Valuation of Ownership Interests in Health Care Entities for Charitable Contributions—Insights from Recent Tax Court Precedents

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An income tax deduction for charitable contributions is generally permitted under Internal Revenue Code § 170(a), subject to certain limitations. This discussion summarizes (1) Internal Revenue Service appraisal requirements for noncash charitable contributions and (2) the judicial factors that the U.S. Tax Court has considered in two recent decisions that involve the valuation of ownership interests in health care entities for charitable contribution purposes.

Introduction

An income tax deduction for noncash charitable contributions is limited to the net amount transferred to charity—that is, the difference between (1) the fair market value of what was contributed and (2) the fair market value of anything received in return.

The Internal Revenue Service (the "Service") has issued guidance regarding the appraisal requirements for determining the fair market value of noncash charitable contributions. In addition, the Service has provided definitions of "qualified appraisal" and "qualified appraiser" for charitable contribution purposes.

This discussion presents (1) the Service appraisal requirements for noncash charitable contributions, (2) the Service definitions of "qualified appraisal" and qualified appraiser," (3) penalties regarding substantial valuation misstatements for the claimed value of charitable contributions, and (4) two recent judicial decisions that have dealt with the valuation of ownership interests in health care entities for charitable contribution purposes.

Appraisal Requirements for Noncash Charitable Contributions

On October 19, 2006, the Service issued Notice 2006-96 providing transitional guidance relating to the new definitions of "qualified appraisal" and "qualified appraiser" for noncash charitable contributions in Internal Revenue Code Section 170(f)(11).

Under Section 170(f)(11)(C), taxpayers must obtain a qualified appraisal for donated property for which a deduction of more than $5,000 is claimed. Under Section 170(f)(11)(D), no charitable deduction is allowed for contributions of property by an individual, partnership, or corporation for which a deduction of more than $500,000 is claimed unless the taxpayer attaches a qualified appraisal of the property to its income tax return.

Section 170(f)(11)(E)(i) provides statutory definitions of a qualified appraisal and qualified appraiser. A qualified appraisal is defined as an appraisal that is (1) treated as a qualified appraisal under regulations or other guidance prescribed by the Service, and (2) conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Service.

A qualified appraiser is defined under Sections 170(f)(11)(E)(ii) as an individual who:

1. has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Service,

2. regularly performs appraisals for which the individual receives compensation, and
3. meets such other requirements as may be prescribed by the Service in regulations or other guidance.

In addition, an individual will not be considered a qualified appraiser for any specific appraisal unless (1) he demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and (2) he has not been prohibited from practicing before the Service at any time during the three-year period ending on date of the appraisal.

Under Section 6662, a taxpayer may be liable for a 40 percent accuracy-related penalty on the portion of an underpayment of tax attributable to a gross valuation misstatement. Section 6662(h)(2)(A) provides that there is a gross valuation misstatement if the value of property as claimed on a tax return is 400 percent or more of the amount determined to be the correct value. The increased penalty will not apply to a charitable deduction only if (1) the claimed value of the property was based on a "qualified appraisal" made by a "qualified appraiser," and (2) the taxpayer made a good faith investigation of the value of the contributed property.

Recent Tax Court Precedents

Bergquist v. Commissioner

Introduction

In *Bergquist v. Commissioner*,[1] the U.S. Tax Court opined on the fair market value of stock in University Anesthesiologists, P.C. (UA), a medical professional service corporation (PSC) donated by five physicians (the "taxpayers") to a tax-exempt entity.

The donation was part of a consolidation of several PSCs into a single medical practice group controlled and managed by the Oregon Health and Science University (OHSU). As a result of the consolidation, the taxpayer PSC stopped operating and the taxpayers became employees (and not shareholders) of the OHSU medical group.

Following the consolidation, the taxpayers donated their stock in UA and claimed for federal income tax purposes charitable donations of $401.79 per share. During its audit, the Service disallowed the taxpayer charitable contribution deduction.

At trial, three valuation analysts presented valuation evidence regarding the fair market value of the voting and nonvoting common stock of UA. Two valuation analysts testified for the taxpayers, and one valuation analyst testified for the Service.

The first taxpayer analyst estimated the fair market value of the donated voting and nonvoting stock in UA at $401.79 per share. The second taxpayer analyst estimated the fair market value of the donated stock in UA at $326 per voting share and $323 per nonvoting share.

The Service analyst estimated the fair market value of the donated stock in UA at $37 per share for the voting stock and $35 per share for the nonvoting stock.

The main difference between the taxpayer analyst reports and the Service analyst report was the valuation premise of value. The taxpayer analyst reports were based on a going-concern premise of value, and the Service analyst report was based on a liquidation premise of value.

The Tax Court accepted the Service analyst valuation conclusion and held that, on the date of donation, the donated UA stock had a fair market value of approximately $37 per share. According to the Tax Court decision, (1) UA would not be treated as a going-concern operation as of the date of donation and (2) the taxpayer claim that the scheduled consolidation of their PSC into the consolidated medical practice group was uncertain was rejected.

In the Tax Court decision, the donation was triggered by the imminent consolidation, and the taxpayers would not have donated their stock if there was a realistic possibility that the consolidation would not occur. As a consequence, the Tax Court did not rely on the taxpayer analyst reports and found that they neglected to consider the imminent consolidation and resulting termination of the PSC operations.

The Facts of the Case

Between 1994 and 2001, the taxpayers were employees of and stockholders in UA. UA was the exclusive provider of anesthesiology medical services to all OHSU hospitals and clinics. OHSU is a public teaching and research hospital in Portland, Oregon. In addition to UA, there were approximately 30 other medical practice groups affiliated with OHSU through separate PSCs, similar to UA.

In the late 1990s, the OHSU executive management team determined that the consolidation into a single medical practice group—controlled and managed by a single PSC, which in turn would be managed by OHSU—would alleviate the perceived risks associated with the operation of numerous separate service providers. The planned consolidation called for the physicians, including the taxpayers, to become employees (but not shareholders) of a newly formed single consolidated medical practice group. The newly formed group would operate and provide medical services through a newly formed tax-exempt PSC.

An additional feature of the restructuring plan was a new governmental pension plan that was exempt from ERISA requirements. OHSU requested a private letter ruling (PLR) on this matter. In the event that the PLR was not obtained, the medical group management developed an ERISA-compliant, nongovernmental pension plan.

The taxpayer employment contracts with UA were on a month-to-month basis and did not include noncompete or no solicitation clauses. Initially, each physician held 100 shares of the UA voting common stock, purchased in 1994 at $1 per share. Consistent with industry norms, UA generally paid bonuses, salaries, and prepaid expenses at the end of each year. The only UA significant booked asset was its accounts receivable. In addition, UA had not declared or paid cash dividends to its stockholders since inception.

After the consolidation, UA would have no physicians and no patients, and would only continue its existence for a limited period of time in order to collect accounts receivable outstanding as of the date of the consolidation.

In 1998, as a result of the decision to consolidate, OHSU formed the OHSU Medical Group (OHSUMG) as a Section 501(c)(3) tax-exempt PSC into which all of the 30 medical practice groups would be consolidated. The target date for the consolidation was initially set for January 1, 2001, and then rescheduled for January 1, 2002.

In the late 1990s, the UA chief executive officer became a member of the OHSU Business Operations Steering Committee, a group formed to assist in the planning and implementation of the consolidation. In early 1999, the UA chief executive officer attended a conference sponsored by the Medical Group Management Association. During the conference, the UA chief executive officer learned that some doctors were claiming substantial charitable contribution deductions for federal income tax purposes relating to donations of stock in their PSCs to academic-affiliated institutions. In June 1999, as a result of those findings, UA held a stockholder meeting to discuss the potential tax benefits of donating UA stock to OHSUMG as a step associated with the consolidation.

In April 2001, legal counsel retained by UA outlined a plan for the UA stockholders relating to their stock donations to OHSUMG. The plan had three main steps:

1. A new class of nonvoting UA stock would be issued through the distribution of a UA stock dividend.
2. Before the consolidation, the physicians would donate their newly created UA nonvoting stock to OHSUMG and claim substantial charitable contribution deductions.
3. After the consolidation, the physicians would donate their UA voting stock to OHSUMG and possibly claim additional charitable contribution deductions.

In May 2001, implementing the first step of the donation plan, UA declared a stock dividend and issued to each of the 28 UA stockholders four shares of nonvoting stock for each share of UA voting stock held. As a result, each UA stockholder held 100 shares of voting stock and 400 shares of nonvoting stock.

"The significant disparity between the taxpayer analysts appraised values and the Service analyst appraised value . . . resulted primarily from the use of two different valuation premises—going concern and liquidation."

In June 2001, UA retained the first taxpayer analyst to estimate the fair market value of the UA stock. The first taxpayer analyst was informed by the UA counsel (1) about the upcoming consolidation and (2) that the UA anesthesiologists would be employed by OHSUMG after the reorganization.

On September 8, 2001, UA staff prepared pro forma cash flow projections with the assumption that at the end of 2001, UA would no longer operate.

On October 5, 2001, the first taxpayer analyst appraised the donated UA voting and nonvoting stock as of August 31, 2001, at $401.79 per share.

The second step of the donation plan was implemented on September 10, 2001. Twenty-four UA stockholders each donated to OHSUMG 40 voting shares and all 400 nonvoting shares. The remaining four UA stockholders donated all 100 voting shares and all 400 nonvoting shares.

In November 2001, the third stage of the donation plan was eliminated because it was determined there would not be enough value in the UA shares to justify the costs related to the charitable donation claim.

In October 2001, the first group of medical practice groups consolidated into OHSUMG. On January 1, 2002, the remaining physician groups consolidated into OHSUMG, including the taxpayers.

After the consolidation, UA continued to operate only to collect its outstanding accounts receivable. The OHSUMG executive management accepted the donation of the UA common stock as a professional courtesy to the UA shareholders. At the time of the donation, the OHSUMG management did not expect to derive any economic benefit from the donated UA stock, such as dividends or distributions. The UA cash flow projections reflected no UA net cash flow for 2002. On this basis, OHSUMG placed a $0 value on its books for all UA donated shares. In addition, the OHSUMG president sent a letter to the taxpayers stating that OHSUMG decided to book the donated stock at no value.

In January 2002, UA stockholders attended several meetings to discuss how they should report and claim charitable contribution deductions on their 2001 federal tax returns. Even though several UA shareholders were concerned about the high value of the taxpayer appraisal and their charitable contribution deductions, they eventually complied with the UA counsel who advised that all physicians claim the same charitable deduction amount for the UA shares to reduce risk of challenge by the Service.

Upon audit, the Service determined that the UA stock had no value on September 14, 2001. And, the Service disallowed any charitable contribution deductions relating to the donation of UA stock.

At trial, the Service analyst testified the fair market value of the UA stock value was $37 per voting share and $35 per nonvoting share.

The Tax Court Opinion

The significant disparity between the taxpayer analysts appraised values and the Service analyst appraised value for the UA stock resulted primarily from the use of two different valuation premises—going concern and liquidation.

The taxpayer analyst reports were based on a going-concern premise of value. The taxpayer analysts used this premise of value based on the theory that, as of the valuation date, the UA consolidation into the new hospital medical practice was not a foregone conclusion, particularly since a favorable ruling on the PLR had not been obtained.

The Tax Court decided that the going-concern premise of value was inappropriate based on the facts of the case, stating "there is no evidence in the record that UA management and the petitioners were concerned in the least with the possibility that OHSUMG might not offer a governmental retirement plan. . . . In addition, the evidence establishes that as of the September 14, 2001 UA stock donation date, it was well known to all concerned individuals that it was highly likely that UA and UA anesthesiologists would take part in the scheduled January 1, 2002 consolidation."

As a result, the Tax Court accepted the Service analyst report conclusion. The Service analyst determined the UA stock value based on the asset-based approach, assuming a liquidation premise of value.

The donation of UA stock was driven by the imminent consolidation of UA into OHSUMG. According to the Tax Court decision, the taxpayers would have donated their UA stock to OHSUMG only if they were certain that the planned consolidation would occur by year-end 2001 or soon thereafter. The Tax Court stated that "a reasonably informed and willing buyer or seller certainly would have known about and would have taken into account the fact that, as of September 14, 2001, there was an extremely high

likelihood that by early 2002, UA would no longer be an operating entity."

The Tax Court agreed with the Service analyst that, on the valuation date, it was known or knowable that UA would no longer be an operating enterprise beginning with January 1, 2002. Considering this imminent transaction and its implied liquidation, the Service analyst did not use the income and market approaches—both approaches assuming ongoing business operations—and instead used the asset-based approach, an approach generally more suitable for a liquidation premise.

After adjusting the balance sheet values of the UA assets and liabilities, the Service analyst applied (1) a 35 percent discount for lack of control (DLOC), (2) a 45 percent discount for lack of marketability (DLOM), and (3) a 5 percent discount for lack of voting rights for the nonvoting UA stock.

The DLOC was derived from a study of mergers and acquisitions of publicly traded companies in the health care industry. The DLOM was derived from (1) a study of restricted stock transactions of health care companies and (2) initial public offerings studies. The Service analyst report concluded a value of $37 per share for the voting stock and $35 per share for the nonvoting stock.

In addition, the Tax Court assessed a 40 percent accuracy-related penalty, agreeing with the Service conclusion that the taxpayers did not act in good faith and did not make a good faith investigation related to the value of the donated UA stock. According to the Tax Court, the taxpayers "are well educated and surely were cognizant of the imprudence of valuing the UA stock at such a high value given the likelihood that by 2002 UA would no longer be an operating entity."

In addition, the taxpayers were aware that OHSUMG had decided to book the donated stock at no value. According to the Tax Court, "while the value of property in the hands of the donee is generally not determinative of FMV . . . petitioners should have at least questioned the difference in reporting by OHSUMG and by themselves." In addition, although the taxpayer argued that they relied in good faith on the taxpayer analyst reports, "a taxpayer will not be considered to have reasonably relied in good faith on advice from an adviser if the advice is based on an unreasonable assumption the taxpayer knows, or has reason to know, is unlikely to be true."

Derby v. Commissioner

Introduction

In *Derby v. Commissioner*,[2] the U.S. Tax Court opined on (1) the fair market value of intangible assets donated by physicians (the "taxpayers") to a tax-exempt entity, (2) whether the transfer of the intangible assets lacked donative intent, and (3) whether the transfer had "dual character."

The taxpayers, more than a dozen individual physicians, were advised by counsel to donate the intangible assets of their medical practice to a tax-exempt entity and take a charitable contribution deduction for the fair market value of those intangible assets. The Service disallowed any deduction.

Two analysts provided appraisal reports regarding the fair market value of the taxpayer assets. The first taxpayer analyst report was relied on by taxpayers for the fair market value of the donated intangible assets in their 1994 tax returns. The fair market value of the taxpayer intangible assets based on the first taxpayer analyst report was approximately $1.6 million.

Counsel for the taxpayers retained the second taxpayer analyst to estimate the fair market value of the donated assets for the trial. The fair market value of the taxpayer intangible assets based on the second taxpayer analyst report was approximately $2.5 million. Only the second taxpayer analyst testified at the trial.

The Tax Court accepted the Service conclusion that the taxpayers failed to show that the fair market value of the assets acquired by the tax-exempt entity exceeded the value of the consideration received by the taxpayers in exchange. In addition, the Tax Court decision found fault with several aspects of the taxpayer analyst report, stating that the taxpayer analyst did not fully reflect physician compensation and other terms of the purchase and employment agreements already in place at the date of valuation.

The Facts of the Case

The taxpayers were physicians practicing in individual and small group practices in the Davis, California, area. In the mid-1980s, the penetration of managed care, in the form of health maintenance organizations (HMOs), became substantial in California and the Davis, California, area. In 1987, in order to better serve patients with HMO coverage, several physicians formed an independent practice association (IPA) named the Davis Area Medical Group, later renamed United Health Medical Group, Inc. (UHMG). The IPA served as an intermediary between its physicians and HMOs.

During the early and mid-1990s, California experienced a significant consolidation of health care providers and insurers into large organizations. HMOs and other hospitals had begun to acquire physician practices in order to expand their patient base and geographical areas.

Based on these industry and economic trends, by early 1993, the taxpayers decided that practicing medicine in an IPA would no longer be economically feasible. The physicians considered affiliating with a larger health care organization that would provide a more secure environment to practice medicine in a managed care setting.

To facilitate the affiliation with a larger health care organization, the UHMG member physicians formed a medical group. A medical group differs from an IPA in the following primary respects: (1) the consolidation of member physician medical practices, (2) the pooling of patient revenue, and (3) the sharing of expenses. The UHMG member physicians decided that after the formation of the medical group, the medical group would then affiliate with a larger health care organization.

The UHMG steering committee identified five potential acquirers, including Foundation Health Corp. ("Foundation") and Sutter Health. During subsequent negotiations, Foundation offered financial consideration including substantial cash payments for the intangible assets, or goodwill, associated with the UHMG physicians' practices. Because of unpleasant past experiences with Foundation's practices relating to approval of drugs and procedures, UHMG physicians rejected the Foundation offer.

Following the rejection of the Foundation offer, during 1993 and 1994, the UHMG physicians conducted negotiations with Sutter Health. Sutter Health was the parent organization of a regional health care system, including a section 501(c)(3) subsidiary, Sutter Medical Foundation (SMF). Unlike the Foundation offer, the Sutter Health offer did not include any payments for intangible assets or goodwill.

The Sutter Health management was unwilling to pay for the UHMG intangible assets primarily for two reasons: (1) a concern that doing so would constitute a criminal offense under the Medicare and Medicaid anti-kickback statute, and (2) a concern that the transaction would become financially nonviable for Sutter Health, based on the financial projections of UHMG's financial performance after the acquisition.

In order to persuade UHMG physicians to accept the Sutter Health offer, the Sutter Health offer provided other benefits and incentives to the taxpayers, including favorable compensation structures, limited noncompete agreements, and participation in various management committees.

During the negotiations with Sutter Health, the taxpayers retained counsel to provide transaction advice. Counsel recommended that the taxpayers donate their practice intangible assets to SMF and claim charitable contribution deductions for the value of the practice intangible assets.

UHMG approved the affiliation with Sutter Health, and the following steps were taken to initiate the transaction:

1. Sutter Health and the affiliating physicians arranged for the appraisals of (a) the business enterprise value of the newly formed medical group and (b) the tangible assets that would be transferred to Sutter Health.
2. A corporation was formed to serve as the entity for the medical group, for purposes of the acquisition of their medical practices by Sutter Health. In April 1994, the Community Health Associates Multispecialty Medical Group, Inc. (dba Sutter West Medical Group (SWMG)), was incorporated as a California professional medical corporation.
3. Effective November 1, 1994, SWMG entered into a professional service agreement (PSA) with Sutter Health. The PSA contained several benefits and incentives to the affiliating physicians, including the freedom from noncompetition agreements and a complex revenue sharing formula that contained a signing bonus and a minimum compensation guarantee. The PSA also secured for SWMG roles in various management and planning committees of Sutter Health and SMF.
4. In October 1994, each affiliating physician purchased a share of SWMG stock.
5. The share purchase was coupled with the signing of (a) a Physician Employment Agreement (PEA) with SWMG and (b) an asset purchase agreement (APA) with Sutter Health and SMF. According to the APA, Sutter Health acquired the medical practice assets from each UHMG physician. The APA also stated that the "seller and buyer believe that the purchase price of the assets is less than their fair market value. The difference between the purchase price and the fair market value of the assets is referred to as the 'contribution.'"

In April 1994, implementing the first step of the transaction, Sutter Health retained the first taxpayer analyst to perform a valuation of Davis Medical Group, a newly formed group comprised of 35 primary care physicians. Using a discounted cash flow method, the first taxpayer analyst report concluded that, as of November 1, 1994, the fair market value of the fixed and intangible assets was $4 million (the "business enterprise value").

The fair market value of the tangible assets of the affiliating physician practices was estimated at $1.2 million (the "tangible asset value"). According to the APA, this amount was equal to the payment received by the SWMH physicians.

On their 1994 federal tax returns, the taxpayers claimed charitable contribution deductions for the transfer of the intangible assets of their medical practices to SMF, equal to the difference between the business enterprise value and the tangible asset value. On its 1994 return, Sutter Health did not report any received donations of intangible assets or goodwill from the taxpayers, despite the transaction documents requiring it to do so.

The formula for allocating each SWMG physician proportionate share of the estimated intangible value was developed by one of the taxpayers (a physician). The formula the taxpayer devised attributed (1) 50 percent of the aggregate value on the basis of each physician's share of gross revenues generated in the year preceding the transfer to SMF; (2) 25 percent on the basis of each physician's "years in the community" up to a maximum of 5 years; and (3) 25 percent on the basis of each physician's share of the aggregate fixed assets transferred to SMF by the SWMG physicians.

After the Service began an audit of the taxpayer 1994 returns, the taxpayer legal counsel retained the second taxpayer analyst to "independently determine the market value of the intangible assets of SWMG, as of November 1, 1994, assuming a sale to a qualified buyer who could either be a for-profit entity or a 501(c)(3) corporation." The second taxpayer analyst used the income, asset, and market approaches to estimate the business enterprise value. The second taxpayer analyst concluded the fair market value of the taxpayer intangible assets was approximately $2.5 million.

As part of the income approach, the second taxpayer analyst calculated the SWMG future distributable earnings by assuming an expense of physician compensation equal to the national median for the Western region. Although the median compensation from the physician compensation survey was approximately 45 percent of revenue, the PSA signed by the taxpayers provided for compensation equal to 58 percent of fee-for-service revenue, 47 to 53 percent of capitation revenue, and at least 55 percent of risk pool revenue.

The Tax Court Opinion

Because payment of money (or transfer of property) generally cannot constitute a charitable contribution if the contributor expects substantial benefit in return, an important decision for the Tax Court was whether there had been a donative transfer of intangible value.

In addition, the Tax Court ruled on the "dual character" transfer claimed by the taxpayers. One of the taxpayer claims was that the charitable contribution deduction had a "dual character." The taxpayers argued that, as part of the acquisition by Sutter Health, they accepted a cash payment equal to the value of the tangible assets, with no consideration for the intangible assets. This was because a payment for goodwill would have triggered a criminal offense under the Medicare and Medicaid antikickback statute.

Generally, only unrequited payments to qualified recipients are deemed deductible. However, a taxpayer who receives a benefit for a contribution may still "claim a deduction for the difference between a payment to a charitable organization and the market value of the benefit received in return, on the theory that the payment has the 'dual character' of a purchase and a contribution."[3] According to the Internal Revenue Code, taxpayers claiming charitable contribution deductions under the "dual character" theory must, at minimum, demonstrate that they purposely contributed money or property in excess of value of any benefit received in return.

The Tax Court held that the donations of the medical practice intangible assets lacked donative intent and, therefore, did not qualify as charitable contributions. According to the Tax Court decision, the taxpayers received corresponding benefits related to the donations and did not make a disinterested gift to a charitable organization. The Tax Court also concluded that the taxpayers failed to show that the consideration received from Sutter Health was less than the value of the transferred assets. Thus, the donations were not charitable contributions based on the "dual character" theory.

In addition, the Tax Court disagreed with numerous aspects of the taxpayer second analyst report conclusion regarding the intangible asset value transferred by the taxpayers. According to the Tax Court decision, the second taxpayer analyst report weaknesses included:

1. the use of a national median derived from physician compensation survey data instead of the actual compensation agreed upon in the transaction agreements;
2. no allocation of any intangible value to the personal goodwill of the SWMG physicians;
3. no adjustment for the lack of noncompetition agreements;
4. no consideration and valuation adjustments based on other agreement terms, such as signing bonuses, guaranteed minimum

compensation, and rights to participate in various management committees of Sutter Health and SMF; and

5. no consideration for the perceived greater professional autonomy granted by Sutter Health as opposed to that offered by other acquirers (such as Foundation).

In addition, the taxpayer second analyst report failed to take into account (1) the state of the California health care industry at the valuation date, and (2) the fact that the physicians solved their main economic issues by affiliating with a large health organization, thereby transferring substantial risks to the acquirer.

The Tax Court concluded that "the SWMG physicians extracted from SMF all that SMF believed it could provide if the affiliation with the physicians were to remain economically viable." The taxpayers secured their ability to maintain or improve their earning levels, which was not possible had they continued to practice medicine on an individual or small group basis. By transferring their practice assets to SMF, the taxpayers received benefits not considered by the taxpayer analyst report conclusion.

Since the taxpayers received consideration for the intangible assets transferred to SMF, their charitable contribution deductions were dismissed by the Tax Court. In addition, the taxpayers did not meet the "dual character" theory, failing to show that the value of what they transferred exceeded the value of what they received in return.

Summary and Conclusion

This discussion presented (1) the Service appraisal requirements for noncash charitable contributions, (2) the Service definitions of "qualified appraisal" and qualified appraiser," (3) penalties regarding substantial valuation misstatements for the claimed value of charitable contributions, and (4) two recent judicial decisions that have dealt with the valuation of ownership interests in health care entities for charitable contribution purposes.

Insights that may be gleaned from the *Bergquist* decision include the following:

1. Even "qualified appraisals" prepared by "qualified appraisers" will be rejected by the Tax Court if they are based on an inappropriate premise of value. The going-concern premise of value used by the taxpayer analysts ignored (a) the imminent consolidation of UA into OHSUMG and (b) the subsequent termination of the UA operations caused by this transaction.
2. Taxpayers may be subject to significant accuracy-related penalties if they do not act in good faith and conduct a good faith investigation regarding the value of the donated stock. The Tax Court found that the taxpayers accepted and acted upon advice that they knew to be unreasonable and unlikely to be true.
3. The significant discounts applied by the Service analyst and accepted by the Tax Court (a DLOC of 35 percent and a DLOM of 45 percent) are noteworthy for estate tax planners and their clients.

Insights that may be gleaned from the *Derby* decision include the following:

1. Even "qualified appraisals" prepared by "qualified appraisers" will be rejected by the Tax Court if they fail to consider any existing transaction terms, such as noncompetition agreements, post-transaction physician compensation, and other contingent physician benefits.
2. There is a significant difference between professional goodwill and personal goodwill. The taxpayer analyst report did not adjust for the fact that the SWMG physicians were not required to execute noncompetition agreements. Therefore, the taxpayer analyst report intangible value included the value of personal goodwill. Personal goodwill may not be donated to charity.
3. The Tax Court was highly critical of the taxpayer reliance on the allocation work of one of the taxpayers (a physician) as the basis for allocation formula. In particular, the Tax Court noted that the value allocation methodology differed from the suggested methodology by the taxpayer analyst. Taxpayers should not act as their own appraisers.

Notes:

1. *Bradley J. Bergquist and Angela Kendrick, et al., v. Commissioner*, 131 T.C. No. 2, 131 T.C. 8 (2008).
2. *Charles A. and Marian L. Derby, et al., v. Commissioner*, T.C. Memo 2008-45 (Feb. 28, 2008).
3. *United States v. Am. Bar Endowment*, 477 U.S. 105, 117, 106 S.Ct. 2426, 91 L.Ed.2d 89 (1986).

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