Email: Susannah@Sabnekar.com

Amended Returns

By Susannah Sabnekar, CPA/ABV, DABFA

(As Published in the May 2004 Edition of the BV Q&A Update)

The Question and Case facts as presented:

Valuation date is May 2001: 2000 S-corp tax return filed 9/01. Amended S-corp filed 10/03. Amended return substantially changes income numbers (down). What is the thinking with respect to whether a willing buyer standing on the valuation date having reasonable knowledge of the relevant facts would be deemed to have knowledge of facts and information in an amended return filed 18 months after the valuation date? In NC, information or events occurring after the valuation date cannot be used to form the opinion of value, but can be used to corroborate. In this case, the amended return was utilized in the opinion of value. (Pointing to cases or literature in the field would be helpful).

Courts General Guidelines

Generally speaking, subsequent events are either those that affect value or those that do not affect value, but give evidence of value that existed at the valuation date. Subsequent events that actually affect value should generally NOT be considered unless they were reasonably foreseeable. Subsequent events that do not affect value, but give evidence of value should be considered.

The court has set forth its opinion on this issue in both *Estate of Jung v. Commissioner* and in *Morton v. Commissioner.*

As set forth in Jung - *"A distinction may be usefully drawn between later-occurring events which affect fair market value as of the valuation date, and later-occurring events which may be taken into account as evidence of fair market value as of the valuation date. When viewed in this light as evidence of value rather than as something that affects value, later-occurring events are no more to be ignored than earlier-occurring events."*

As set forth in Morton – *"Subsequent events or conditions which affect the value of the property can be taken into account only if they are reasonably foreseeable on the valuation date. Conversely, subsequent events, which merely provide evidence of the value of the property on the valuation date, can be taken into account regardless whether they are foreseeable on the valuation date.*

Moreover, in *Taube v. Commissioner* and in *Estate of Gilford v. Commissioner*, the court expressed its unwillingness to accept hindsight from experts.

In general, it appears that the court supports the contention that property is valued as of the valuation date based on market conditions and facts available on that date without regard to consideration of subsequent events. However, subsequent events can be considered for the "limited purpose" of establishing what the willing buyer and seller's expectations were on the valuation date and whether such expectations were both intelligent and reasonable.

Additional Considerations

Another question to consider is whether the information was "known or knowable"? If the error necessitating the amended return was known or knowable, a strong argument exits to consider the amended return. For example, if an obvious error existed in the reporting of gross revenue (i.e. $1,000,000 was reported when it should have been $100,000 and all other years under analysis suggest that the lower amount was appropriate) this type of error should have been known. Was there an error in GAAP that should have been known? Would an inquiry of management have revealed that this type of recognition error was foreseeable? Were there accrual adjustments with subsequent reversals or corrections that were knowable?

According to various books authored by Jay E. Fishman, Shannon P. Pratt, James R. Hitchner, and others, (see work cited) appraisals should be based on information that is available or determinable as of the valuation date. With this in mind, financial statements for periods ending after the valuation date are not generally used as direct evidence in the valuation engagement. However, in certain limited instances subsequent period financial statements are used. They are particularly useable when the information reported therein is considered "knowable".

The Uniform Standards of Appraisal (USPAP), under Standard Three (Appraisal Review, Development and Reporting) previously only applied to the review of real estate appraisals. Those references have been eliminated making it clear that these standards apply to business appraisers. According to Standard Three,

> "*The appraisal review must be conducted in the context of market conditions as of the effective date of the opinion in the work being reviewed. Information available to the reviewer that could not have been available as of or subsequent to the date of the work being reviewed must not be used by a reviewer in the development of an opinion as to the quality of the work under review.*

While there is no discussion regarding knowable, known or the particular type of subsequent event, the language could be interpreted to conclude that information

available *should* be considered. Yet, this section really seems to limit its application to market conditions while the issue at hand appears to focus on knowledge regarding the financial statements.

Under USPAPs Statement on Appraisal Standards No. 3 (SMT-3), retrospective value opinions are discussed. Again, there is not clear guidance when the issue is actually an error in the financial statements. This statement focuses on assessment of market conditions and expectations. In that specific area, it is acceptable to utilize subsequent data as a confirmation of trends. However, the appraiser is cautioned to assess a logical cut-off date and is advised to use the effective date as opposed to the "as of report" date if subsequent data is not consistent with the effective date.

The Analysis that should have occurred

Given the facts, it is clear that the appraisal work was conducted *after* the existence of an amended return. In my opinion, the appraiser would immediately be required to determine whether the error necessitating the amendment was foreseeable, known or knowable. In addition, the appraiser would most assuredly want to consider possible litigation issues that might develop. The issue here is not confirmation or assessment of market conditions. It would appear that the real issue is "reliable" financial data. If the appraiser is a CPA, there are additional rules and standards that exist. While our engagement letters and assumptions and limiting conditions set forth that we are not responsible for the accuracy of the data presented within the financial statements, we are clearly charged with the obligation to produce results that are reliable.

The appraiser would need to be mindful that damage experts involved in litigation may be extremely aggressive in perceived "valuation procedural abuses" that might result from concluding that subsequent events (such as an amended tax return) may be ignored, particularly if it *can* be reasonably concluded that the information should have been known, was knowable or was foreseeable.

The Answer

The question at hand hinges on: Was the Amended S-Corporation filing foreseeable, known or knowable? If the amended filing was reasonably foreseeable, known or knowable, then inclusion of the amended tax return *IS* appropriate. However, if the amendment was necessitated due to unforeseen or unpredictable events, then it is possible that it should *NOT* have been considered.

Work Cited

Please call for references.