the submitting individuals.

More specifically, the Petitioner’s expert failed the Petitioner and the court by failing to apply common methodology and by relying on erroneous (and easily verifiable) assumptions. Furthermore, the expert’s unwillingness to correct factual and methodological errors and unwillingness to change his opinion was unacceptable. As a result, the Daubert challenge was sustained, and the Respondent’s notice of deficiency was upheld.

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