Make Sure an Appraisal is Worth it

By Reg P. Wydeven
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As many of you know, I'm a bit of a 'Star Wars' connoisseur. Ever since I was five and my folks took us to see the movie at the drive-in, I was captivated. For birthdays and Christmases after that, I received Star Wars books, toys, t-shirts and other memorabilia. By the time I was a teenager, I had amassed quite a collection.

When the prequel trilogy of movies started being released in 1999, the Star Wars merchandising bonanza was on once again. I've continued to add to my collection, and it's so much fun to share it with my kids to see them enjoy it as much as I did when I was little (plus they're a convenient excuse to keep adding).

Like most collectors, I perceive my Star Wars junk as being priceless. However, because there are a whole lot more Star Wars geeks even more hardcore than me, my collection actually has some value, even if it's less than what I think it's worth.

That's why my brother-in-law suggested that I get my Star Wars collection insured. Our insurance agent, however, required that I get my collection appraised. Apparently he didn't take my word for it that it's worth $7 million.

In addition to determining the value of my complete set of Topps® Star Wars trading cards, appraisers now also have to worry about new potential penalties for inaccurate appraisals under the Pension Protection Act of 2006.

Last fall I wrote about how the PPA put additional requirements on employers offering retirement plans and gave additional investment opportunities to taxpayers. The PPA also created Section 6695A of the Internal Revenue Code which is triggered when appraisals for income and transfer tax purposes are either too high or too low. The new penalties will be applicable to appraisals provided in connection with returns or claims for refunds filed after August 17, 2006.

Several requirements must be met before the new penalties will be assessed. First, an appraisal must be prepared in connection with a tax return or a claim for a refund. Second, the appraiser (even if they're not a professional) must know that the appraisal will be used for a return or refund claim. Finally, the appraisal must result in a "substantial" or "gross valuation misstatement."

A "substantial valuation misstatement" occurs if the value of property is 150 percent or more of the amount determined to be the correct value." Inflated values are problematic if a taxpayer tries to take an income tax charitable deduction, such as if I were to donate my collection to the famous Rancho Obi-Wan Star Wars museum for a tax write-off.

A "gross valuation misstatement" occurs if the value of property reflected on an estate or gift tax return is determined to be 40 percent or less of the correct value. Here a penalty would be imposed if I died and my collection was undervalued to avoid any death taxes.

The penalty imposed on an appraiser will be the lesser of (1) 10% of the amount of the underpayment of tax resulting from the appraisal or (2) 125% of the gross income the appraiser received in connection with the preparation of the appraisal.

While the penalties apply to taxpayers' appraisers, appraisers who work for the IRS are immune from the penalties even if they are way off. Apparently we don't know the true power of the Dark Side.