9-26-2011

Excluding Expert Valuation Testimony

Wendy G. Gerzog
University of Baltimore School of Law, wgerzog@ubalt.edu

Excluding Expert Valuation Testimony

By Wendy C. Gerzog


Wendy C. Gerzog

Wendy C. Gerzog is a professor at the University of Baltimore School of Law.

In *Boltar*, a case in which the Tax Court addressed the valuation of a conservation easement, the court ruled on the admissibility of expert testimony.

In its 2003 partnership return, Boltar claimed a charitable deduction for a conservation easement on property it owned in Lake County, Ind.[1] The company valued the easement at $3.245 million.[2] The government reduced that figure to $42,000 in its notice of final partnership administrative adjustment (FPAA). The government also filed a pretrial motion to exclude the taxpayer's expert report and testimony under the Federal Rules of Evidence (FRE) and *Daubert*.[3] The court ruled favorably on the government's motion and held that the amount of the taxpayer's deduction was limited to that allowed in the FPAA.

At the end of 1996, Laura Lake Development Co. LLC purchased two parcels (northern and southern parcels) of approximately 10 acres each for $10,000 an acre. On October 1, 1999, it transferred those parcels to Boltar.[4] On November 8, 2002, Shirley Heinz Land Trust Inc. (Land Trust) quitclaimed approximately 10.3 acres (eastern parcel) just east of the southern parcel to Boltar.[5] At all relevant times, the southern parcel was encumbered by a pipeline utility easement. Also, as of December 29, 2003, the date of the taxpayer's donation, both the northern and southern parcels were subject to an access (golf cart) easement.

On December 29, 2003, the taxpayer granted a conservation easement to the Land Trust on approximately eight acres of the eastern side of the southern parcel. Of that easement, approximately 2.82 acres of the southern parcel (plus additional land in the northern parcel as well as all the acreage in the eastern parcel) is forested wetland under the U.S. Corps of Army Engineers' jurisdiction. The discharge of fill material in those wetlands was subject to permit application and mitigation for lost resources.

On the donation date, both the northern and southern parcels were zoned R-1 single-family residential use. The eastern parcel was zoned as a planned unit development (PUD) and part of a proposed, but not finalized, development project.

The taxpayer attached an appraisal report to its 2003 return. DeClark, managing director and principal of Integra Realty Resources, and Meyers, a senior real estate analyst for Integra, relying only on a draft of the easement, prepared the taxpayer's report.[6] The report stated that the "highest and best use" of the burdened property was residential use and determined values based on a 174-unit condominium project. The appraisal incorrectly assumed that the subject property was "under the jurisdiction of the city of Hobart" and zoned as a PUD.[7]

Saying that the Integra valuation did not determine the value of the subject property both before and after the easement burden, the government's expert valued the property at $42,000.[8] Although the government expert accepted that the highest and best use of the property would be residential, the taxpayer's assumed use was unavailable until the properties were developed. But, at that point, the properties were landlocked, without access to a public road.[9]

---

[1]*See Boltar LLC v. Commissioner*, 136 T.C. No. 14, at 2-3 (2011), *Doc 2011-7257*, *2011 TNT 66-10*. Boltar LLC is incorporated in Delaware and has its principal place of business in Colorado. *Id.*

[2]The taxpayer claimed a fair market value of $3.27 million for the easement but reduced that amount by $25,000 based on property value enhancement of Boltar's adjacent properties. *Id.* at 6.

[3]*Daubert v. Merrell Dow Pharm. Inc.*, 509 U.S. 579 (1993).

[4]The transfer was "in payment of a note and to prevent foreclosure." *Boltar*, 136 T.C. No. 14, at 3.

[5]*Id.*

[6]*Id.* at 6.

[7]*Id.* at 7.

[8]*Id.*

[9]*Id.* at 7-8.

The court first described the statutory and regulatory requirements for charitable contributions, for valuing contributions in-kind, and for a contribution of a partial interest in real property, especially a contribution of a conservation easement in perpetuity. Valuation for contributions in-kind is at fair market value on the date of donation.[10] For conservation easements, the regulations require that FMV be based on comparable sales prices, if readily available. However, when there are insufficient sales for ''a meaningful or valid comparison,'' the regulations require that FMV of the easement generally be computed by taking the FMV of the property without the easement and subtracting the property's value after the easement is granted.[11]

The court rejected the taxpayer's own valuation method because it did not explain in any intelligible way why it was departing from the regulations' requirements. By contrast, the government used both a before- and after-easement valuation difference of $31,280, applying primarily comparable sales.[12]

In its motion in limine, the government contended that the taxpayer's expert report ''was neither reliable nor relevant.''[13] It did not contain before- and after-easement property values, did not value all the taxpayer's contiguous parcels as the regulations required, and the PUD was an impossible use on the nine-acre burdened property.

The court held that the principles enunciated in *Daubert* controlled the decision in *Boltar*.[14] As the government's reply brief outlined, the taxpayer's expert report lacked consideration of ''zoning restraints and density limitations and . . . pre-existing conservation easements.''[15] The report ignored that the PUD was inappropriate for the subject land and disregarded that it ''was not economically feasible to construct and would not be legally permissible to be built in the foreseeable future.''[16] In response, the taxpayer maintained that *Daubert* was inapplicable to a bench trial.

Also, the court held that FRE Rule 702 applied both to bench and jury trials. The rule establishes standards of reliability. *Daubert* emphasized the need for the trial court to serve as a ''gatekeeper'' to exclude unreliable evidence.[17] Its gatekeeper function is used ''to increase the efficiency of trials and the objectivity of judgments.'' Also, that function should discourage the proliferation of an abusive ''cottage industry of experts.''[18]

The reason for excluding unreliable evidence is the burden it places on the opposing party and on the judicial process. ''Expert opinions that disregard relevant valuation or exaggerate value to incredible levels are rejected.''[19] Despite the appraisers' qualifications, in their zealousness and advocacy of their client's interests, experts can produce an unprofessional report that ignores relevant facts. In that instance, as here, the court must reject an absurd, unreliable, and irrelevant expert opinion.[20] In *Boltar*, the court found that ''the expert report is so far beyond the realm of usefulness that administration is inappropriate and exclusion serves salutary purposes.''[21]

The court determined that the taxpayer's expert report did not incorporate ''realistic or objective assumptions.''[22] Rather, the report applied erroneous factual premises and used an inappropriate analysis. The taxpayer did not refute any of the government's objections, nor did it make any ''adjustments or corrections to [the government's] calculations.''[23] Essentially, the court found that the appraisers' report ''as a whole is too speculative and unreliable to be useful.''[24] The factual errors in the report ''demonstrate the lack of sanity in their result.''[25]

The court granted the government's motion and excluded the taxpayer's expert valuation report. Lacking any credible evidence from the taxpayer, the court was left with the government's expert valuation report and testimony[26] and the burden of proof on the taxpayer. Holding for the government, the court sustained the government's easement value and deficiency assessed in the statutory notice.[27]

Daubert

Daubert concerned litigation against a drug company that manufactured Bendectin by infants who had allegedly suffered birth defects from their mothers' taking the drug. The case focused on the standard for admissibility of scientific evidence and

[10] *See* reg. section 1.170A-1(c)(2), 1.170A-7(c).
[11] *See* reg. section 1.170A-14(h)(3)(i).
[12] *Boltar* at 11.
[13] *Id.* at 12.
[14] *Id.*
[15] *Id.* at 13.
[16] *Id.*
[17] *Id.* at 14.
[18] *Id.* at 16.
[19] *Id.* at 15.
[20] *Id.* at 15-16.
[21] *Id.* at 16.
[22] *Id.* at 17.
[23] *Id.* at 20-21.
[24] *Id.* at 21.
[25] *Id.* at 22.
[26] Although the government's experts concluded that the easement was worth less than the amount stated in the statutory notice, the government did not ask to increase the taxpayer's deficiency. *Id.* at 24.
[27] *Id.*

whether the *Frye*[28] test had been replaced by the adoption of FRE Rule 702. The *Frye* test had required ''general acceptance'' in the scientific community to determine whether to admit new scientific evidence at trial.[29]

The company had moved for summary judgment, arguing that Bendectin had not been shown to cause human birth defects and that the petitioners had not produced admissible evidence showing the contrary.[30] The petitioners responded by producing testimony from eight reputable experts who had concluded that Bendectin could, indeed, cause birth defects.[31]

In *Daubert*, the court agreed with the petitioners that the *Frye* test was displaced by the FRE. ''The Rules occupy the field.''[32] Although the rules control, the court said, that change did not mean there were no restrictions on the admissibility of evidence.

Rule 702,[33] which covers expert testimony, allows the trial judge to screen evidence to ensure relevance and reliability.[34]

The court explained the policy behind this rule:

> Unlike an ordinary witness . . . an expert is permitted wide latitude to offer opinions, including those that are not based on firsthand knowledge or observation. . . . Presumably, this relaxation of the usual requirement of firsthand knowledge . . . is premised on an assumption that the expert's opinion will have a reliable basis in the knowledge and experience of his discipline.[35]

The court recognized that the trial judge's gatekeeper role might occasionally result in a jury's being uninformed about ''authentic insights and innovations. That, nevertheless, is the balance that is struck by Rules of Evidence designed not for the exhaustive search for cosmic understanding but for the particularized resolution of legal disputes.''[36]

Essentially, the FRE give the trial judge the charge of requiring ''that an expert's testimony rests on both a reliable foundation and is relevant to the task at hand.''[37]

Conclusion

The court in *Boltar*, relying on the FRE and *Daubert*, rejected what any reasonable reader would consider to be an outrageously flawed expert report. Sanity checks are always welcome.

---

[28]*Frye v. United States*, 293 F. 1013 (1923).
[29]*Daubert*, 509 U.S. at 582-586.
[30]*Id.* at 582.
[31]*Id.* at 583.
[32]*Id.* at 587.
[33]Rule 702, cited in *Daubert*, 509 U.S. at 588, provides: ''If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.''
[34]*Daubert*, 509 U.S. at 589.
[35]*Id.* at 592.
[36]*Id.* at 597.
[37]*Id.*