APPRAISAL TODAY

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Index

An Appraiser Gets Audited by the IRS! My Story…

I never expected to be selected for an audit because my tax return changes very little from year to year and I don't have much to target. I have been in business for 30 years.

However, anyone can be selected for a random small business audit, which I had never heard of. On June 13, 2017 I received a 10 page letter stating that I had a random audit for my entire tax return: appraisal business, publishing business, rental real estate, and personal for 2015. The IRS can only go back 3 years, unless there is fraud, where there is no limit.

I was previously audited in the early 1970s for my husband's commercial fishing business. I represented myself and failed miserably. There is no way to know what you should say or not say. It is much worse than testifying in court, where you are an objective expert and your attorney helps you get ready. .

This audit was one of the most stressful events in my life. That was the first, and last time that I represented myself. No one is perfect. We all make mistakes.

Like most people, I was not afraid of being audited. But, once I got the audit notice, I felt very, very stressed, which is not unusual. Everything was being reviewed and my record keeping had weaknesses. I don't like uncertainty and want to plan ahead, but I did not know what to expect. Without the help of my enrolled agent, it would have been much worse.

Because I had a random audit, where the IRS looked at everything, it was a very good example for other appraisers, so I wrote this very long article before I forgot a lot of the details. Also, some appraisers have more than one business, like me.

What is your probability of being audited?

I attended a home office tax webinar last month and found out that small businesses have a 1 in 3 chance of being audited over a 20 year period. I was unable to find any data on the probability of a random audit, but it is much lower. Several online sites referenced "less than a 1% probability".

Almost everyone I spoke with had been audited in the 70s and 80s. The current Treasury Secretary, Steven Mnuchin, has said he could get a lot of money for the government if his budget was increased instead of decreased. Some Democrats wanted increases, but I doubt if any Republicans listened. Trump proposed a $249 million budget cut. For every dollar the agency spends, it collects $4. Its enforcement activities do even better: $1 returns $6. Who does not hate the IRS? Not me.

The IRS budget for 2017 is $11.9 billion. It has been cut by 18 percent since 2010, after adjusting for inflation, and the agency has lost roughly 13,000 employees - around 14 percent of its workforce.

What does this mean for you? Fewer audits.

For me, it means that I had Very Bad Luck getting selected for a random audit!!

The main small business problem - poor record keeping

73% of audits found poor record keeping - a big problem. At least 83% of small business audits paid extra taxes.

I fit right in - poor record keeping on mileage log and owed extra taxes.

The standard advice is: if you can't prove the deduction, don't take it. Fortunately, I was able to get receipts or other good documentation, for all my expenses.

Fortunately, the IRS examiner said mine was the best organized records she had ever seen. Maybe that's why she did not look at much except my mileage expenses. I guess she knew that it had a low probability of problems. I spent many days organizing my records and looking for missing information.

How far back can IRS audits go?

My tax people always recommended keeping my records for 7 years. But, the IRS cannot go back farther than 3 years. That is why I was audited originally for 2015, when they audited my mileage and income records. (That is where I failed in the 2015 audit.) I sent them records for auditing the same issues in 2016. I know the results will be the same for 2016 - income is okay and mileage is way over-stated.

The only exception is fraud, when there is no statute of limitations. This is typically for unreported income.

Fortunately, a few years ago, the IRS changed the Independent Contractor penalties period from 6 years to 3 years. This is good as the most likely significant fines and penalties for appraisal businesses is misclassifying appraisal (and clerical) workers as independent contractors.

Who can represent you?

Often, for audits of certain sections of a tax return, you can reply by postal mail or electronically. Mine was so comprehensive the IRS required a two day meeting.

For tax returns filed in the past, your return must have been signed by a CPA or Enrolled Agent. Otherwise you represent yourself. In my previous audit in the early 1970s regarding my husband's commercial fishing business, I was recently married and did the return myself. He had used a CPA for many years previously. I never did another return myself. It is too easy for a tax payer to say something they regret later, which is exactly what I did.

For returns filed 1/1/16 and later, the IRS changed the requirements to: "Unlimited representation rights allow a credentialed tax practitioner to represent you before the IRS on any tax matter. This is true no matter who prepared your return. Credentialed tax professionals who have unlimited representation rights include:

- Enrolled agents
- Certified Public Accountants
- Attorneys

My enrolled agent represented me. I filled out a form giving him authorization to handle the audit. I did not communicate at all with the IRS agent.

If a CPA or enrolled agent did not prepare and sign your return and can represent you, I strongly recommend hiring one to represent you.

How soon do you have to meet with the IRS?

I receive my letter June 13 and a meeting date of June 23 was requested. I rescheduled it for August 23, as a lot of work was required to get ready. Two businesses plus a duplex rental property required much preparation!

What is a random audit?

For my previous audit in the early 1970s, the IRS only requested information on my husband's commercial fishing business.

This time, it was a random audit. There is not much info about it online. Several online web sites referenced less than a 1% probability. After lots of tax payer complaints, they were stopped or significantly reduced. They were brought back in 2015 as "Compliance Research Examinations". I just had very bad luck.

Here is one online description: "A random audit is a kind of tax colonoscopy, “the most intrusive and detail-oriented (audit)," Vento says, noting that IRS agents can ask taxpayers for birth certificates and marriage licenses to verify their filing status."

Per the IRS examiner, my return was randomly selected.

Here is what my letter said:

"Your return was selected at random for a Compliance Research Examination. We usually select returns for general examinations because there is some indication that the return is incorrect. We also randomly select returns for compliance research examinations in order to gather data for use throughout the Service to improve our tax system."…

"The random selection of your return does not mean it contains errors, but allows the IRS to collect information in a statistically valid manner about how taxpayers meet their tax responsibilities. This information will help us determine what changes to IRS forms, publications, and tax laws may improve voluntary compliance. It will also be used to guide improvements to how the tax laws are enforced, and to programs designed to help taxpayers understand and comply with the tax laws.…

"There may not be any errors in your return; however, if there are, we will tell you and give you a chance to explain them… if you overpaid we will send you a refund plus interest. If any tax is due… You will pay taxes, interest, and penalties.”

Unreported income - what the IRS really looks for during all audits

In my 2-day audit, the auditor spent most of the time looking for unreported income. She looked at all personal withdrawals from my business accounts and compared it with the deposits into my personal account. There was an $11,000 difference.

My enrolled agent found out what happened. For unknown reasons, in my publishing business, I had posted 6 income payments as an expense check written to Ann O'Rourke, over a 2 month period in 2015. He said it was from selecting the wrong choice on a pull down menu in Quickbooks. It showed up on the General Ledger printout, which I had never looked at.

I reviewed all my records from 2000 to 2017 and only found 4 mistakes in all the other years.

The auditor did have a very strange question while looking for the unreported income. "What is this cash deposit for $1,250 on 9/15/15 for?" Fortunately, I remembered that I had sold my electronic drum set to a musician leaving in a few days for Brazil. I required cash. I somehow remembered what happened. I don't think someone could make up a story like that!

I got a receipt but did not keep it. If it would have been a check I would not have had a copy. Now I make copies of all personal checks received and always get receipts for cash.

It was very stressful for 2 days, while she was looking for the "laundered money".

Be very careful in your record keeping to avoid unreported income

I have only accepted cash payment for an appraisal a few times over the past 30 years, but I remember the temptation to not report the income. I always did because I would have worried about it. It was for bankruptcy and bail bond appraisals, where I always required cash, in advance, for an appraisal.

I remember the COD days prior to 2008, when mortgage brokers had a large segment of the lending business and appraisers were paid "COD" at the door. I also remember seeing appraisers with lots of cash in their pockets and talking about going to the bank the check was issued from to cash it. I am sure it was very tempting to pocket some of it.

Always report all of your income. Don't take a chance. Now you know why.

Classifying trainees (and licensed appraisers) as independent contractors - your greatest business risk

I could not find many appraisers who had been audited except for those who were investigated for having incorrectly classified appraisers as independent contractors when the IRS said they were employees. Some also classified clerical workers, working in their offices, as independent contractors.

When I started my business in 1986, I hired a trainee. I paid her as an independent contractor as "that is what everyone else does." Later that year, I heard about local appraisal companies that were audited by the state of California. Some went bankrupt. Others were able to pay a fine and changed everyone to employees. Once the state audits an appraisal company, they send the info to the

IRS.

I read the IRS "20 factors" and realized my trainee was not an independent contractor. She quit after a year and I worried for the 3 year IRS audit period about getting audited and paying a big fine.

Appraisers don't have many IRS problems except for this issue. I was audited in a random audit this year, and the only problem in my appraisal business was poor record keeping on my mileage log.

Mileage log - your biggest risk - targeted by the IRS

Keeping auto expenses is easy. Keeping a mileage log is not. At a recent appraisal webinar I asked about 10 appraisers if they kept an accurate log. Only one did.

At the home office webinar I recently attended, most of the questions from the attendees at the end of the webinar, were about auto deductions and mileage. I guess I'm not the only one with poor record keeping on mileage.

The examiner only looked at my mileage log and possibly a few other expenses. I suspect that not very many small business owners keep an accurate log.

I had not kept an exact mileage log for many years - entering in beginning and ending odometer reading on every trip.

For my total mileage, I used auto repair records, which is the best way. I had auto repair done in 2/15 and 2/16 so I calculated an average month and multiplied it by 12.

When I started my business in 1986 I kept a good mileage log for about 5 years, but then it was very sporadic. Most of my mileage driven was for business so I used 70%. Unfortunately, in 2015 I did very few appraisals outside of Alameda, a small city about 7 miles by 3 miles.

I re-created a mileage log using google maps. I had only done 35 appraisals in 2015 because I do many apartments and commercial properties, but it was still very time consuming to recreate a mileage lot. When I used to do many more single family appraisals, I don't even want to think how long it would have taken.

Of course, it did not include second trips to the subject or comps, so it was low. The Alameda appraisals, subject and comps, averaged 4 miles driven. Apartment appraisals required more driving for rentals and comps and averaged about 10 miles. I did a few houses outside of Alameda where the mileage was typically 30-40 miles or more. I also did a few commercial appraisals which required driving in other cities for comps, about 60-70 miles.

I go on brokers opens almost every week and kept a flyer from each property, so I added them all up and gave them 1.5 miles each.

I also did the mileage for CE classes and monthly local commercial broker meetings.

My business mileage was 20%, not 70%.

Mileage log tips

The biggest problem is recording the beginning and ending miles to calculate the total miles driven for the year.

You must have a record of your odometer reading at the beginning and end of the year. Starting in 2018, I will write it down every January 1, and put it in a special file.

The best way to prove your total mileage is to use receipts from auto repair, oil change, etc. I had repairs done in February 2015 and February 2016, so I calculated the average month and estimated the 2015 mileage. I am now being audited for 2016 mileage. Fortunately, I had an oil change in February 2017.

If audited you can use google maps to calculate the miles you actually drove, but it is time consuming and probably won't match the "guesstimated" mileage reported on your tax return. Also, it will not include return trips for extra comps etc.

If you use Quickbooks online, they offer a smartphone mileage app, but between two addresses it calculates multiple mileages.

Apps that require entering your beginning and ending odometer readings are a hassle. That's why most of us don't do mileage logs.

I strongly recommend using a smartphone app that records your trips using google maps and compiles detailed reports.

The person teaching the home office webinar was selling a very good app for $10 per month or $100 per year. When I heard the price, it seemed high. But, when I thought about it, it was worth the money. Why? I know I will not record mileage. Also, figured that if real estate agents, who are generally less tech savvy can use it, it should be easy to use.

I was audited in August and still can't remember to record my beginning and ending odometer reading on every business trip. I know that an app, for me, has to be very, very easy to use and the results will be okay for IRS record keeping. The developer, Sandy Botkin is a CPA, former Attorney for the IRS, and has appeared as a tax expert on CBS, etc. Check it out at https://taxbot.com and compare it to other smartphone apps. There are other apps, both free and paid.

I signed up for a 14 day free trial, which requires a credit card but can be cancelled. Then I will have an idea of what I want. I can always cancel and get a cheaper app.

What if you don't want to hassle with mileage record keeping?

The deduction depends on the number of business miles driven. The more miles, the larger the deduction. However, an audit can cover up to a 3 year period. Mine was for 2015 but also included 2017 as I had errors.

I will lose about 2/3 of my deductions for 2015 and 2016. But, I had only driven 5,000 total miles with 1,250 for business, much less than I had estimated. The original deduction I claimed was about $3,500. When I redid my mileage, the deduction dropped to about $1,500.

What was the IRS audit like?

The audit was in my enrolled agent's office. I was not there, but the auditor said that it was the best organized records she had ever seen. Since I was not there, I had to be sure that my enrolled agent could easily find the records she requested. I had no idea what she would look at, so I spent many days getting it ready.

In dramatic contrast, when I got the summaries ready for my CPA or enrolled agent to do my tax returns, it only took me a day. I had been doing them for over 30 years and was very, very familiar with the process. Over the years, I quit using personal checkbook or credit cards for receipts and made very few mistakes when entering data into quickbooks.

I did not want to be at the audit as it is too tempting to make a comment that should not have been made. When she had questions, my enrolled agent called me.

I don't think she looked at many records, except for income and mileage. She spent most of her time looking for unreported income.

The auditor/examiner made a visit to my home office, but did not visit my business office.

Does your accounting profit and loss statement match your tax return?

Mine did not and it created a very big problem in the audit.

Since 1992 I have had two separate businesses, appraisal and publishing. But, many expenses are shared, such as telephone, rent, office supplies, etc. Some expenses are paid in the appraisal business and some in the publishing business. When doing my tax return, I allocated the expenses based on income.

My enrolled agent suggested having one tax return for both businesses. Apparently, my allocation method was not a standard IRS accounting method.

I also posted my personal withdrawals as "personal" instead of "owner's draw". It showed up as an expense on my profit and loss statement.

There was also a difference because some expenses were not paid through

Quickbooks.

What bank and accounting records did the IRS request?

All bank statements, personal and business, from January 1, 2015 to January 31, 2016. They also requested December 1, 2014 to December 31, 2014.

All source documents verifying non-taxable income such as bank loans, credit card advances, etc.

Original accounting records such as summary sheets, worksheets etc. for all income and expenses for the Schedule C business and the Schedule E rental property, profit/loss statements, general ledger, balance sheet, etc.

Copies of all forms 1099 for 2015.

What records were requested for individual income and expense accounts and where did I have problems?

For individual expenses the IRS requests "cancelled check, receipt or other proof of payment".

For rent or lease of office, the above plus periodic statement or invoice.

Proof of payment and periodic statements for telephone, data services, web services, etc.

For depreciation, "proof of cost or adjusted basis…"

What if you don't have the expense records requested?

The IRS really wants to see receipts.

Checks are easy. Usually you write a check using a statement or invoice. Of course, I did not staple the check to the invoice, so I had to go through and set it up for the audit.

Most of my expenses are done on my business American Express account. I somehow assumed that would be adequate and did not keep receipts, especially for automatic payments. Big mistake.

How hard was it to get bank statements and receipts from 2015?

You must have receipts for credit card transactions, which I did not know.

I had misplaced a few receipts from expenses paid by check. But, since I did not keep receipts from most of my credit card transactions, it was a lot of work to get them.

It seems like it would be easy, but there are always some sort of missing receipts, bank statements, etc. that are missing.

My bank only had the past two years. I had to pay to get the missing 2015 months, January to June.

Many companies only keep records online back to 2016 and 2017. I had to take a lot of time calling and contacting them for 2015 records.

Fortunately, Amazon has records going back many years, so I was able to print copies of all the purchases. I use an Amazon business account.

I changed credit card processing companies in mid-2015. One said I could not get 2015 records without a subpoena. Their paper statements have no information on the thousands of individual credit card charges for my publishing business. I have thousands of email receipts from the other credit card company also. I was very upset and nervous. Fortunately, the IRS did not audit my credit card income records. I guess they already knew it was a nightmare.

A few tips if you can't get receipts

As mentioned above, some companies do not keep 2015 records online.

For various reasons, I was unable to get receipts for some of my appraisal classes. I made copies of my CE certificates and printed a page from the providers web site showing typical costs.

For automatic renewal credit card expenses such as MLS, data, web site, etc. I made a copy of the home page of the company matching my monthly or annual cost that was on the credit card statement.

I set up a separate file for recurring credit card expenses that had information from the company web sites if I was not able to obtain information on my payments from the vendor web sites.

What about business income and expenses in your personal checkbook or personal credit card?

Do Not Use a Personal Checkbook for your appraisal business!! I am always surprised to get a check for a subscription using a personal checking account. I have always had a business checking accounts and a business credit card.

But, almost everyone has something not in their Quickbooks records. If you do this, be sure to set up something in your Quickbooks software to account for this. One way is to write a reimbursement check to yourself for the expense.

The copy shop I use does not accept American Express, so I used a personal credit card. When I was audited, it did not show up in my Quickbooks records. I decided to not claim the $700 expense as I had not set it up.

I moved back to my duplex 6 years ago, after I sold my big house. Since I only had one apartment rented, I decided to use my personal checkbook. However, I did not make copies of the rent checks. Another mistake. I was able to document the rent using my bank statement and I had the original lease. I could have gotten a statement from the tenant. The rent increased in 2015 and I had a copy of the letter to the tenants also. Fortunately, I had receipts and checks for all expenses.

Home office deduction

The IRS examiner visited my home office. The deduction was allowed.

I recently attended a home office deduction webinar for real estate agents and learned a lot. Some of the tips are below.

I have been writing about home office deduction since 1992, when I started writing this newsletter. It was tricky to get and was targeted by the IRS. This all changed in 1999, with the Solomon decision. Dr. Solomon was an anesthesiologist who worked for 3 hospitals, but did not have an office in any of them. He did all his administrative work in his home office. This use was approved by congress, after being denied by the Supreme Court.

There are some specific requirements. For example, the home office must be used exclusively for business. One taxpayer lost his deduction when the examiner visited his home office and there were children's books and toys in the office. (They must schedule the visit in advance.) Big Mistake.

The basic requirements:

1. Used regularly for business.
2. Portion of home.
3. Principal place of business.

Here are a few myths:

1. Will increase audit risk. No.
2. Needs to be in commercial zoning. No.
3. Need a separate entrance. No.

More tips:

- The office can be part of a room.
- You must prove the percent of the room, or desk, etc. that is used exclusively for home office. Keeping a time log for 90 days is a good way to estimate this.

Home office depreciation recapture on sale

I did not claim a home office until recently because of depreciation recapture. When the house is sold I would have to pay back taxes on the depreciation deduction I took. The maximum tax rate is 25% on recapture of depreciation. This is called "unrecaptured section 1250 gain."

If you claim a home office deduction and don't claim depreciation, when your house is sold, the IRS will tax you for it.

In 2010 I sold my big house and significantly downsized my office. Also, I moved back to my small duplex apartment and kept the other unit rented. Of course, I needed more office space.

If you sell rental property, you have this depreciation tax due. So I decided to convert one of my 1 car garages to office space and claim a home office deduction.

What if you have 2 offices: regular business office and home office?

That's what I have. A small office in an office building and a converted 1 car garage at my home.

This can be tricky unless you use the home office only for management/administrative purposes, which was the Solomon law.

I do administrative work at my regular office. But, it is very small so I converted a 1 car garage for my appraisal files and to meet clients (my regular office was full of desks, tables, etc.) with a table, printer, etc. The garage is detached.

The IRS examiner allowed the home office deduction (meet clients and detached from my apartment, two of the requirements).

What about depreciation on your tax return when you are audited?

All my equipment is expensed, so I did not claim any depreciation expense.

For my rental property, which I depreciate, they requested "Proof of cost or adjusted basis, including but not limited to settlement statement at purchase, receipts or invoices for additional improvement costs." I purchased it in 1985 and I could not easily find the original settlement statement.

My husband died in 2004 and the depreciation basis was significantly increased. Fortunately, I found a copy of my 706 form (Estate Tax Return), with a copy of the appraisal showing the new basis. Fortunately, the auditor did not ask for proof of improvements made so I did not have to go through all my tax records. Most were on short term depreciation schedules and had been fully depreciated before 2015.

What bookkeeping methods do you use?

I have been using Quickbooks since Quicken 1.0. Previous to that I used a "pegboard" to write checks and post to acccounts. Income was manual and a hassle. It was very tedious to do financial statements.

Appraisal business accounting is relatively easy. But, you may want to have your accountant take look at yours. I never asked anyone about my method of allocating shared expenses between my two companies. I am a finance person, not a bookkeeper. From a financial analyst point of view it was great. But, a mess from the IRS' point of view.

Best Practices - what did I learn?

I always have been a "glass half full" person. I learn the most from my mistakes.

I will keep all receipts.

I will make copies of all checks for deposit, including personal checks, as my bank does not send me copies of checks deposited.

I will set up a method to include business expenses paid for with personal credit card in Quickbooks.

I will use an app for mileage.

What if you don't want to hassle with keeping all your records complete and organized?

You will have my experience, which was very, very stressful.

I met with my enrolled agent a few weeks after receiving the audit notice to go over my record keeping. He realized very quickly that it would be very difficult at the audit as the records were not organized enough for him. Plus there were too many missing receipts, particularly for automatic credit card charges.

Even if I attended the audit with him, it would take a lot of time to find the information requested by the examiner. The 2-day audit was scheduled for 2 months after the notice at my enrolled agent's office. I spent a lot of time working on getting ready and had to turn down many appraisal orders.

At a minimum, make a commitment to get receipts and put them in a box or filed in your computer.

For me, the mileage log was the biggest problem and I lost most of the deduction. I also will lose most of the deduction for 2016 as the IRS can audit the next year. Consider doing your mileage using a smartphone app, the easiest way. Or, you can write down your beginning and ending odometer readings, which is a big hassle for most of us.

Where to get more information

What did you learn from this article? Any record keeping ideas? More paranoia about IRS audit???

For specific questions, such as about your home office or independent contractors, check with your tax advisor. The IRS regularly makes changes. Google is very helpful, but it can be hard to figure out if there is anything more recent that an article online. Also, your tax advisor is familiar with your business.

Here are some basic audit articles.

www.foxbusiness.com/features/2013/06/17/4-types-irs-audits-what-to-know-and-how-to-prepare-for-each-one.html a short explanation of the 4 types of IRS audits

www.bankrate.com/finance/money-guides/how-to-prepare-for-an-audit-1.aspx More advice - easy to understand.

There is lots of information online about what to expect at an audit, guidelines for examiners, etc.

I will put more of this into Part 2 of this article.

Appraisals for estates and trusts - the most popular non-lender appraisals - Part 1

At a recent residential seminar, one of the topics was non-lender appraisals. When the speaker took a survey of attendees, estate and trust appraisals was definitely the most popular.

These types of appraisals do not require court testimony. Most other types of non-lender work, such as bankruptcy and divorce, cansometimes require court testimony. But, when lender work slows down, competition increases for estate work.

However, if you are willing to testify in court, you will have very little competition for assignments and significantly higher fees. A future article will discuss what it involved.

I strongly recommend considering this type of work, particularly since lender appraisals are moving quickly toward desktop appraisals. Also, we are already in a downturn.

Most of my current appraisal work is for estates and trusts. Many are multiple appraisal assignments. A few years ago, I did a 19 property assignment in my city with a $15,000 fee. What types of properties did I appraise? 17 were residential rentals, homes, 2-4 units, and apartment buildings. Two were small commercial.

If you want to diversify from lender/AMC work, I strongly recommend estate appraisals. Any appraiser can do them. The only tricky part is going into the past, which is not that difficult. You are paid your full fees in advance (or 50% up front). The effective date of the appraisal is almost always in the past.

Many appraisers are worried about their futures - will appraisers be needed 5, 10, or 20 years in the future? Most appraisals are done for lending purposes. Lending has been changing to placing much more emphasis on the credit worthiness of the borrower than the value of the collateral.

Even if there are problems requiring appraisals in the future, lending is a notoriously cyclical business.

Why not try working for other types of clients who provide a more stable source of income? An excellent option for both commercial and residential appraisers is appraisals for estate, trust, and gift purposes.

With the recent popularity of living trusts, and sophisticated tax avoidance methods such as family limited partnerships, appraisals are needed both for tax planning purposes prior to a property owner's death and for settling an estate after death.

Why do I like estate and trust appraisals? I very rarely have turnaround pressure, value pressure, or payment problems.

This month I discuss the basics of estate/trust appraising. Next month I will cover more issues, such as IRS audits, future of the estate tax, marketing and other issues.

Use the IRS definition of Fair Market Value

Always include this definition in your appraisal reports. It is similar to the Fannie definition.

"Fair Market Value is defined as: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate." Regulation §20.2031-1

Erase lender requirements from your appraisal reports, and how you develop the appraisals

You are subject only to USPAP and IRS appraisal requirements.. There are not many appraisal requirements. I will discuss them next month in Part 2.

What forms to use?

DO NOT use any of the current Fannie forms for ANY non-lender work. Use the General Purpose Appraisal Form or the Appraisal Institute form. Both are in your forms software package.

Or, you can make up your own narrative style reports.

Do NOT use the Fannie certification and limiting conditions. They are for lender purposes.

I regularly hear about appraisers using lender forms for divorce and getting into trouble in court.

Appraisal for stepped up basis

No one knows the future of federal estate taxes or when property will be sold. I always strongly recommend getting an appraisal as of the date of the first spouse's death to set the basis for capital gains.

Most of my estate work is to establish a new capital gains basis as of the date of death for the "marital exemption".

This is particularly important when the first spouse dies, as the real estate is a "pass through" to the surviving spouse and no taxes are due at that time.

When the second spouse sells a property or dies, capital gains taxes are due, but only for an increase over the basis established when the first spouse dies.

When my husband died 7 years ago, I had our properties appraised. Our home had almost tripled in value ($385,000 to $900,000) since our purchase in 1985. When I sold it 4 years later, I paid no capital gains tax.

Who orders the appraisals?

For residential appraisals (up to a few homes or small income properties) I am often called by the executor, who gets my name from a real estate agent or google. Usually the attorney or accountant asks the executor to obtain an appraisal.

For larger estates, the appraisals are typically handled by:

1. Attorneys (estate distribution, tax issues)
2. Accountants and enrolled agents (tax returns)
3. Executors and administrators
4. Trustees

Appraisals for non-tax purposes

I regularly do estate-related appraisals for non-tax purposes. The executor sometimes needs values to partition an estate. For example, the decedent has two children, one gets the house and the other gets the stocks, but the estate is to be divided equally between them. Or, two or three properties are left to the children, but the will doesn't specify how they are to be divided.

Sometimes the beneficiaries can't agree on "how much they can get" from the property. One of them may not trust real estate agents and think they 'will try to list it low.' The executor gets an appraisal.

If a relative or a private party wants to purchase the property from the estate, the executor will likely want an appraisal as part of his or her fiduciary duty.

When there is a private sale, I also do a current appraisal to help the seller establish a sales price.

Low vs. high values

As in all other types of appraisal, I try to go in the mid-range of value. I tell them that if nobody likes my value, it's probably okay.

I am often hired by the executor. Sometimes they ask for a low value. But, if they are setting a basis for future sale, a high value is to their advantage. Or, they decide to use your low (or high) value to try to sell the property.

For example, a property is valued at $275,000, rather than $300,000, and is sold 10 years later for $400,000. The taxable gain would be $100,000 if previously appraised at $300,000 and $125,000 if previously appraised at $275,000.

Date of value and retrospective appraisals

Always ask about the effective date of the appraisal. If the appraisal is for an estate, it is seldom today's date, unless the person died today. I have been requested to do appraisals as far back as 1955. For trust purposes, where no one has died yet, the value is typically today's value.

The executor can choose either the date of death, or a date six months later for the effective date of valuation (alternative valuation date) if values are changing. Next month's Part 2 will discuss this issue in more detail.

If the property is held in joint tenancy and an estate tax return is not filed, an appraisal may not be done at the time of the death of the first joint tenant. Later, when the surviving joint tenant (typically the spouse) dies, the estate needs to establish the basis as of the date of the death of the first joint tenant. This may be many years later.

How far back in time should you accept appraisals? My fee escalates the further back in time. Even doing an appraisal with a date two years ago can be tough. Maybe the property has been sold and there is a new owner, the market may have changed substantially, etc.

For example, I recently accepted an appraisal dated back to 2012 for a house. The property had been sold in 2004 and a major rehab was done about a year prior to the sale. It took quite a bit of research and many phone calls to find someone who had worked on the house and was familiar with what had been done. What was my fee? Fifty percent over my standard fee, and it was too low. I now charge (for a home) $100 extra per year if I have to go back in time over 2-3 years.

A few times a year I am called about a value of a home many years in the past. My fee would be very, very high. I would use newspaper advertisements, assessment records, and deed recordings. It would definitely be an interesting challenge!

Appraisals done as close to the required date as possible are more accurate and reliable than those done sometime later. If challenged by the IRS, a current appraisal is more credible than one done at a later date. Be sure your fee is high enough to justify the amount of time you will have to spend.

Fees - do NOT quote your AMC or lender fees

Next month I will have more details on fees.

But, the primary issue is appraisers charging the same fee for estates as they charge for AMC and lender fees. They also give a discount for more than one value in the past. I never do this. The farther back the value, the more difficult the appraisal.

People are used to paying for appraisals for lenders, which are much higher than AMCs and some lenders charge borrowers.

Tips on doing retrospective appraisals

My #1 tip is don't underbid! Although it would seem that being able to use old comps would be great, it is often difficult to get additional information from the listing and selling agents, as they are focused on the present, not the past.

Be sure to find out what has changed since the date of death. The more changes, the higher the fee as you will have to review repair bids, interview those who were in the house before it changed, etc.

The farther back in time, and the more the market has changed, the more difficult the appraisal. My market (San Francisco Bay Area) is very volatile and has experienced large declines and large increases in value. I review an appraisal I did during that time period to see what the market was like.

Although typically you don't go very far forward (from the date of death) for data, I have gone forward as far as 6 months and made a negative time adjustment due to significant increases in value. I check the pending and listing dates to see how close they are to the effective date of the appraisal.

If the property has been sold and there is no interior access available, it can be very difficult to determine the condition on the effective date of the appraisal. I have interviewed neighbors and relatives, building department records, and sometimes contacted the current owners.

My most difficult retrospective appraisal was only 6 months in the past, but the home had been transformed from a crackhouse to a beautiful home by the heir. The work was done by a relative with very limited documentation. I interviewed lots of people.

Three dates

In your reports you will have three dates:

1. Effective date of the appraisal. (Usually date of death.)
2. Date of inspection.
3. Date of the report.

Be sure to include all three dates in the appraisal report. I put them in bold face type in the neighborhood section and the reconciliation sections on form reports and in the letter of transmittal and near the value conclusion on narrative reports.

I always include the statement: Appraisal assumes there have been no changes to the subject property between the effective date of the report and the date of inspection. Or, I discuss any changes between the two dates.

What about doing driveby appraisals

I don't do them unless there is a specific reason, such as the property has been sold and there is no access. If so, I charge a much higher fee due to the research required, such as interviewing relatives, neighbors, etc.

Other appraisers do drivebys for estates. It is my decision.

Some differences/problems with estate appraisals as compared with lender appraisals

I always let them speak about the deceased person. Everyone grieves differently. Some say nothing. Others talk about them. I consider it my "appraisal counseling/listening". My spoused died in 2004 and I know what it it like.

Unfortunately, the anticipation of money (greed) from estates seems to bring out the worst in some people. You will be hearing about ungrateful relatives, "love child" from the 60s showing up, etc. I listened to these stories also.

Problems I have encountered include:

- Not clear on effective date of the appraisal. (I call the accountant or attorney.)
- "Crazy" heir calling me night and day. (I returned the full fee. I was the third appraiser to do so.)
- No estate checkbook set up for payments. (The executor can be reimbursed from the estate.)
- Bounced check from estate checkbook. (I inquire when the account was set up and how money will be put into the account if it is recent.)
- Relative occupying the property who doesn't want to move out. (Similar to a tenant being evicted, but worse. I try to move as fast as possible during the inspection and try to get them to allow me to take interior photos.)

- Relatives fighting over jewelry, glassware, etc. during my inspection. (I just try to ignore them.)
- Insist on paying really low fees. (I tell them to call someone else.)

What geographic area is best for this work?

Obviously, the higher the values, the more is saved by getting an appraisal to reduce capital gains when the property is sold.

Also, there are wide differences around the country in the use of trusts, which often want appraisals done.

Even in lower priced areas, if there is a sale to a relative or tenant, often the executor will get an appraisals. Or, the beneficiaries are fighting over "who gets what".

I live in the San Francisco Bay Area, which is a prime market for estate and trust work. The population greatly increased after World War II and many of those who moved here are setting up trusts or passing away.

Home values have increased substantially and then declined a lot in the past 15 years.

Real estate prices are high, with the median price of homes at around $850,000. If you have an expensive home that you purchased many years ago, more and more people are over the current estate tax exemption. Education levels are higher and more people are setting up trusts for their assets.

What if you're in an area with lower priced real estate? Your potential market will be smaller, but there are always out-of-state heirs who need to find out what their property is worth, charitable donations, etc.

If one spouse passes away today, it is safer to get an appraisal to establish a new basis, as the property and other assets could be much higher when the second spouse dies.

Even if homes are selling for $80,000, establishing a new basis at $80,000 with an appraisal will really help if the property is ever sold as values do go up over time. They will save the cost of the appraisal fee by a lot of taxes saved.

Should you do this type of work?

I don't really know why so few appraisers work for estates and trusts. There is seldom much turnaround pressure, few or no payment problems, and reasonable fees. Any value pressures, if any, are typically much less than for lenders.

If you are in an area with lower priced properties, doing appraisals for estate and probate purposes may not give you a lot of work, but does provide an excellent diversification opportunity. Also, sometimes there are multiple properties to appraise.

Many appraisers don't like to do litigation and/or divorce work because of the hassles and court testimony. Appearing in court is very unlikely for this type of work, unless it's a very complicated and large estate and it ends up in tax court.

For estates, the attorney will let you know ahead of time if court testimony may be required. You can say no if you don't want to do court testimony.

In the past, many residential appraisers didn't like to do work for one-time non-lender clients. But the market has changed, and non-lender work can keep you going when the lender market is down.

Where to get more information

The IRS Web site at www.irs.gov is a "gold mine" of information. For example, google "IRS Real Property Valuation Guidelines" to see what IRS examiners look for.

In this brief article I can only touch on some of the most important points. Being knowledgeable about estate, trust, and tax issues makes your appraisal services more marketable and convincing.

The tax laws and issues are complicated and keep changing. Classes and seminars are available in many communities. Check at your local adult school or college. Many books have been written for laypersons on estate planning, probate, and trusts.

Check at your local library or book store. Books published by Nolo Press are well written.

Next month I will have lots more details.

Fannie and Freddie Are Not Your Friends

by Barry Bates

Editor's note: Barry was unable to complete his full dissection of Fannie and Freddie by this month's newsletter deadline. But, he was able to write a short intro for this hot topic. He will continue the topic next month. I am very grateful to Barry for writing for Appraisal Today about his unique perspective on the mortgage lending industry, especially his humorous comments plus fun fotos.

Author's note: I'm into a new phase of medications in this nasty little case of prostate cancer I picked up 17 years ago, and until now, I had been able to avoid nausea. But it's a special gift with this new androgen blocker, and I was taking it in stride at first, but then I noticed what topic I had laid out for myself for this issue of

Appraisal Today.

Fannie and Freddie??! Oh, NO, said Mr. Bill!

It's yet another economic set of tonics that cause nausea! Well, my favorite dysfunctional aunt and uncle are in the news again, and once again, they're on the brink of greatness or immediate collapse.

So that you don't have to read my entire rant, the bottom line, in my opinion, is that if the "35 appraisal organizations" really want to stop F&F from issuing appraisal waivers, you need to complain to their mom and dad, the FHFA, not to them individually.

Plus, over a 45-year career, I could never make my mind up whether GSEs (government sponsored enterprises) were a good idea in the first place. Plus I suspect that the chummy nicknames were progeny of their marketing departments, to make them sound homespun and friendly. I never found Fannie friendly, and only one love song has ever been written about her (Embed Photo 2 Buster Brown, 1959, Fannie Mae, 45rpm FIRE Records].

A brief history of Fannie and Freddie

Just as a refresher, the first GSE emerged in 1916 as the Farm Credit System, today best known by one of its offspring, Farmer Mac (Federal Agricultural Mortgage Corporation). It now provides an entire third of mortgage loans made in rural areas of the US. (Wikipedia has great articles on all these entities, if you're troubled by insomnia.)

In 1932, Congress, dazed by the Great Depression, stimulated outlay of credit by forming the 11 Federal Home Loan Banks, which make loans to communities and banks (not individuals. Originally, the loans were made to "building and loan" associations, the forerunners of the ill-fated savings and loan associations, which still exist, but which declined in number by 53%(3,234) between 1986 and 1995, "primarily due to unsound real estate lending" (the Wiki article on S&Ls has a brilliant 15-point list of the other causes).

The two brothers that ran the S&L that employed your humble author in 1986 were the same ones I mentioned last month. The one carried a pearl-handled Walther PPK and the other handed the keys to his 1978 Rolls Royce Silver Shadow to a valet at a restaurant in San Francisco that did not offer valet parking.

Some of my experiences working for mortgage lenders

By the way, that 45-year career of mine consisted of 22 jobs. I felt no love lost between mortgage management and its appraisers, so I adopted a simple plan.

After about 2 years, I would either get bored, the organization would start displaying some kind of Hunter S. Thompsonian "bad craziness" or was sold, or I decided I was worth more money than my supervisor was willing to pay me. So I just followed the dollar signs. Today I regret that approach; it was cynical, and always left me in front of a fire.

Toward the end of the 90s, I had a fun job as chief appraiser of a nationwide household name in second mortgage financing. (Be patient; there's a relevant point here.) The company had never had an appraiser on staff. I had fun hiring review staff and setting up a high-tech (at the time) process for delivering appraisals, and I found that I was being viewed as a circuit speaker at conferences. Rumors of the company's sale to a large Eastern bank began to circulate.

I had one visit from FDIC auditors, who asked me, "when did you get your first visit from the Bank's due diligence team?" I had to answer that I had no such contact. This was obviously one of those transactions where the buyer didn't much care about due diligence. The company was excited to have the name and the expansion of balance sheet.

A friend of mine, the nanny of all my employer's troubled loans at a warehouse office in the Midwest, informed me that my fully hands-off review department was given only a 5% stream of collateral to review. In other words, 95% of appraisals went to the closing table with no collateral oversight, just an appraisal "for the file".

I was surprised that my opinions on value were never challenged despite the quadrupedal, mammalian nature of our loan officers, but I never looked under the covers.

I found a new job as chief of a big subprime shop in LA, and prepared to move south. After the Bank's acquisition closed, I was told that the new owner had "found" a billion dollars of defaulted loans in the Kansas City warehouse. Lucky for me, the issue did not follow me to Hollywood.

Mortgage lending's moral compass and the GSEs

So: the relevant point: the mortgage industry represents a huge temptation for people whose moral compass comes out of a cereal box.

Its oversight, the federal agencies that are supposed to ensure safety and soundness, have displayed a combination of incompetence, misplaced safeguards, pusillanimity and collusion that have exacerbated nearly every U.S. financial crisis since the Great Depression.

This is not the fault of the auditor who shows up to look at the books, which have been cooked so far as to be illegible. These are good guys with families and children who are maneuvered by politics and greed above their heads.

Needless to say, "finding" a billion dollars of bad loans after acquiring another institution probably reflects a crime of gargantuan proportions. The bank was subsequently acquired and closed by a bigger bank which folded its portfolio in with much bigger pools.

Some articles refer to "holding" vs. "pooling", similar references to investment holding periods. I think "pooling" is more descriptive, because once you start pooling, the neighborhood kids come over and, well, you know…start peeing in your pool.

Unfortunately, I've seen microcosms of this kind of catastrophe over and over, and I must admit that sometimes it had made me jealous because I never had the opportunity to take down my bucket to the "money river" (cf. Vonnegut)as I've watched others do. I'd love to say it was because I was a spiritual or moral giant. I just didn't know how to do it.

Later in my career, when appraising a single family home, a broker or lender would sometimes intimate that my fee could be higher if the value could be. I loved saying, "Look, I'm more than willing to be complicit in mortgage fraud. But, not for a lousy 450 bucks!"

The GSEs today

At the moment, financial pundits can't seem to decide whether Fannie and Freddie are long for this world. To some extent, I wonder if the cycle of bloom and doom among the GSEs isn't a function of a morally flawed concept that brought them into being.

The stated purpose of a mortgage GSE is to serve investors and home loan borrowers by buying and securitizing mortgages, thus freeing capital in the private sector to make affordable home loans to Americans seeking what used to be called "The American Dream" of homeownership, and to provide solid returns to investors buying its securities.

Nowhere in its various charters does it guarantee a living to appraisers. The markets still can't agree that the GSEs facilitate lower costs to borrowers because of what those markets once believed by an "implicit guarantee" that investors would be bailed out by the government if the mortgage market tanked.

When it did a magnificent bellyflop in 2008, it was indeed bailed out by the taxpayers (government in disguise), but this left the GSEs with red balance sheets. Fannie alone is at least $300 billion under water. GSEs like Fannie, Freddie and Ginnie hold over $5 trillion (that's trillion with a T.) in mortgages.

About the author

Barry Bates entered the appraisal profession in 1972, after four years in the US Army, and another four at the University of California, Berkeley, where he majored in English Literature and minored in Slavic Languages and Criminology.

He had many appraisal-related lender jobs after that, including Countrywide and Morgan Stanley Mortgage Capital in Boca Raton, Florida.

In 2006, Bates founded InsideValuation, a provider of commercial broker price opinions and IAG evaluations, which was sold to Lighthouse Real Estate Solutions.

At 71, Barry has had wide-ranging experience and a technological perspective in a fast-paced career that serves as a testament to the fact that he has never been able to hold down a steady job.

He is now "retired" and lives in Pittsburgh, Pennsylvania with his wife, Kathleen and their two dogs. He writes for real estate publications and, in his own words, tries to get into more trouble. In 2008, he filed whistleblower suits against MERS (on behalf of county recorders) in 12 states, all of which failed miserably.

Barry Bates wants to hear from you! Send your comments and criticisms by email. He can be reached at barrettbates@gmail.com.

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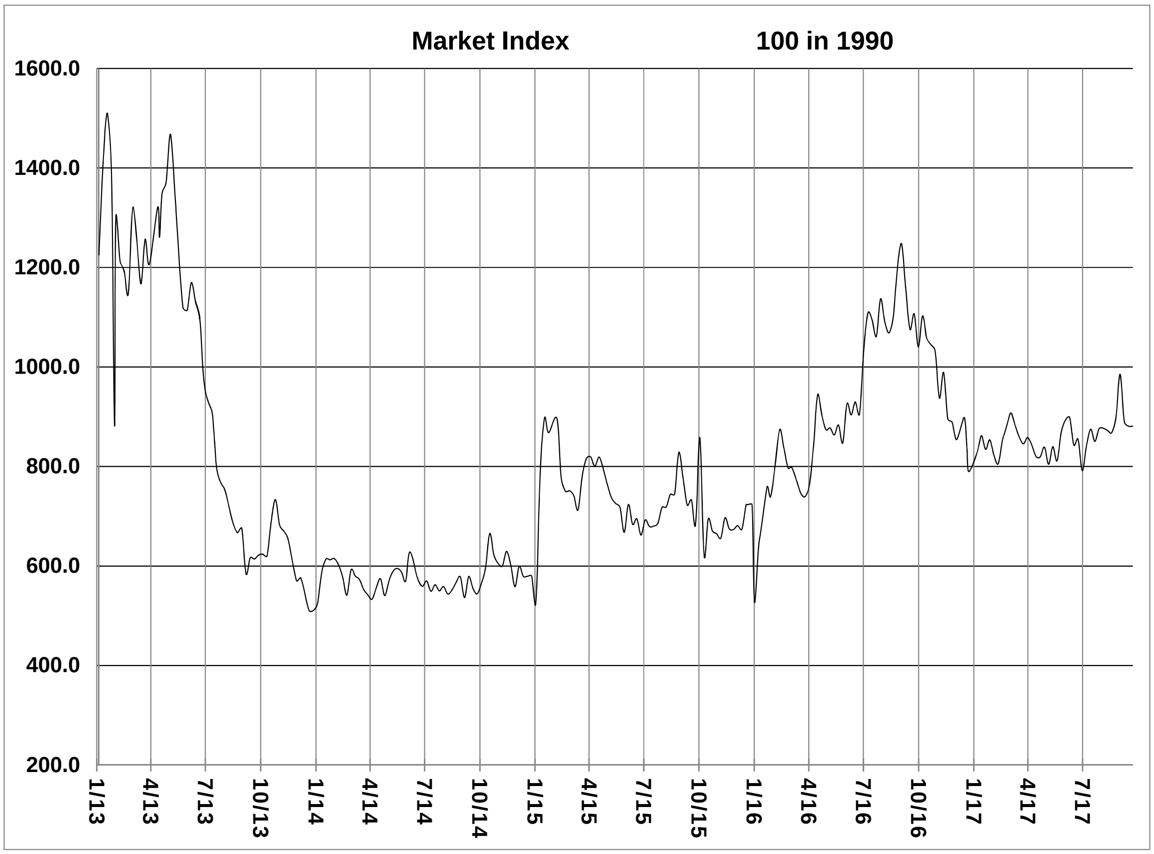
MBA Loan Volume Application Index 1/13 to 9/17

As you can see below, between 2013 and today, volume peaked in early 2013, declined, then peaked again in 8/16. For many appraisers, volume started dropping in early 2017. A good demonstration of the ups and downs of mortgage lending.



The survey covers approximately 75 percent of all U.S. retail residential mortgage applications, and has been conducted weekly since 1990. Respondents include mortgage bankers, commercial banks and thrifts. Base period and value for all indexes is March 16, 1990=100.

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