MSG

ACCOUNTANTS, CONSULTANTS, & BUSINESS VALUATORS

IRS BUSINESS VALUATION STANDARDS

RELEASED JULY 27, 2006

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MANUAL TRANSMITTAL

Department of the Treasury — Internal Revenue Service

4.48.4

JULY 1, 2006

PURPOSE

(1) This transmits new IRM 4.48.4, Engineering Program, Business Valuation Guidelines.

BACKGROUND

(1) This material is the product of the Valuation Policy Council (VPC), a cross-functional committee with executive representation from LMSB, SBSE, and Appeals. The VPC was established in 2001 to assist IRS leadership in setting direction for valuation policy that cuts across functional lines, and in identifying process improvements to improve compliance and better utilize resources.

NATURE OF MATERIAL

(1) This IRM provides specific guidance for:

a. Developing the valuation issue
b. Resolving the issue when possible
c. Preparing reports

(2) This document provides specific instructions to examiners with respect to:

a. Planning the valuation assignment
b. Analyzing relevant information
c. Preparing work papers
d. Reviewing a third-party valuation

EFFECT ON OTHER DOCUMENTS

None

AUDIENCE

All IRS employees who provide valuation services or review the valuations and appraisals prepared by others.

Kelly Cables for Deborah M. Nolan
Commissioner, Large Mid Size Business

4.48.4
Business Valuation Guidelines

Table of Contents

4.48.4.1 (07-01-2006) Introduction

(1) The purpose of this document is to provide guidelines applicable to all IRS personnel engaged in valuation practice (herein referred to as "valuators") relating to the development, resolution and reporting of issues involving business valuations and similar valuation issues. Valuators must be able to reasonably justify any departure from these guidelines.

(2) This document incorporates by reference, the ethical and conduct provisions, contained in the Office of Government Ethics (OGE) Standards of Ethical Conduct, applicable to all IRS employees.

(3) Valuations of assets owned and/or transferred by or between controlled taxpayers (within the meaning of Treasury Regulation section 1.482-1(i)(5)) may present substantive issues that are not addressed in these guidelines.

4.48.4.2 (07-01-2006) Development Guidelines

(1) Successful completion of a valuation assignment includes planning, identifying critical factors, documenting specific information, and analyzing the relevant information. All relevant activities will be documented in the workpapers.

(2) A review appraisal may be the best approach to the assignment.

4.48.4.2.1 (07-01-2006) Planning

(1) Valuators will adequately plan the valuation assignment. Their managers will supervise the staff involved in the valuation process.

(2) Quality planning is a continual process throughout the valuation assignment.

4.48.4.2.2 (07-01-2006) Identifying

(1) In developing a valuation conclusion, valuators should define the assignment and determine the scope of work necessary by identifying the following:

a. Property to be valued
b. Interest to be valued
c. Effective valuation date
d. Purpose of valuation
e. Use of valuation
f. Statement of value
g. Standard and definition of value
h. Assumptions
i. Limiting conditions
j. Scope limitations
k. Restrictions, agreements and other factors that may influence value
l. Sources of information

4.48.4.2.3 (07-01-2006) Analyzing

(1) In developing a valuation conclusion, valuators should analyze the relevant information necessary to accomplish the assignment including:

- The nature of the business and the history of the enterprise from its inception
- The economic outlook in general and the condition and outlook of the specific industry in particular
- The book value of the stock or interest and the financial condition of the business
- The earning capacity of the company
- The dividend-paying capacity
- Existence or non existence of goodwill or other intangible value
- Sales of the stock or interest and the size of the block of stock to be valued

- The market price of stocks or interests of corporations or entities engaged in the same or a similar line of business having their stocks or interests actively traded in a free and open market, either on an exchange or over-the-counter
- Other relevant information

(2) The three generally accepted valuation approaches are the asset-based approach, the market approach and the income approach. Consideration should be given to all three approaches. Professional judgment should be used to select the approach(es) ultimately used and the method(s) within such approach(es) that best indicate the value of the business interest.

(3) Historical financial statements should be analyzed and, if necessary, adjusted to reflect the appropriate asset value, income, cash flows and/or benefit stream, as applicable, to be consistent with the valuation methodologies selected by the valuator.

(4) The valuator should select the appropriate benefit stream, such as pre-tax or after-tax income and/or cash flows, and select appropriate discount rates, capitalization rates or multiples consistent with the benefit stream selected within the relevant valuation methodology.

(5) The valuator will determine an appropriate discount and/or capitalization rate after taking into consideration all relevant factors such as:

- The nature of the business
- The risk involved
- The stability or irregularity of earnings
- Other relevant factors

(6) As appropriate for the assignment, and if not considered in the process of determining and weighing the indications of value provided by other procedures, the valuator should separately consider the following factors in reaching a final conclusion of value:

a. Marketability, or lack thereof, considering the nature of the business, business ownership interest or security, the effect of relevant contractual and legal restrictions, and the condition of the markets.
b. Ability of the appraised interest to control the operation, sale, or liquidation of the relevant business.
c. Other levels of value considerations (consistent with the standard of value in Section 4.48.4.2.2 (1) list item g) such as the impact of strategic or synergistic contributions to value .
d. Such other factors which, in the opinion of the valuator, that are appropriate for consideration.

4.48.4.2.4
(07-01-2006)
Workpapers

(1) Workpapers should document the steps taken, techniques used, and provide the evidence to support the facts and conclusions in the final report.

(2) Valuators will maintain a detailed case activity record (Form 9984, Examining Officer's Activity Record) which:

- Identifies actions taken and indicates time charged
- Identifies contacts including name, phone number, subject, commitments, etc.
- Documents delays in the examination

(3) The case activity record, along with the supporting workpapers, should justify that the time spent is commensurate with work performed.

4.48.4.2.5
(07-01-2006)
Reviewing

(1) In reviewing a business valuation and reporting the results of that review, a valuator should form an opinion as to the adequacy and appropriateness of the report being reviewed and should clearly disclose the scope of work of the review process undertaken.

(2) In reviewing a business valuation, a valuator should:

a. Identify the taxpayer and intended use of the opinions and conclusions, and the purpose of the review assignment.
b. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review.
c. Identify the scope of the review process conducted.
d. Determine the completeness of the report under review.
e. Determine the apparent adequacy and relevance of the data and the propriety of any adjustments to the data.
f. Determine the appropriateness of the valuation methods and techniques used and develop the reasons for any disagreement.
g. Determine whether the analyses, opinions, and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.

(3) In the event of a disagreement with the report's factual representations, underlying assumptions, methodology, or conclusions, a valuator should conduct additional fact-finding, research, and/or analyses necessary to arrive at an appropriate value for the property.

4.48.4.3
(07-01-2006)
Resolution Guidelines

(1) Valuators will make efforts to obtain a resolution of the case after fully considering all relevant facts.

4.48.4.3.1
(07-01-2006)
Objective

(1) The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the valuator will facilitate resolution of issues without litigation.

(2) The valuator will work in concert with the internal customer and taxpayer to attempt to resolve all outstanding issues.

4.48.4.3.2
(07-01-2006)
Arriving at Conclusions

(1) Once the valuator has all the information to be considered in resolving the issue, the valuator will use his/her professional judgment in considering this information to arrive at a conclusion.

(2) Valuators may not have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, should decide when they have substantially enough information to make a proper determination.

(3) Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy, and conflicts of interest.

4.48.4.4 (07-01-2006) Reporting Guidelines

(1) Valuators should prepare reports of their findings.

(2) This section requires specific information to be included or addressed in each report.

4.48.4.4.1 (07-01-2006) Overview

(1) The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.

(2) Valuation reports should contain all the information necessary to allow a clear understanding of the valuation analyses and demonstrate how the conclusions were reached.

4.48.4.4.2 (07-01-2006) Report Contents

(1) The extent and content of the report prepared depends on the needs of each case.

(2) Valuation reports should clearly communicate the results and identify the information relied upon in the valuation process. The valuation report should effectively communicate the methodology and reasoning, as well as identify the supporting documentation.

(3) Subject to the type of report being written, valuation reports should generally contain sufficient information relating to the items in Identifying and Analyzing to ensure consistency and quality.

(4) Reports written with respect to Reviewing shall contain, at a minimum, information relating to those items in Identifying and Analyzing necessary to support the revised assumptions, analyses, and/or conclusions of the valuator

4.48.4.4.3 (07-01-2006) Statement

(1) Each written valuation report should contain a signed statement that is similar in content to the following: To the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the subject of this report or to the parties involved with this assignment.
- My compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- My analyses, opinions, and conclusions were developed, and this report has been prepared in conformity with the applicable Internal Revenue Service Valuation Guidelines.

Intangible Property Valuation Guidelines

§ 4.48.5

MANUAL TRANSMITTAL

Department of the Treasury | Internal Revenue Service

4.48.5

JULY 1, 2006

PURPOSE

(1) This transmits new IRM 4.48.5, Engineering Program, Intangible Property Valuation Guidelines.

BACKGROUND

(1) This material is the product of the Valuation Policy Council (VPC), a cross-functional committee with executive representation from LMSB, SBSE, and Appeals. The VPC was established in 2001 to assist IRS leadership in setting direction for valuation policy that cuts across functional lines, and in identifying process improvements to improve compliance and better utilize resources.

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EFFECT ON OTHER DOCUMENTS

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AUDIENCE

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Kelly Cables for Deborah M. Nolan
Commissioner, Large Mid-Size Business

4.48.5
Intangible Property Valuation Guidelines

Table of Contents

4.48.5.1 (07-01-2006) Introduction

(1) The purpose of this document is to provide guidelines applicable to all IRS personnel that are engaged in valuation practice (hereinafter referred to as "valuators"), relating to the development, resolution, and reporting of issues involving intangible property valuations and similar valuation issues. Valuators must be able to reasonably justify any departure from these guidelines.

(2) For purposes of this document, intangible property includes but is not limited to any commercially transferable interest in any items included in the following six categories:

- Computer software
- Patents, inventions, formulae, processes, designs, patterns, trade secrets, or know-how
- Copyrights and literary, musical, or artistic compositions
- Trademarks, trade names, or brand names
- Franchises, licenses, or contracts
- Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data
- Other similar items

(3) An item is considered similar if it derives its value not from physical attributes, but from its intellectual content or other intangible properties.

(4) The guidelines provided here regarding identifying, documenting, and analyzing the property are applicable to all types of intangible property. The information does not provide specific details for every type of intangible property.

(5) This document incorporates by reference, the ethical and conduct provisions, contained in the Office of Government Ethics (OGE) Standards of Ethical Conduct, applicable to all IRS employees.

(6) Valuations of assets owned and/or transferred by or between controlled taxpayers (within the meaning of Treasury Regulation section 1.482-1(i)(5)) may present substantive issues that are not addressed in these guidelines.

4.48.5.2 (07-01-2006) Development Guidelines

(1) Successful completion of a valuation assignment includes planning, identifying critical factors, documenting specific information, and analyzing the relevant information. All relevant activities will be documented in the workpapers.

(2) A review appraisal may be the best approach to the assignment.

4.48.5.2.1 (07-01-2006) Planning

(1) Valuators will adequately plan the valuation assignment. Their managers will supervise the staff involved in the valuation process.

(2) Quality planning is a continual process throughout the valuation assignment.

4.48.5.2.2 (07-01-2006) Identifying

(1) In developing a valuation conclusion, valuators should define the assignment and determine the scope of work necessary by identifying the following

a. Property to be valued
b. Interest to be valued
c. Effective valuation date
d. Purpose of valuation

e. Use of valuation
f. Statement of value
g. Standard and definition of the value
h. Assumptions
i. Limiting Conditions
j. Scope limitations
k. Restrictions, agreements and other factors that may influence value
l. Sources of information

(2) The interest to be valued may include:

a. Form of ownership, contractual/exploitation rights, etc.
b. Fractional, geographic, exclusive/non-exclusive interest

4.48.5.2.3
(07-01-2006)
Documenting

(1) In developing a valuation conclusion, valuators should obtain the relevant information necessary to accomplish the assignment.

(2) Valuators should begin with a general definition and analysis of what constitutes the intangible property because it can assume many forms. To have economic value, intangible property should:

- Be subject to specific identification and recognizable description
- Be subject to legal existence and protection, which may be incorporated within a larger entity
- Be subject to private ownership and be legally transferable
- Generate some measurable amount of economic benefit
- Potentially enhance the value of other assets with which it is associated

(3) The description of the property should clearly identify the particular intangible property being valued. The description should be unambiguous and provide a complete identification of relevant transactions, and geographic scope of the property, where applicable. It may also specify physical, functional, technical, or economic parameters to identify the particular intangible property.

(4) There may be a need to define what is meant by "intangible asset" from the point of view of the Internal Revenue Code and the Treasury Regulations, specifically, IRC 936 (h)(3)(B) and Treasury Regulation section 1.482-4(b).

(5) The valuator should be aware that certain kinds of intangible property are also referred to as intellectual property. Intellectual property is often registered under federal and state statutes for protection. This may create legal and economic attributes that relate to value.

(6) Information relevant to the specific property being valued includes:

a. The cost, date, and manner of acquisition
b. The date on which the property is being appraised
c. Any additional appraisals and the date (or dates) on which the property was appraised
d. Information on agreements or understandings entered into (or expected to be) that relate to the use, sale or other disposition of the property, including sales of the property since the valuation date
e. The economic outlook of the market in general and the outlook of the specific property in particular
f. Such other factors which, in the opinion of the valuator, are appropriate for consideration

(7) If the intangibles subject to valuation have been transferred between or developed by controlled taxpayers within the meaning of Treasury Regulation Section 1.482-1(i)(5), section 482 and the regulations under that section may require consideration of additional issues, including, for example, which controlled taxpayer is the owner of the intangible under Treasury Regulation Section 1.482-4(f)(3)(ii). In such cases, prior to conducting the valuation, the valuator should coordinate with the referrer to ensure that all relevant issues have been identified.

4.48.5.2.4
(07-01-2006)
Analyzing

(1) In developing a valuation conclusion, valuators should analyze the relevant information necessary to accomplish the assignment.

(2) All factors that affect the value should be considered including:

a. An in-depth analysis of all rights and risks of ownership
b. The market conditions near the valuation date
c. The near-term and long-term market demand for the subject property
d. Effects of relevant contractual or legal restrictions
e. Whether the property needs additional development
f. If the property needs additional development, the length of time required to get the property to market

(3) Analyze any relevant transactions including:

- All material facts
- Information concerning contracts and transactions, including agreements, instruments, and schedules
- Legal, accounting, financial, economic opinions, and memoranda
- All participants and their roles
- The form of consideration paid and received

(4) Analysis of a transaction may reveal other property or services related to the primary transaction such that a bundle of property rights or services are or should be involved.

(5) Different types of risk assumed by the owner or acquire could impose requirements on allocation of risk. Risks that may need to be accounted for include:

- R&D risks with success or failure of research activities
- Manufacturability risks producing in a cost effective and consistent manner
- Marketing risks from fluctuating costs, demand, and pricing; competitive risks with competitors' responses, or introduction of new products
- Risks associated with government regulation
- Other legal risks such as legal activities required to secure the exclusivity of a product or process

(6) The specific valuation approach, such as market, cost, or income should be appropriate. Judgment should be used to select the approach(es) ultimately used and the method(s) within such approaches that best indicate the value of the property. The relationship between these approaches and fair market value must be demonstrated.

(7) Some fundamental methods utilized to value intangible property include:

a. Market based methods rely on identification of similar intangible property sold under similar conditions. This method requires the existence of an active market involving comparable property, e.g., royalty rates in arms-length transactions.

b. Cost-based methods estimate the cost to reproduce/replace or to pay to purchase the subject intangible (the "make or buy" decision), using historical costs, or reproduction costs. The cost approach for estimating fair market value may be difficult to apply due to quantification problems related to economic obsolescence or future income potential.
c. Income-based methods focus on the income-producing capacity of intangible property. The present value of the net economic benefit to be received over the life of the asset (cash receipts less cash outlays) can estimate the value. The income method relies on estimates, future earnings, the duration of income streams, and risks associated with the realization of the forecasted income. The income approach usually computes the net present value (NPV) of the intangible by use of the discounted cash flow (DCF) method.
d. Monte Carlo (or probabilistic) methods are similar to discounted cash flow methods except that they rely on probability analysis of estimated ranges to produce a statistical prediction of the expected value.
e. Option valuation methods apply to longer term and higher risk intangibles when early expenses are significant, and projected returns are in the distant future.

(8) Only those approaches and methods deemed appropriate for dealing with the valuation issue in question should be analyzed in detail, and reasons should be given for using them. Also, it should be documented why other methods were rejected.

a. The valuator should check the sensitivity of the methods applied to various assumptions made and parameters used including sensitivity of projections, discount rates, and useful lives.
b. Depending on the valuation methods applied, there may be need to consider the property's related functions in research and development; product design and engineering; manufacturing, production and process engineering; extraction; assembly; purchasing and materials management; marketing and distribution; accounting, finance, legal and management. Data pertaining to the costs related to performing the functions in question should be provided to support, if possible, the description of the functions performed and resources employed.

(9) The valuator should identify potential comparable properties. As available and appropriate, this should include an explicit, itemized list of selection criteria employed for selecting the comparable intangible assets. In addition to general standards of comparability, namely functions, contractual terms, risks, economic conditions, and property or service, certain refinements may be applied specifically to intangible assets. The comparable intangible should:

- Be used in similar products and processes within the same industry or market
- Have similar profit potential (as measured by the net present value of benefits to be realized, including a consideration of capital investment and start-up expenses required and the risks to be assumed)
- Have similar terms, including exploitation rights, exclusivity, geographic limitations, duration, grant-back rights, and functions or services to be performed

- Be in the same stage of development and possess a similar degree of uniqueness

(10) The market approach should consider the identification and justification of:

- The existence of an active market involving comparable intangibles
- Past transactions of comparable intangibles
- Price information for comparable transactions
- Arm's length transactions between independent parties

(11) The cost approach begins with an estimate of the cost to reproduce the intangible. One method is using historical cost. Adjustments should be made for obsolescence.

(12) The income approach considers:

a. The income generation capacity of the subject intangible and forecasts the future stream of earnings or cash flow
b. The expected remaining useful life of the intangible, how long the economic benefit is expected to continue, which may depend on product life cycle: introduction, growth, maturity, and decline
c. The risk associated with receiving anticipated benefits, as may be measured by the discount rate reflecting the opportunity cost of capital, inflation, liquidity, real interest, and risk premium

(13) The final opinion of value should reflect the appropriateness of each method, and the veracity and reliability of the data supporting each method, leading the reader logically to the final opinion of intangible value. It should ensure applied methods' results yield similar levels of value, reconcile the results, and set forth all assumptions and limiting conditions affecting the analyses, opinions, and conclusions.

4.48.5.2.5
(07-01-2006)
Workpapers

(1) Workpapers should document the steps taken, techniques used, and provide evidence to support the facts and conclusions in the final report.

(2) Valuators will maintain a detailed case activity record (Form 9984, Examining Officer's Activity Record) which:

- Identifies actions taken and indicates time charged
- Identifies contacts, including name, phone number, subject, commitments, etc.
- Documents delays in the examination

(3) The case activity record, along with the supporting workpapers, should justify time spent as commensurate with work performed.

4.48.5.2.6
(07-01-2006)
Reviewing

(1) In reviewing an intangible property valuation and reporting the results of that review, a valuator should form an opinion as to the adequacy and appropriateness of the report being reviewed and clearly disclose the nature of the review process undertaken.

(2) In reviewing an intangible property valuation, a valuator should:

a. Identify the taxpayer and intended use of the valuator's opinions and conclusions, and the purpose of the review assignment

b. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review
c. Identify the scope of the review process conducted
d. Determine the completeness of the report under review within the scope of work applicable in the review assignment
e. Determine the adequacy and relevance of the data and the propriety of any adjustments to the data
f. Determine the appropriateness of the comparable and/or valuation methods and techniques used and develop the reasons for any disagreement
g. Determine whether the analyses, opinions and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement

(3) In the event of a disagreement with the report's factual representations, underlying assumptions, methodology, or conclusions, a valuator should conduct additional fact-finding, research and/or analyses necessary to arrive at an appropriate value for the property.

4.48.5.3
(07-01-2006)
Resolution Guidelines

(1) Valuators will make efforts to obtain a resolution of the case after fully considering all relevant facts.

4.48.5.3.1
(07-01-2006)
Objective

(1) The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the valuator will facilitate resolution of issues without litigation.

(2) The valuator will work in concert with the internal customer and taxpayer to attempt to resolve all outstanding issues.

4.48.5.3.2
(07-01-2006)
Arriving at Conclusions

(1) Once the valuator has all the information to be considered in resolving the issue, the valuator will use his/her professional judgment in considering this information to arrive at a specific conclusion of value.

(2) Valuators may not have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, should decide when substantially enough information is available to make a proper determination.

(3) Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy, and conflicts of interest.

4.48.5.4
(07-01-2006)
Reporting Guidelines

(1) Valuators should prepare reports of their findings.

(2) This section requires specific information to be included or addressed in each report.

4.48.5.4.1
(07-01-2006)
Overview

(1) The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.

(2) Valuation reports should contain all the information necessary to allow a clear understanding of the valuation analyses and demonstrate how the conclusions were reached.

4.48.5.4.2 (07-01-2006) Report Contents

(1) The extent and content of the report prepared depends on the needs of each case.

(2) Valuation reports should clearly communicate the results and identify the information relied upon in the valuation process. The report should effectively communicate the methodology and reasoning, as well as identify the supporting documentation.

(3) Subject to the type of report being written, valuation reports generally should contain sufficient information relating to the items in Identifying, Documenting, and Analyzing above, to ensure consistency and quality.

(4) Reports written with respect to Reviewing above shall contain, at minimum, information relating to those items in Identifying, Documenting, and Analyzing necessary to support the assumptions, analyses and/or conclusions of the valuator.

4.48.5.4.3 (07-01-2006) Statement

(1) Each written valuation report should contain a signed statement that is similar in content to the following:

To the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the subject of this report or to the parties involved with this assignment.
- My compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this report.
- My analyses, opinions, and conclusions were developed, and this report has been prepared in conformity with the applicable Internal Revenue Service Valuation Guidelines.

Tangible Personal Property Valuation Guidelines

§ 4.48.3

PURPOSE

(1) This transmits new IRM 4.48.3, Engineering Program, Tangible Personal Property Valuation Guidelines.

BACKGROUND

(1) This material is the product of the Valuation Policy Council (VPC), a cross-functional committee with executive representation from LMSB, SBSE, and Appeals. The VPC was established in 2001 to assist IRS leadership in setting direction for valuation policy that cuts across functional lines, and in identifying process improvements to improve compliance and better utilize resources.

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AUDIENCE

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Kelly Cables for Deborah M. Nolan
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4.48.3
Tangible Personal Property Valuation Guidelines

Table of Contents

4.48.3.1 (07-01-2006) Introduction

(1) The purpose of this document is to provide guidelines applicable to all IRS personnel that are engaged in valuation practice (hereinafter referred to as "valuators") relating to the development, resolution and reporting of issues involving tangible personal property valuations and similar valuation issues. Within these guidelines the term "personal property" refers to tangible personal property. Valuators must be able to reasonably justify any departure from these guidelines.

(2) Personal property includes but is not limited to paintings, watercolors, prints, drawings, sculpture, ceramics, furniture, decorative arts, antiques, textiles, carpets, silver, rare manuscripts, historical memorabilia, antiquities, ethnographic art, collectibles, gems and jewelry. Machinery and equipment and other items classified as personal property are all intended for inclusion. The guidelines provided here regarding identifying, documenting and analyzing the property are applicable to all types of personal property. The information cannot provide specific details for every type of personal property, but a similar detailed breakdown can be outlined for any kind of property.

(3) IRM 4.48.2, Valuation Assistance for Cases Involving Works of Art, which requires all taxpayer cases selected for audit with taxpayer claimed values of $20,000 or more per item of art to be sent to Art Appraisal Services for review by the Commissioner's Art Advisory Panel is still applicable.

(4) This document incorporates by reference the ethical and conduct provisions, contained in the Office of Government Ethics (OGE) Standards of Ethical Conduct, applicable to all IRS employees.

(5) Valuation of assets owned and/or transferred by or between controlled taxpayers (within the meaning of Treasury Regulation section 1.482–1(i)(5)) may present substantive issues that are not addressed in these guidelines.

4.48.3.2 (07-01-2006) Development Guidelines

(1) Successful completion of a valuation assignment includes planning, identifying critical factors, documenting specific information, and analyzing the relevant information. All relevant activities will be documented in the workpapers.

(2) A review appraisal may be the best approach to the assignment.

4.48.3.2.1 (07-01-2006) Planning

(1) Valuators will adequately plan the valuation assignment. Their managers will supervise the staff involved in the valuation process.

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k. Restrictions, agreements and other factors that may influence value
l. Sources of information

(2) The interest to be valued includes:

a. Fee simple, leased fee, etc.
b. Fractional interest
c. Personal property held in partnerships, corporations and trusts

4.48.3.2.3
(07-01-2006)
Documenting

(1) In developing a valuation conclusion, valuators should obtain the relevant information necessary to accomplish the assignment.

(2) Personal property items should include, where applicable;

- Name of the artist, culture, maker or place or origin
- Title, type or subject matter
- Medium, such as oil on canvas, or material, such as silver, porcelain, oak, etc.
- Age or date created
- Size/dimensions or weight if applicable
- Any marks, signatures, distinguishing features or labels on the item
- History (provenance) of the item
- A record of any exhibitions at which the item was displayed
- Any reference source citing the item
- The physical condition of the item
- A professional quality photograph of a size and quality fully showing the item
- Other information deemed to be relevant to the specific property being valued

(3) The photograph should be an 8x10 inch color photograph or a color transparency not smaller than 4x5 inches.

(4) Machinery and equipment should include:

- Manufacturer, model and serial number of equipment
- Age and condition of equipment
- Legal description
- Description of property, including name, physical features, dimensions, capacity access, etc.
- Description of improvements and modifications, including features, condition, and any forms of physical, functional or economic obsolescence
- Use(s) to which the property is being put, including but not limited to value as a stand-alone or as part of an entire plant or larger manufacturing, research or development system
- The owner of record and, if practical or available, copies of bill of sale, blueprints and placed in service date
- The history of the property, including any sales in the five (5) years preceding the valuation date or any sales since the valuation date to the present; both periods of sales should include the sales dates, prices and the names of the sellers and buyers
- If during either of the two preceding periods, the property was rented, then the dates when the property was leased, rental terms, copies of leases, rent rolls and a history of income and expenses
- Quality photograph of the subject property showing the item and improvements and modifications

(5) Regardless of the type of property, additional information should be obtained:

- The valuation date
- The cost, date and manner of acquisition
- The appraised fair market value
- The date (or dates) on which the property was appraised
- Information of any agreements or understandings entered into (or expected to be entered into) that relates to the use, sale or other disposition of the property, including for example the sales of property since the valuation date
- The economic outlook of the market in general and the outlook of the specific property in particular
- Such other factors which, in the opinion of the valuator, are appropriate for consideration

4.48.3.2.4
(07-01-2006)
Analyzing

(1) In developing a valuation conclusion, valuators should analyze the relevant information necessary to accomplish the assignment.

(2) All factors that affect the value should be considered.

(3) The specific valuation approach, such as the market approach, the income approach, the replacement/reproduction cost approach or the liquidation value should be considered for relative propriety of its application. Professional judgment should be used to select the approach(es) ultimately used and the method(s) within such approach(es) that best indicate the value of the property. When valuing personal property the income approach is often not applicable. The relationship between these approaches and fair market value must be demonstrated.

(4) The specific basis for the valuation, such as relevant public and/or private sales (ideally complete descriptions and illustrations should be included), particularly around the valuation date and the analysis of these specific sales and relevance to the item being valued.

(5) The market conditions near the valuation date should be considered.

(6) The market demand for the subject property and the importance of the property and its relationship to its relevant artist/type/group etc. should be considered.

(7) The effects of condition, style, quality, medium, artist or culture, provenance, restorations, rarity should be considered.

(8) The effects of relevant contractual or legal restrictions should be considered.

(9) The valuator should clearly explain and provide reasoning for the value conclusion.

(10) Any additional information or special circumstances that may affect the fair market value of the property.

Note: While the foregoing items listed represent the ideal information required, it is understood that each item of information will not be readily available in every case.

4.48.3.2.5
(07-01-2006)
Workpapers

(1) Workpapers should document the steps taken, techniques used, and provide the evidence to support the facts and conclusions in the final report.

(2) Valuators will maintain a detailed case activity record (Form 9984 Examining Officer's Activity Record) which:

- Identifies actions taken and indicates time charged
- Identifies contacts, including name, phone number, subject, commitments, etc.
- Documents delays in the examination

(3) The case activity record, along with the supporting workpapers, should justify that the time spent is commensurate with work performed.

4.48.3.2.6
(07-01-2006)
Reviewing

(1) In reviewing a personal property valuation and reporting the results of that review, a valuator should form an opinion as to the adequacy and appropriateness of the report being reviewed and clearly disclose the scope of work of the review process undertaken.

(2) In reviewing a personal property valuation, a valuator should

a. Identify the taxpayer and intended use of the opinions and conclusions, and the purpose of the review assignment.
b. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review.
c. Identify the scope of the review process conducted.
d. Determine the completeness of the report under review.
e. Determine to the adequacy and relevance of the data and the propriety of any adjustments to the data.
f. Determine to the appropriateness of the comparables and/or valuation methods and techniques used and develop the reasons for any disagreement.
g. Determine whether the analyses, opinions, and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.

(3) In the event of a disagreement with the report's factual representations, underlying assumptions, methodology, or conclusions, a valuator should conduct additional fact-finding, research, and/or analyses necessary to arrive at an appropriate value for the property.

4.48.3.3
(07-01-2006)
Resolution Guidelines

(1) Valuators will make efforts to obtain a resolution of the case after fully considering all relevant facts.

4.48.3.3.1
(07-01-2006)
Objective

(1) The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the valuator will facilitate resolution of issues without litigation.

(2) The valuator will work in concert with the internal customer and taxpayer to attempt to resolve all outstanding issues.

4.48.3.3.2
(07-01-2006)
Arriving at Conclusions

(1) Once the valuator has all the information to be considered in resolving the issue, the valuator will use his/her professional judgment in considering this information to arrive at a specific value conclusion.

(2) Valuators may not have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, should decide when substantially enough information is available to make a proper determination.

(3) Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy, and conflicts of interest.

4.48.3.4
(07-01-2006)
Reporting Guidelines

(1) Valuators should prepare reports of their findings

(2) This section requires specific information to be included or addressed in each report.

4.48.3.4.1
(07-01-2006)
Overview

(1) The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.

(2) Valuation reports should contain all the information necessary to allow a clear understanding of the valuation analyses and demonstrate how the conclusions were reached.

4.48.3.4.2
(07-01-2006)
Report Contents

(1) The extent and content of the report prepared depends on the needs of each case.

(2) Valuation reports should clearly communicate the results and identify the information relied upon in the valuation process. The report should effectively communicate the methodology and reasoning, as well as identify the supporting documentation.

(3) Subject to the type of report being written, valuation reports should generally contain sufficient information relating to the items in Identifying, Documenting, and Analyzing above, to ensure consistency and quality.

(4) Reports written with respect to Reviewing shall contain, at a minimum, information relating to those items in Identifying and Analyzing necessary to support the revised assumptions, analyses, and/or conclusions of the valuator.

4.48.3.4.3
(07-01-2006)
Statement

(1) Each written valuation report should contain a signed statement that is similar in content to the following:
To the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the subject of this report or to the parties involved with this assignment.
- I have (or have not) made a personal inspection of the property that is the subject of this report.
- My compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this report

- My analyses, opinions and conclusions were developed, and this report has been prepared in conformity with the applicable Internal Revenue Service Valuation Guidelines.

Real Property Valuation Guidelines

§ 4.48.6

MANUAL TRANSMITTAL

Department of the Treasury | Internal Revenue Service

4.48.6

JULY 1, 2006

PURPOSE

(1) This transmits new IRM 4.48.6, Engineering Program, Real Property Valuation Guidelines.

BACKGROUND

(1) This material is the product of the Valuation Policy Council (VPC), a cross-functional committee with executive representation form LMSB, SBSE, and Appeals. The VPC was established in 2001 to assist IRS leadership in setting direction for valuation policy that cuts across functional lines, and in identifying process improvements to improve compliance and better utilize resources.

NATURE OF MATERIAL

(1) This IRM provides specific guidance for:

a. Developing the valuation issue
b. Resolving the issue when possible
c. Preparing reports

(2) This document provides specific instructions to examiners with respect to:

a. Planning the valuation assignment
b. Analyzing relevant information
c. Preparing work papers
d. Reviewing a third-party valuation

EFFECT ON OTHER DOCUMENTS

None

AUDIENCE

All IRS employees who provide valuation services or review the valuations and appraisals prepared by others.

Kelly Cables for Deborah M. Nolan
Commissioner, Large Mid Size Business

4.48.6
Real Property Valuation Guidelines

Table of Contents

4.48.6.1
(07-01-2006)
Introduction

(1) The purpose of this document is to provide guidelines applicable to all IRS personnel engaged in valuation practice (hereinafter referred to as "valuators") relating to the development, resolution and reporting of issues involving real property valuations and similar valuation issues. Valuators must be able to reasonably justify any departure from these guidelines.

(2) This document incorporates by reference, the ethical and conduct provisions, contained in the Office of Government Ethics (OGE) Standards of Ethical Conduct, applicable to all IRS employees.

(3) Valuations of assets owned and/or transferred by or between controlled taxpayers (within the meaning of Treasury Regulation section 1.482–1(i)(5)) may present substantive issues that are not addressed in these guidelines.

4.48.6.2
(07-01-2006)
Development Guidelines

(1) Successful completion of a valuation assignment includes planning, identifying critical factors, documenting specific information, and analyzing the relevant information. All relevant activities will be documented in the workpapers.

(2) A review appraisal may be the best approach to the assignment.

4.48.6.2.1
(07-01-2006)
Planning

(1) Valuators will adequately plan the valuation assignment. Their managers will supervise the staff involved in the valuation process. Quality planning is a continual process throughout the valuation assignment.

4.48.6.2.2
(07-01-2006)
Identifying

(1) In developing a valuation conclusion, valuators should define the assignment and determine the scope of work necessary by identifying the following:

a. Property to be valued
b. Interest to be valued
c. Effective valuation date
d. Purpose of valuation
e. Use of valuation
f. Statement of value
g. Standard and definition of value
h. Subject to be valued
i. Assumptions
j. Limiting conditions
k. Scope limitations
l. Restrictions, agreements and other factors that may influence value
m. Sources of information

(2) The interest to be valued at a minimum includes:

a. Fee simple, leased fee, life estates, easements, rights-of-way, etc.
b. Fractional interests
c. Real property held in partnerships, corporations and trusts

4.48.6.2.3
(07-01-2006)
Documenting

(1) In developing a conclusion, valuators should obtain the relevant information necessary to accomplish the assignment, including:

- A complete description and location of the property
- Any consideration of rights or encumbrances such as water, riparian, mineral, easements, and rights-of-way

- The owner of record and, if practical or available, copies of deeds, plat maps, blueprints and surveys
- The history of the property, including any sales within the five (5) years preceding the valuation date or any sales since the valuation date to the present. Both periods of sales should include the sales dates, prices, mortgage amounts, and the names of the sellers, buyers and mortgage lenders
- If, during either of the two preceding periods, the property was rented, then the dates when the property was leased, rental terms, copies of leases, rent rolls and a history of income and expenses
- Information and, if available, photographs of the subject property and neighborhood if applicable
- The cost, date and manner of acquisition
- The appraised fair market value
- The date (or dates) on which the property was appraised
- Information relating to any other agreements or understandings entered into (or expected to be entered into) that relates to the use, sale or other disposition of the property, including, for example, any sale of the property since valuation date
- The economic outlook in general and the condition and outlook of the specific property in particular
- Such other factors which, in the opinion of the valuator, are appropriate for consideration

(2) A complete description and location of the property includes:

- Street and number, if one exists
- Section, block and lot number, if one exists
- Legal description
- Description of land, including physical features, dimensions, access, etc.
- Description of improvements, including features, condition, and any forms of physical, functional or economic obsolescence
- Use(s) to which the property is being put
- Zoning and permitted uses

4.48.6.2.4
(07-01-2006)
Analyzing

(1) In developing a valuation conclusion, valuators should analyze the relevant information necessary to accomplish the assignment.

(2) Determine the Highest and Best Use of the property as vacant and as improved.

(3) Approach to Value --- The Valuation Process. The valuator should determine which methodologies are to be utilized in developing the opinion of value of the subject property. The valuator should consider the appropriate valuation approaches, such as the market approach, the income approach and the cost approach. Professional judgment should be used to select the approach(es) ultimately used and the method(s) within such approach(es) that best indicate the value of the property.

(4) In the Market or Sales Comparison Approach, properties similar to the subject properties sold close to the valuation date are compared to the subject property. Adjustments are made for financing, condition of sale, date of sale, physical characteristics and location to indicate the value of the subject. Care should be taken to consider the number of sales available, their relative com-

parability, the degree and rationale for adjustments to the sales and the relative correlation and reliability of the value indications from the sales.

(5) In the Cost Approach, an estimated reproduction or replacement cost of the improvements is computed and then reduced for physical, economic and functional depreciation. This value should be computed as of the date of valuation. To this result, an amount is added for the value of the underlying land. This approach is generally useful for specialty properties where other approaches lack sufficient supporting data and where land value and depreciation amounts are reasonably determinable.

(6) In the Income Approach, an income stream is projected based on analysis of historical financial income and expense statements, vacancy rates, rent rolls and terms of existing leases. Value is derived by converting net income/cash flow projections to present value using an applicable capitalization technique reflective of typical investors for the type of property in question. Care should be taken to justify and support projections of income and expenses including any unusual or non-recurring items. Adjustments to income and expense data should be made as necessary to reflect the appropriate income streams consistent with the valuation methodology selected. All discount/capitalization rates should be justified with reliable market data, industry surveys or market supported technical methodology and computations.

(7) The reconciliation and final opinion of value should consider the appropriateness of each approach to the value of the specific property, the quantity, veracity and reliability of the data supporting each approach and should logically lead the reader to the final opinion of value. If a particular approach is not utilized or ignored the valuator should explain the reasons for doing so. Large differences between conclusions from different approaches should be explained.

(8) As appropriate for the assignment, and if not considered in the process of determining and weighing the indications of value provided by other procedures, the valuator should separately consider the following factors in reaching a final conclusion of value:

- Marketability, control, or lack thereof
- The legal form of ownership
- The security of ownership interest
- The effect of relevant contractual and legal restrictions
- The market conditions
- Other appropriate factors, in the opinion of the valuator

(9) The valuator should clearly explain and provide reasoning for the value conclusion.

4.48.6.2.5
(07-01-2006)
Workpapers

(1) Workpapers must document the steps taken and techniques used and provide the evidence to support the facts and conclusions in the final report.

(2) Valuators will maintain a detailed case activity record (Form 9984, Examining Officer's Activity Record) which:

- Identifies actions taken and indicates time charged
- Identifies contacts, including name, phone number, subject, commitments, etc.
- Documents delays in the examination

(3) The case activity record, along with the supporting workpapers, should justify time spent is commensurate with work performed.

4.48.6.2.6 (07-01-2006) Reviewing

(1) In reviewing a real property valuation, and reporting the results of that review, a valuator should form an opinion as the adequacy and appropriateness of the report being reviewed, and must clearly disclose the scope of work of the review process undertaken.

(2) In reviewing a real property valuation, a valuator should:

a. Identify the taxpayer and intended uses of the valuator's opinions and conclusions, and the purpose of the review assignment.
b. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review.
c. Identify and state the scope of the review process conducted.
d. Determine the completeness of the report under review within the scope of work applicable in the review assignment.
e. Determine the adequacy and relevance of the data and the propriety of any adjustments to the data.
f. Determine the appropriateness of the comparable and/or valuation methods and techniques used, and develop the reasons for any disagreement.
g. Determine whether the analyses, opinions and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.

(3) In the event of a disagreement with the report's factual representations, underlying assumptions, methodology or conclusions, a valuator should conduct additional fact-finding, research and/or analyses necessary to arrive at an appropriate value for the property.

4.48.6.3 (07-01-2006) Resolution Guidelines

(1) Valuators will make efforts to obtain a resolution of the case after fully considering all relevant facts.

4.48.6.3.1 (07-01-2006) Objective

(1) The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the valuator will facilitate resolution of issues without litigation.

(2) The valuator will work in concert with the internal customer and taxpayer to attempt to resolve all outstanding issues.

4.48.6.3.2 (07-01-2006) Arriving at Conclusions

(1) Once the valuator has all the information to be considered in resolving the issue, the valuator will use his/her professional judgment in considering this information to arrive at a conclusion.

(2) Valuators may not have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, should decide when substantially enough information is available to make a proper determination.

(3) Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy and conflicts of interest.

4.48.6.4
(07-01-2006)
Reporting Guidelines

(1) Valuators should prepare reports of their findings.

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4.48.6.4.1
(07-01-2006)
Overview

(1) The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.

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4.48.6.4.2
(07-01-2006)
Report Contents

(1) The extent and content of the report prepared depends on the needs of each case.

(2) Valuation reports should clearly communicate the results and identify the information relied upon in the valuation process. The valuation report should effectively communicate the methodology and reasoning, as well as identify the supporting documentation.

(3) Subject to the type of report being written, valuation reports should generally contain sufficient information relating to the items in Identifying, Documenting, and Analyzing above, to ensure consistency and quality.

(4) Reports written with respect to Reviewing above shall contain, at a minimum, information relating to those items necessary to support the revised assumptions, analyses and/or conclusions of the valuator.

4.48.6.4.3
(07-01-2006)
Statement

(1) Each written valuation report should contain a signed statement that is similar in content to the following

To the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the subject of this report or to the parties involved with this assignment.
- I have (or have not) made a personal inspection of the property that is the subject of this report.
- My compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this report.
- My analyses, opinions and conclusions were developed, and this report has been prepared, in conformity with the applicable Internal Revenue Service Valuation Guidelines.