

# PAINTING A DARK PICTURE: THE NEED FOR REFORM OF IRS PRACTICES AND PROCEDURES RELATING TO FINE ART APPRAISALS

## I. INTRODUCTION

The appraisal of art work presents unique difficulties and challenges for the taxpayer, the appraiser, and the Internal Revenue Service ("IRS"). As appraisals are the basis upon which estate, income, and gift taxes are assessed,<sup>1</sup> accuracy is critical. Fraudulent and inaccurate appraisals, if not detected, almost always translate into lost tax revenue for the government.<sup>2</sup> Serious concerns regarding bogus appraisals and lost tax revenues have resulted in the promulgation of numerous tax reforms, regulations, and procedures<sup>3</sup> during the last four decades,<sup>4</sup> including the implementation of stiff penalties for appraisers and taxpay-

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<sup>1</sup> See *infra* notes 17-33 and accompanying text (describing fair market value standard mandated by IRS for all appraisals of art works submitted for estate and charitable donation tax purposes).

<sup>2</sup> See Bell, *Changing I.R.C. § 170(e)(1)(A): For Art's Sake*, 37 CASE W. RES. L. REV. 536, 542 (1987) [hereinafter *Art's Sake*]. During the first ten years of the Art Advisory Panel's ("Art Panel" or "Panel") operation, it reviewed appraisals with a claimed total of \$276 million. Adjustments of \$75 million were made. See also Ostroff, *IRS Unit Takes Critical Look at Art Values*, L.A. Daily J., June 26, 1986, at 5, col. 1 [hereinafter *Critical Look*]. In 1985, of 1,266 items examined by the Art Advisory Panel to be contributed to charities, the total value of 899 items was decreased by over \$18.3 million. In comparison, the value of only 33 items was increased by almost \$800,000. During that same year, of the 272 estate objects that were examined, the value of 83 items was increased by a total of \$3.5 million. A decrease of \$1.2 million for 35 works was also made. *Id.*

During recent years, the number of adjustments have continued to escalate, partially in response to the increase in values being claimed. In 1988 alone, the Panel recommended total adjustments of \$52,724,000 for items with a claimed aggregate value of \$176,482,000. Commissioner of IRS, *Annual Summary Report for 1988 of Closed Meeting Activity of the Art Advisory Panel* [hereinafter *1988 Annual Summary Report*]. In 1989, the Panelists recommended total adjustments of \$17,727,000 for the year on items with a total claimed value of \$109,307,000. Commissioner of IRS, *Annual Summary Report for 1989 of Closed Meeting Activity of the Art Advisory Panel*, in THE LAW AND BUSINESS OF ART 833, 836-37 (PLI 1990) [hereinafter *1989 Annual Summary Report*].

<sup>3</sup> See *infra* notes 91-116 and accompanying text for an outline of the following: Revenue Procedure 66-49 of 1966 which provides information and guidelines for taxpayers and appraisers submitting valuations of art works to the IRS; section 7517 of the Internal Revenue Code implemented in 1976 which requires the IRS to disclose information regarding estate and gift valuations made by the Service; and selected provisions of the Deficit Reduction Act of 1984 which authorizes strong penalties for appraisers and taxpayers who submit grossly inaccurate appraisals, and which also attempts to define the term "qualified appraiser."

<sup>4</sup> See *Art's Sake*, *supra* note 2, at 546 (author asserts that new appraisal regulations and Art Advisory Panel currently provide IRS with effective procedures to attack valuation abuses).

ers.<sup>5</sup> To bolster these measures, the IRS created the Art Advisory Panel ("Art Panel" or "Panel")<sup>6</sup> which reviews the appraisals of works of art submitted by the taxpayer and makes recommendations for valuation adjustments.

While tax reform and IRS regulatory measures have been effective to a degree in deterring blatant fraud and gross error in the area of fine art appraisals,<sup>7</sup> serious problems will persist unless changes are made in the definition of "fair market value" in the Treasury Regulation.<sup>8</sup> The current definition, which serves as the guide for all art appraisals submitted to the IRS is very ambiguous, resulting in confusion for appraisers and inconsistency in valuations.<sup>9</sup> The ambiguity arises from the IRS' failure to state whether auction value, retail value, or private sales figures<sup>10</sup> are appropriate for fine art appraisals. Large discrepancies normally exist between these values and thus clarification is greatly needed.

The discretionary power afforded the Art Panel is vast, largely due to this imprecise definition of fair market value in the Treasury Regulation.<sup>11</sup> The Art Panel can justify any adjustment that it makes by claiming that the new figures represent either retail or private sale values, figures which may not be available to

<sup>5</sup> See *infra* notes 105-09 and accompanying text (describing new sanctions).

<sup>6</sup> See *infra* notes 34-43 and accompanying text (describing purpose, history, and structure of the Art Panel).

<sup>7</sup> See *Art's Sake*, *supra* note 2, at 546 n.69. The Panel has continued to make substantial adjustments and has become increasingly aggressive during the last two years. In 1983, adjustments were estimated at only 10.17%, as compared to an average of 29% during the Panel's first five years of operations. In 1988, however, adjustments were recommended on 74% of the appraisals reviewed and the Panel recommended acceptance of only 24% (2% required further staff development). On the adjusted items, the Panel recommended a 45% reduction on the overvalued items in charitable contribution claims and a 63% increase on the undervalued items in estate and gift appraisals. *1988 Annual Summary Report*, *supra* note 2, at Summary of Regular Meetings section. In 1989, adjustments were recommended on 52% of the appraisals reviewed, and recommended acceptance of 45% (3% required additional staff development). On the adjusted items, the Panel recommended a 53% reduction on the overvalued items for charitable contributions, and a 101% increase on the undervalued items in estate and gift appraisals. *1989 Annual Summary Report*, *supra* note 2, at 836.

<sup>8</sup> Treas. Reg. §§ 1.170A-1(c)(2) (as amended in 1984) (for charitable contributions), § 20.2031-1(b) (as amended in 1965) (for estate tax purposes). The two regulations contain identical language.

<sup>9</sup> See Note, *The Implications of Changing the Current Law on Charitable Deductions—Maintaining Incentives for Donating Art to Museums*, 47 OHIO ST. L.J. 773, 781-82 (1986) [hereinafter *Maintaining Incentives*]; Speiller, *The Favored Tax Treatment of Purchasers of Art*, 80 COLUM. L. REV. 214, 229 (1980) [hereinafter *Purchasers of Art*].

<sup>10</sup> In this Note, auction value refers to the price fetched at public auction. Retail value means the price obtained by professional art dealers. Private sales figures refer to the price achieved in any type of sale between two parties in a non-public setting, *i.e.*, a sale that does not occur at auction or in a dealer's gallery.

<sup>11</sup> Treas. Reg. §§ 1.170A-1(c)(2), 20.2031-1(b).

the public.<sup>12</sup> The range of values that the Art Panel can choose from when making these adjustments should be limited to auction value whenever possible, since these records are public and can be easily verified.<sup>13</sup>

A check on the discretionary power of the Panel is necessary because the current structure and composition of the Art Panel present opportunities for abuse and bias in the review process. Dealers who serve on the Art Panel can benefit from high appraisal valuations for works by artists or schools of paintings that they sell.<sup>14</sup> Since personal commercial interests are at stake, neutrality and objectivity may be difficult to maintain.

To better protect the position of the taxpayer and to provide for a fairer and more consistent appraisal process, the legislature should specifically adopt auction value as the standard for determining fair market value. Auction results often more accurately reflect current market developments and trends than do unverifiable retail or private sale figures,<sup>15</sup> and thus appear to be a more equitable and appropriate value on which to base taxes.

Part II of this Note examines the Treasury Code definition of fair market value<sup>16</sup> and the history, purpose, composition, and overall effectiveness of the Art Panel in evaluating works under this standard. Part III discusses the appraisal process, the problems that exist in the appraisal industry as a whole, and the need for more uniform and enforceable standards. Part IV summarizes the measures taken by the IRS and the legislature to cor-

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<sup>12</sup> There is no publication which provides information regarding retail or private sale records. These figures are often kept confidential. Interview with Dr. Elaine Banks, Director of Paintings, William Doyle Galleries, in New York City (Fall 1989) [hereinafter Interview with Dr. Banks].

<sup>13</sup> Information regarding prices fetched at auction for art works can be easily obtained. Domestic and international auction records are published annually. For examples, see 1 THE ART SALES INDEX 1989/90 (22d ed. 1990); 24 INTERNATIONAL AUCTION RECORDS (E. Mayer ed. 1990); SOTHEBY'S INTERNATIONAL PRICE GUIDE (J. Marion ed. 1988-89); GORDON'S PRINT PRICE ANNUAL 1990 (A. Wehner ed.). Most auction houses mail price lists to all subscribers of their sales catalogue shortly after the sale occurs, and by request to non-subscribers. Information regarding prices realized is also usually available by calling an auction house directly. Such information can be obtained almost immediately after a lot is sold.

<sup>14</sup> See *Purchasers of Art*, *supra* note 9, at 236. The author quotes the Chairman of the Panel as stating in response to this problem, "In a perfect world, we would get appraisals from people who were both knowledgeable and isolated. I don't know how to find these people." *Id.*

<sup>15</sup> For a description of auction, retail and private sale values, see *supra* note 10. Most dealers buy at auction, and thus in order to make a profit, must sell the items they purchase at a considerable markup. Private collectors are often intimidated by the auction process, and are thus willing to pay higher prices when purchasing at a dealer's gallery.

<sup>16</sup> Treas. Reg. §§ 1.170A-1(c)(2) (as amended in 1984), 20.2031-1(b) (as amended in 1965).

rect the abuses and problems connected with appraisals of fine art and the subsequent review process. Part V focuses on the problems that persist in the system despite the actions taken by the government, and suggests certain reforms and solutions.

## II. FAIR MARKET VALUE AND THE EFFECTIVENESS OF THE ART PANEL IN REVIEWING APPRAISAL SUBMISSIONS

### A. *The Significance of Fair Market Value*

Fair market is the official value assigned by an appraiser when evaluating a work of art for tax purposes. The IRS created the Art Advisory Panel to review taxpayers' appraisals of fine art and to make recommendations regarding their acceptability. This review process by the Art Panel raises serious questions regarding the objectivity of some of the Art Panel members, the ambiguity surrounding the definition of fair market value found in the code, and the inequality of bargaining positions between the taxpayer and the IRS when evaluating works of art.

The Internal Revenue Code allows as a tax deduction any charitable contribution "actually paid during the taxable year."<sup>17</sup> If a taxpayer makes a charitable contribution in property other than money, section 1.170A-1(c)(1)<sup>18</sup> provides that the amount of the contribution is the fair market value of the property at the time the contribution was made. Fair market value is defined as "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 sell and both having reasonable knowledge of relevant facts."<sup>19</sup>

The same definition of fair market value applies for estate tax purposes.<sup>20</sup> Taxes are assessed according to the fair market value assigned to the items as of the date of death of the deceased.<sup>21</sup> Appraisals must be submitted with estate tax returns if household and personal effects have an artistic or intrinsic value totaling in excess of \$3,000.<sup>22</sup> If the estate property is considered to have a resale value of less than \$3,000, then an itemized appraisal is not required.<sup>23</sup> However, most estates meet this low

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<sup>17</sup> *Id.* § 1.170A-1(a).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* § 20.2031-1(b).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* § 20.2031-6(b).

<sup>23</sup> *Id.* § 20.2031-6(a), (b).

minimum and an itemized appraisal of the contents of the home is usually necessary.

When making charitable contributions, taxpayers want to obtain the highest appraisal value possible for a donated work of art, typically a retail value, in order to receive the maximum tax deduction benefit.<sup>24</sup> When reviewing appraisals submitted to the IRS for charitable donations, the Art Panel's primary goal is to lower inflated values. Over-valuation of donated properties has been a serious and recurring problem that has plagued the IRS.<sup>25</sup>

The opposite concern exists regarding appraisals for estate tax purposes. The estate wants to pay the least amount of taxes possible, and will therefore usually submit the lower auction value when available.<sup>26</sup> The Art Panel will be quick to raise any figures on estate appraisals that it considers to be undervalued.<sup>27</sup>

When reviewing an appraisal submission, the IRS is highly suspicious of any signs of collusion between the taxpayer and the appraiser.<sup>28</sup> The IRS and the courts are extremely disapproving of any type of business or personal relationship existing between the two.<sup>29</sup> The IRS regulations insist that any appraiser involved in the preparation of an appraisal for tax purposes be completely independent, having no connection or commercial interest in the property that is being appraised.<sup>30</sup>

The appraisal and review processes are further complicated by the nature of the subject matter being evaluated. The uniqueness that characterizes every work of art makes it especially difficult to determine a work's monetary worth. No work has a direct equivalent, and even works on the same theme by a given artist

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<sup>24</sup> See *Maintaining Incentives*, *supra* note 9, at 782.

<sup>25</sup> For a discussion of rampant abuses in area of charitable deductions, see *Maintaining Incentives*, *supra* note 9, at 784. See also *1989 Annual Summary Report*, *supra* note 2, at 834, where the Commissioner states that "[i]tems in contributions tend to be over-valued, while items in estates tend to be undervalued."

<sup>26</sup> See *Maintaining Incentives*, *supra* note 9, at 782. However, the phenomenon of "auction fever" can create artificially high prices at auction. Two bidders who desperately want a specific item may be willing to pay an inflated price in order to obtain it. Thus, the latest price fetched at auction may be higher than, or the equivalent of, the price that a retail dealer would demand. For more on the artificiality of auction prices, see S. BURNHAM, *THE ART CROWD* 52-66 (1973).

<sup>27</sup> For a summary of recommendations to increase values on estate and gift appraisals submitted to the IRS, made by the Panel in 1988 and 1989, see *supra* note 7.

<sup>28</sup> See *infra* notes 110-16 and accompanying text (discussing § 155 of the Deficit Reduction Act of 1984 which requires complete appraiser independence when making an evaluation for submission to the IRS).

<sup>29</sup> For a discussion of cases in which the credibility of appraisers was questioned because the courts feared collusion, see *infra* notes 132-39 and accompanying text.

<sup>30</sup> *Id.*

are imperfect substitutes.<sup>31</sup> This phenomenon makes the appraisal and review processes very subjective to a large extent.<sup>32</sup> As a result, valuations are largely a reflection of personal experience, knowledge, and aesthetic judgment and will often vary from appraiser to appraiser.<sup>33</sup>

### B. *The Creation of the Art Panel: Its Purpose and Function*

The Art Advisory Panel was created by the IRS in 1968<sup>34</sup> to “determine whether realistic appraisals of fair market value [were being] placed on works of art donated to charity.”<sup>35</sup> Originally, the Art Panel consisted of ten members, including dealers and art experts from museums and universities.<sup>36</sup> IRS Commissioner, Sheldon Cohen, stated in reference to the Art Panel members, that the “[t]ax administration should benefit . . . by having this highly qualified group provide IRS with *independent*, expert judgments on the values of art objects.”<sup>37</sup>

The IRS guidelines specified that, when submitting an appraisal, the taxpayer was required to include: (1) a description of the object; (2) the cost, date and manner of acquisition; (3) proof of authenticity; (4) a photograph of the object; and (5) the factors on which the valuation was based.<sup>38</sup> The Art Panel was originally asked to classify these valuations for paintings, sculpture, and decorative arts as either clearly justified, questionable, or clearly unjustified.<sup>39</sup> The Art Panel was further instructed to recommend the names of appraisers the IRS should consult for appraisal review and submissions.<sup>40</sup>

The Art Panel has since been expanded, and now consists of twenty-five experts<sup>41</sup> who meet bi-annually in private for a period

<sup>31</sup> See Baumol, *Unnatural Value: Or Art Investment as Floating Crap Game*, 15 J. ARTS MGMT. & L. 47, 51-56 (1985) (discussing the completely random valuation of art works resulting from a lack of market substitutes).

<sup>32</sup> But see Karlen, *Appraiser's Responsibility for Determining Fair Market Value: A Question of Economics, Aesthetics and Ethics*, 13 COLUM.-VLA J.L. & ARTS 185, 189-99 (1989) [hereinafter *Appraiser's Responsibility*] (judgments about artistic values are objective).

<sup>33</sup> See *Furstenberg v. United States*, 595 F.2d 603, 604 (Ct. Cl. 1979) (five experienced and highly qualified appraisers suggested very different values for a work of art). For further discussion of this case, see *infra* notes 137-39 and accompanying text.

<sup>34</sup> I.R.S. News Release, 7 Stand. Fed. Tax Rep. (CCH) ¶ 6573 (Feb. 1, 1968).

<sup>35</sup> *Id.* The Panel's creation was suggested by the Association of Art Museum Directors to help the IRS correct the tendency of taxpayers making donations to inflate the value of art works for tax purposes.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* (emphasis added).

<sup>38</sup> *Id.* at ¶ 6574.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> See Malkin, *How the IRS Looks at Art*, CONNOISSEUR, May 1989, at 170 [hereinafter

of one or two days. A specialized division to review prints was also later established.<sup>42</sup> These experts receive no compensation for their services and membership is on a rotating basis, usually lasting for a period of two years.<sup>43</sup>

Current policy requires that all art objects valued at over \$20,000 be automatically referred to the Art Panel for review.<sup>44</sup> Items valued at less than \$20,000 are handled in the IRS district offices,<sup>45</sup> and will not normally be sent to the Art Panel for review<sup>46</sup> due to the Panel's tremendous volume of work. In contrast to the Art Panel members, the district office appraisers often have little or no training in art.<sup>47</sup> Although technically, the decisions arrived at by the Art Panel are only advisory, the IRS district offices consider them binding.<sup>48</sup> The IRS always follows the Art Panel's recommendations when negotiating with taxpayers.<sup>49</sup>

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*IRS Looks*]. Recent members of the Art Panel have included art dealers, museum directors and curators, academicians, and a representative from Sotheby's auction house. The members are affiliated with such notable institutions as the Metropolitan Museum of Art, Yale University, the Texas State Historical Association, the National Gallery of Art, and the Boston Museum of Fine Art, as well as with respected galleries such as the Knoedler Gallery, the Kornblatt Gallery, and Stair Saintry.

<sup>42</sup> See *Maintaining Incentives*, *supra* note 9, at 783.

<sup>43</sup> See *IRS Looks*, *supra* note 41, at 170. The Panel is presently chaired by art historian Karen E. Carolan who serves as the chief of the IRS's Art Appraisal Services.

<sup>44</sup> For the pertinent provisions of the Internal Revenue Manual, see *infra* notes 45-6.

<sup>45</sup> 2 Internal Revenue Manual-Audit (CCH) pt. IV, § 42(16)4.2 (Nov. 19, 1982) provides in part:

(2) Any taxpayer's appraisal of a single work of art with a claimed value of \$20,000 or more must be referred to the National Office for review by the Commissioner's Art Advisory Panel. However, in cases that involve more than one such item, the requesting district office should refer all such appraisals in excess of \$20,000 for sample selection. The National Office Art Valuation Group will select from such referrals representative items for review by the Panel and request photos and other essential information and materials necessary for FMV determination.

Section 42(16)4.3 (Nov. 6, 1984) provides in part:

(6) If a questionable individual item appraisal under \$20,000 has substantial significance and the aggregate number of dollars in the case is large, the National Office Art Valuation Group, upon request, will provide, as available, guidance to resources for review assistance short of referral to the Art Advisory Panel.

<sup>46</sup> 2 Internal Revenue Manual-Audit (CCH) pt. IV, § 4366(2) (June 28, 1976) makes a special provision for estate and gift tax cases. The audit manual states:

[A]n item may be referred for Panel review even if the claimed value by the taxpayer is under \$20,000 if there is reason to believe the reasonable fair market value may exceed \$20,000. . . . The easiest single test is by determining whether or not in published reports of alleged auction sales of works ascribed to the named artist, sales are reported in excess of \$20,000.

<sup>47</sup> See *Purchasers of Art*, *supra* note 9, at 234. The provision in 2 Internal Revenue Manual-Audit (CCH) pt. IV, § 4366(2) which allows referral to the Art Advisory Panel serves as a useful screening device and safety mechanism for the district office appraisers when presented with a difficult evaluation problem in estate and gift tax cases. For the exact provision, see *supra* note 46.

<sup>48</sup> See *Purchasers of Art*, *supra* note 9, at 236.

<sup>49</sup> The Commissioner of Internal Revenue stated:

Approximately 250-300 items are evaluated by the Panelists at each one-day meeting.<sup>50</sup> The Panelists normally work from color transparencies, supplemented by written materials sent from the National Office incorporating information from the taxpayer's appraisal reports and results from authentication and market research conducted by IRS staff members.<sup>51</sup> In general, working from photographs makes it more difficult to judge the quality, condition, and authenticity of the works. On some items, one or more of the Panelists will see the property itself and may comment on the adequacy of the photograph and description.<sup>52</sup> In extreme situations, a case will be called back for a second or third viewing to obtain more information or a better photograph if the Panel feels that it is necessary.<sup>53</sup> All meetings of the Art Advisory Panel are closed to the public.<sup>54</sup>

While the Art Panel has served a valuable purpose by correcting and deterring fraudulent and grossly inaccurate appraisals,<sup>55</sup> it is unclear whether many of the adjustments made by the Art Panel in recent years have been valid or consistent. Dealers, who normally comprise a significant portion of the Art Panel,<sup>56</sup> have a commercial interest in seeing that values for the works of artists they represent remain high when appraised.<sup>57</sup> The objec-

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The determinations of the Art Advisory Panel become the position of the Service. If agreement is not reached at the Examination level, Art Appraisal Services and the Art Advisory Panel will provide additional assistance to Appeals and District Counsel. This assistance includes participating in taxpayer conferences, preparing expert reports, and securing expert witnesses including members of the Panel and other outside experts.

1989 Annual Summary Report, *supra* note 2, at 835.

<sup>50</sup> See Carolan, *Documenting Art Appraisals for Federal Tax Purposes*, in *THE LAW AND BUSINESS OF ART* 797, 825 (PLI 1990) [hereinafter *Documenting Art Appraisals*]. For a description of a typical Panel meeting, see *IRS Looks*, *supra* note 41, at 170.

<sup>51</sup> See 1989 Annual Summary Report, *supra* note 2, at 833. In addition to receiving photographs and information regarding size, medium, condition, provenance, public exhibitions, and literary references, the Panelists are provided with information "on public and private sales of apparently similar works by the same artist." *Id.* (emphasis added). The Panelists are also told the value claimed on the taxpayer's tax return. *Id.*

The identity of the taxpayer is not revealed to the Panelists, however, it is suspected that the prominence of many of the works being evaluated often results in the taxpayer's identity being recognized by the Panelists. *Id.* at 834.

<sup>52</sup> *Id.* at 833.

<sup>53</sup> See *IRS Looks*, *supra* note 41, at 170-72.

<sup>54</sup> The IRS asserts that the primary reason why these meetings are closed to the public is to minimize recognition of taxpayers' identities. *Id.* Such closure protects the confidentiality of tax return information. 1989 Annual Summary Report, *supra* note 2, at 833. See also *Documenting Art Appraisals*, *supra* note 50, at 825.

<sup>55</sup> For a brief summary of adjustments made by the Panel since 1968, see *supra* note 2.

<sup>56</sup> See *supra* notes 41-3 and accompanying text (describing Panel).

<sup>57</sup> See *IRS Looks*, *supra* note 41, at 172-74 (examining criticisms that Panel has received on conflict of interest grounds). See also *Purchasers of Art*, *supra* note 9, at 236.

tivity of museum officials in the review process has also been questioned on the grounds that such officials will not risk offending a major donor by lowering the value of a work being submitted on an appraisal.<sup>58</sup>

Independence in the appraisal process is essential if fair and consistent results are to be achieved. Experts who serve on the Art Panel should not be held to a lesser standard of objectivity than other appraisers submitting appraisals to the IRS.<sup>59</sup> Better checks and controls over the Art Panel are necessary to guard against these potential abuses of discretion and the self-serving of professional commercial interests.<sup>60</sup>

### III. THE APPRAISAL PROCESS AND THE ROLE OF THE APPRAISER IN DETERRING VALUATION ABUSE

The definition of appraiser remains unclear today, despite new guidelines established by the Deficit Reduction Act of 1984.<sup>61</sup> In general, the appraisal industry has few regulations or controls.<sup>62</sup> A number of appraisal associations exist,<sup>63</sup> but membership status is often easily attained and can be quite misleading.<sup>64</sup>

For example, one organization, the American Society of Appraisers ("ASA"), allows individuals to become members simply by paying a membership fee.<sup>65</sup> Once this fee is paid, the new

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<sup>58</sup> See *IRS Looks*, *supra* note 41, at 172.

<sup>59</sup> See *infra* notes 110-16 and accompanying text (discussing regulations requiring complete independence in the appraisal process). Any appraiser who has a financial interest in the price of the work being appraised is prohibited from making a valuation.

<sup>60</sup> For a contrary opinion suggested by a Panel member, see *IRS Looks*, *supra* note 41, at 174. Barbara Kornblatt asserts that the commercial interests on the Panel are self-canceling. She states that,

It is in the interest of neither the dealer nor the collector to have an artist overvalued . . . . Precipitous price rises imply an unstable reputation for the artist, a potential loss for the collector, and thus a danger to the investor, including the dealer himself. Moderating a price rise saves money for the taxpayer while also helping to stabilize the art market.

*Id.*

<sup>61</sup> Pub. L. No. 98-369, § 155, 98 Stat. 691, 692 (1984) (codified as amended at 26 U.S.C. § 170 note (1988) (Substantiation of Charitable Contributions of Property)). See *infra* notes 110-11 and accompanying text for the full provision.

<sup>62</sup> See Homer, *Fine Art Appraisers: The Art, the Craft, and the Legal Design*, 8 COLUM. J.L. & ARTS 457, 462-63 (1984) [hereinafter *Art Appraisers*].

<sup>63</sup> Such associations include the American Society of Appraisers ("ASA"), The Appraiser Association of America ("AAA"), The Art Dealers Association of America ("ADAA"), and the International Society of Appraisers ("ISA"). According to association rules, members of the ADAA are not permitted to render appraisals for income tax purposes, but may issue appraisals for estate and gift tax purposes. For a description of the various associations and the requirements for membership, see *id.* at 464 n.23.

<sup>64</sup> *Id.* at 464.

<sup>65</sup> *Id.* at 464 n.24. To become a formal member, the ASA has educational and appraisal experience requirements. See *id.* n.26.

member is given the title of "Associate Appraiser," which is considered the minimal level of membership and does not constitute a professional designation.<sup>66</sup> However, as long as the individual does not expressly write the professional designation after his or her name, it is not fraudulent for this person to hold himself out as a "member."<sup>67</sup> For a client seeking appraisal services, this title of "associate appraiser" can be quite misleading. The client does not necessarily know to further inquire into the appraiser's qualifications.

Other organizations require formal education and experience before appraisers are recognized as "professional."<sup>68</sup> Although various levels of expertise exist within these organizations, the competence of the appraisers is never ensured.<sup>69</sup> Thus, the possibility of misrepresentation remains great within this industry, which continues to lack uniform regulations.

In contrast to most independent appraisers, and even members of appraisal associations, representatives of auction houses are generally considered to be good sources of reliable and accurate fine art evaluations.<sup>70</sup> Experts from auction houses are usually well-trained, experienced and unbiased, normally having no direct commercial interest in the items that they appraise.<sup>71</sup> During a typical auction year, appraisers from the larger auction houses encounter a tremendously large volume of works ranging widely in quality. This exposure gives them the experience necessary to make accurate comparisons and appraisals.<sup>72</sup> More importantly, however, auction house representatives are intimately involved and up-to-date with the latest market developments.<sup>73</sup> Such market awareness is key to providing current and well-informed appraisals.

In addition to substantial practical experience, most auction

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 464.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 464-66.

<sup>70</sup> See Note, *Imposing the Underwriter's Duty of Care on Art Auctioneers*, 7 CARDOZO ARTS & ENT. L.J. 359, 364 n.34 (1989) [hereinafter *Duty of Care*].

<sup>71</sup> Auction house appraisers usually derive no direct financial advantage by valuing a work at a specific price, as opposed to dealers and independent appraisers who often work on a commission basis.

<sup>72</sup> Although auction is only one method of disposing of art, nearly 50% of art transactions are handled this way. L. DUBOFF, ART LAW 53 (1984).

<sup>73</sup> See Donoghue, *Art Appraisals and Valuation for Federal Tax Purposes: Mechanics of New IRS Appraisal Rules*, in THE LAW AND BUSINESS OF ART 248 (PLI 1988) (describing the major auction houses as having a large number of experts "constantly in touch with objects and actual realized prices"). See also *Duty of Care*, *supra* note 70, at 364 nn.34 & 36.

house experts tend to have strong academic backgrounds in their fields, which can play an important role in the appraisal process.<sup>74</sup> Also, these experts usually have well-developed connections and informational networks which are useful in obtaining both consultative opinions<sup>75</sup> and photocertificates<sup>76</sup> when necessary. Furthermore, high standards are expected of appraisers from the major auction houses,<sup>77</sup> which are often in direct competition to obtain the most desirable works of art. This competition forces the appraisers to make the most accurate and thoughtful appraisals possible,<sup>78</sup> and works as an effective check against misrepresentation, while also ensuring a high degree of competence.

In assigning values to a work of art, an appraiser will often refer to auction records as a main source of information, when available.<sup>79</sup> Previous sales records are used as a base from which the appraiser can draw a comparison. If numerous prices have been achieved during a span of several years, it may be possible to discern a trend in popularity or demand for an artist's work. The appraiser considers various other factors as well, including authenticity, condition, rarity, size, medium, subject matter, provenance,<sup>80</sup> and overall aesthetic quality.<sup>81</sup> Generally, the

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<sup>74</sup> See *Duty of Care*, *supra* note 70, at 364 n.34.

<sup>75</sup> Some dealers who specialize in a particular artist will give confidential opinions as to the authenticity of a work as a professional courtesy. Although these dealers may not issue formal photocertificates, their opinion is often considered to be definitive in the art community. Interview with Dr. Banks, *supra* note 12.

<sup>76</sup> Photocertificates are documents issued by a designated expert for a particular artist attesting to a work's authenticity. For some artists, clients will not bid on a painting at auction without the reassurance that the work has been "accepted" and approved by the definitive expert. Quite often the expert will charge for this service. *Id.*

<sup>77</sup> Sotheby's, Inc. ("Sotheby's") and Christie, Manson & Woods International ("Christie's") are the two largest auction houses with international operations. Sotheby's held its first recorded auction in London in 1744. Christie's was established in London in 1766. For a brief history of Sotheby's and Christie's, see B. HARVEY & F. MEISEL, *AUCTIONS: LAW AND PRACTICE* 5-6 (1985). For a discussion of the intense rivalry between these two auction houses, see Watson, *Sotheby's vs. Christie's: Uncivil War*, N.Y. Times, May 27, 1990, § 2, at 1, col. 2.

<sup>78</sup> Most clients who are planning to dispose of a valuable painting or collection at auction will obtain at least two appraisals in an effort to secure the most favorable selling terms possible. Interview with Dr. Banks, *supra* note 12. For a discussion of the competitive bidding practices between the major auction houses for blockbuster works, see Osborn, *For Art's Sake: Records Belie Art Market's Blue Funk*, USA Today, May 18, 1990, at 1B. The houses have been boosting pre-sale estimates and even guaranteeing unrealistic reserves in order to get important painting and sculpture consignments. *Id.*

<sup>79</sup> See *supra* note 13 (explaining how information about auction results can be obtained).

<sup>80</sup> Provenance is the record of all known past ownerships and locations of a work of art. See THE THAMES & HUDSON DICTIONARY OF ART TERMS 154 (1984).

<sup>81</sup> See *Duty of Care*, *supra* note 70, at 364 (describing the appraisal process). See also 1989 Annual Summary Report, *supra* note 2, at 833 (list of factors that Art Advisory Panel members consider when reviewing taxpayer's appraisal).

more typical the painting or piece is of an established artist's work, the more highly valued it is, while atypical works tend to bring lower prices.<sup>82</sup> Works that have been in a private collection and have not been up at auction or offered by a dealer recently, are considered to be the most desirable.<sup>83</sup> However, no precise formula exists when evaluating a work of art—a degree of subjectivity is always involved.<sup>84</sup>

Stricter qualification requirements in the appraisal industry would help to eliminate the problem of inaccurate appraisals resulting from incompetence or misrepresentation. Until uniform regulations are adopted, it appears that appraisers from the larger, well-established auction houses are likely to provide the most independent and reliable valuations available.

#### IV. GOVERNMENT INTERVENTION IN THE AREA OF FINE ART APPRAISALS

Following the implementation of section 1.170A of the Internal Revenue Code ("IRC"), which included a definition for the term "fair market value,"<sup>85</sup> the government enacted new rules, guidelines, and penalties to help regulate and fine-tune the appraisal and review process for works of fine art.<sup>86</sup> Clarification of the process was necessary due to continued confusion in the area of fine art appraisals.<sup>87</sup> Stricter rules were also required to help deter the frequent abuses that were occurring, especially in

<sup>82</sup> Interview with Dr. Banks, *supra* note 12.

<sup>83</sup> *Id.* Works that have been off the market for a substantial period of time are often referred to as being "fresh." See Potterton, *Designer Label Impressionists*, *Fin. Times*, Nov. 10, 1990, § I, at 16, where it is asserted that freshness is a "decided advantage" in today's market.

The world's two most expensive paintings, Renoir's "Au Moulin de la Galette" and Van Gogh's "Portrait of Dr. Gachet" were both in private collections before being sold at auction. "Au Moulin de la Galette", which fetched \$78.1 million, was sold by the widow of John Hay Whitney after being in the family's collection for six decades. Van Gogh's "Portrait of Dr. Gachet", which sold for \$82.5 million, came from the Kramarskis who had inherited the painting from their father. The painting had been on loan at the Metropolitan Museum in New York. Both paintings were bought by Mr. Ryoei Saito in May, 1990. See Norman, *The Big Boom That Came Before the Bust*, *The Independent*, Dec. 29, 1990, at 33.

<sup>84</sup> See *supra* notes 31-33 and accompanying text.

<sup>85</sup> Treas. Reg. §§ 1.170A-1(c)(2) (as amended in 1984), 20.2031-1(b) (as amended in 1965). See *supra* note 8 and accompanying text.

<sup>86</sup> For a review of these regulations, see *infra* notes 92-116 and accompanying text.

<sup>87</sup> In an effort to clarify the ambiguous definition of fair market value found in the code, the IRS issued Determining the Value of Donated Property, Publication 561, I.R.S. Publications Rep. (CCH) ¶ 33,901. The Publication states that factors such as the cost of the donated property, sales of comparable properties, and replacement cost are considered by the IRS in its review of fair market value determinations. However, Publication 561 fails to address the more critical issue of whether retail, auction, or private sales figures are to be used in fine art appraisals for tax purposes.

the area of charitable deductions.<sup>88</sup>

Despite the numerous improvements that have been realized in certain areas of the appraisal process for tax purposes, the ambiguity surrounding the term "fair market value"<sup>89</sup> has been left unaddressed. No clarification has been offered and the ambiguity surrounding the term continues to cause serious difficulties for both taxpayers and appraisers who are subject to IRS review.<sup>90</sup>

In 1966, the IRS in Revenue Procedure 66-49 ("Procedure") further defined the law and regulations surrounding the appraisal format and review process applicable to noncash and unique properties.<sup>91</sup> The purpose of the Procedure was "to provide information and guidelines for taxpayers, individual appraisers, and valuation groups relative to appraisals of contributed property for Federal income tax purposes."<sup>92</sup> The Procedure specifies that appraisals for this purpose should be obtained from "qualified and reputable sources" and that "the appraisal report should accompany the return when it is filed."<sup>93</sup> Section 3.02 lists the information that must be included in this appraisal report.<sup>94</sup>

More detailed data regarding the valuation of the art object is required pursuant to section 3.03 of the Procedure. In addition to a description of the object indicating size, subject matter, medium, and provenance, further information such as sales of other works by the same artist occurring around the valuation date, the economic state of the art market at the valuation date, and a statement as to the standing of the artist in his profession and in the particular school or time period, is also required.<sup>95</sup> Furthermore, section 4 of Revenue Procedure 66-49<sup>96</sup> stresses

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<sup>88</sup> See *supra* note 2 and accompanying text.

<sup>89</sup> Treas. Reg. §§ 1.170A-1(c)(2), 20.2031-1(b).

<sup>90</sup> See *supra* notes 9-10 and accompanying text.

<sup>91</sup> Rev. Proc. 66-49, 1966-2 C.B. 1257.

<sup>92</sup> *Id.* § 1.

<sup>93</sup> *Id.* § 3.01.

<sup>94</sup> In general, an appraisal report should contain at least the following:

(1) A summary of the appraiser's qualifications.

(2) A statement of the value and the appraiser's definition of the value he has obtained.

(3) The bases upon which the appraisal was made, including any restrictions, understandings, or covenants limiting the use or disposition of the property.

(4) The date as of which the property was valued.

(5) The signature of the appraiser and the date the appraisal was made.

*Id.* § 3.02.

<sup>95</sup> *Id.* § 3.03.

<sup>96</sup> *Id.* § 4.

that the taxpayer, not the IRS, bears the burden of proving the fair market value listed on his return. The IRS is empowered to either accept the value claimed based on the information submitted in section 3.03, or to make its own determination as to the fair market value.<sup>97</sup>

The implementation of IRC section 7517<sup>98</sup> in 1976, which requires written disclosure of IRS valuations, provides some protection for taxpayers who submit appraisals to the IRS pursuant to the Procedure guidelines. Section 7517(a) states that the Secretary "shall furnish, on the written request of the executor, donor, or the person required to make the return of the tax . . . a written statement . . . not later than 45 days after the later of the date of such request or the date of such determination or proposed determination" explaining the adjustments made by the IRS.<sup>99</sup> Section 7517(b) then specifies that a statement be provided with respect to the value of an item of property and shall "(1) explain the basis on which the valuation was determined or proposed, (2) set forth any computation used in arriving at such value, and (3) contain a copy of any expert appraisal made by or for the Secretary."<sup>100</sup>

Such disclosure is important to the taxpayer whose valuation has been challenged by the IRS. Without such vital information, the taxpayer and the appraiser cannot properly prepare a response. In addition, information regarding the Art Panel's discussions as a whole, and individual members' contributions specifically, should be offered.<sup>101</sup> The taxpayer and the appraiser are at a disadvantage without the benefit of this knowledge.

The Deficit Reduction Act of 1984 ("Deficit Reduction Act" or "Act"),<sup>102</sup> also referred to as the Tax Reform Act of 1984, prompted new regulations that have had profound effects on charitable donations and the whole tax appraisal process.<sup>103</sup> The primary purpose of these new provisions was to end instances of

<sup>97</sup> *Id.* § 4.04.

<sup>98</sup> I.R.C. § 7517 (1988).

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> For the primary reason put forth by the IRS for keeping Panel meetings closed to the public, see *supra* note 54.

<sup>102</sup> Pub. L. No. 98-369, § 155, 98 Stat. 691-92 (1984) (codified as amended at 26 U.S.C. § 170 note (1988) (Substantiation of Charitable Contributions of Property)) [hereinafter Deficit Reduction Act].

<sup>103</sup> For a discussion of the Deficit Reduction Act of 1984 and how the new provisions have helped to prevent abuses in the area of art donations, see *Maintaining Incentives*, *supra* note 9, at 784-87.

gross overvaluation of donations to charitable organizations.<sup>104</sup> As part of the Act, stricter requirements for appraisers and appraisals were implemented. The Act authorizes stiff sanctions for appraisers aiding or assisting in the understatement of tax liability.<sup>105</sup> For example, a 30% penalty is imposed on the donor for overstating the valuation of charitable deduction property by more than 150%, if an underpayment of \$1,000 or more results.<sup>106</sup> An appraiser is subject to a \$1,000 penalty for assisting an individual's underpayment of taxes.<sup>107</sup> The appraiser also may be barred from presenting appraisals to the IRS in the future.<sup>108</sup> The penalties applicable to taxpayers and appraisers correspond to the sanctions to which attorneys and accountants are subject when appearing before the IRS or in court proceedings.<sup>109</sup>

The Deficit Reduction Act, section 155(a)(4), dictates that an appraisal submitted to the IRS be prepared by a "qualified appraiser."<sup>110</sup> "Qualified appraiser" is defined as

an appraiser qualified to make appraisals of the type of property donated, who is not—

- (i) the taxpayer,
- (ii) a party to the transaction in which the taxpayer acquired the property,
- (iii) the donee,
- (iv) any person employed by any of the foregoing persons . . . , or
- (v) to the extent provided in such regulations, any person whose relationship to the taxpayer would cause a reasonable person to question the independence of such appraiser.<sup>111</sup>

The Deficit Reduction Act also states that, in regard to appraisal fees, "an appraisal shall not be treated as a qualified appraisal if all or part of the fee paid for such appraisal is based on a percentage of the appraised value of the property."<sup>112</sup> Shared commercial interests of any type between the appraiser and the taxpayer are therefore strictly prohibited.

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<sup>104</sup> *Id.* at 784.

<sup>105</sup> Deficit Reduction Act, *supra* note 102, § 156.

<sup>106</sup> 26 U.S.C. § 6659(d) (1988).

<sup>107</sup> 26 U.S.C. § 6701(b)(1)(A).

<sup>108</sup> For a discussion of these sanctions and their anticipated impact, see Lore & Garvis, *Appraiser Sanctions Clarified in Prop. Regs.*, 62 J. TAX'N 305 (1985).

<sup>109</sup> *Id.*

<sup>110</sup> Deficit Reduction Act, *supra* note 102, § 155(a)(4).

<sup>111</sup> *Id.* § 155(a)(5)(A).

<sup>112</sup> *Id.* § 155(a)(5)(B).

The penalties and new requirements imposed by the Tax Reform Act of 1984 reflect the government's concern regarding fraud in fine art appraisals. The emphasis on independence of the appraiser reveals both a continued distrust of appraisers and a lingering fear of collusion between the taxpayer and the appraiser hired to make a valuation.<sup>113</sup> The severity of the penalties for both the appraiser and taxpayer underscores the government's desire that appraisers take a more responsible role when making appraisals for tax purposes.<sup>114</sup>

The cooperation of appraisers in the tax appraisal process could prove to be essential as the work load of the IRS and the Art Panel continues to mount.<sup>115</sup> Now that stricter penalties are being enforced, both the taxpayer and the appraiser will probably be more cooperative and less willing to initiate fraud. The Tax Reform Act clearly demonstrates that the appraiser cannot escape responsibility for a fraudulent appraisal by claiming that he followed the taxpayer's orders. The appraiser is now charged with a duty of complete independence and total objectivity, and is accountable to the IRS for his professional judgment.<sup>116</sup>

#### V. CURRENT POLICIES AND TAX APPRAISAL REGULATIONS: THE NEED FOR ADDITIONAL REFORM

The measures taken by Congress<sup>117</sup> since the implementation of the 1954 Internal Revenue Code, have served to raise public and professional awareness of common and recurring abuses in the area of fine art appraisals.<sup>118</sup> The procedures developed by the IRS have also served an important practical function by setting forth clear guidelines regarding the appraisal format and the technical aspects of the valuation process. However, additional clarification and regulation are greatly needed in the areas of appraiser qualifications, fair market value standards, and review and appeal procedures.

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<sup>113</sup> *Id.* § 155(a)(4) and (5)(A), (B).

<sup>114</sup> 26 U.S.C. § 6659 (1988).

<sup>115</sup> The Art Panel presently reviews more than 250 works each day when the Panel is in session. *See supra* note 50 and accompanying text.

<sup>116</sup> *See Appraiser's Responsibility, supra* note 32, at 213.

<sup>117</sup> *See supra* notes 91-97 and accompanying text for a summary of Revenue Procedure 66-49, notes 98-100 and accompanying text for a summary of I.R.C. § 7517, and notes 102-12 and accompanying text for a summary of the Deficit Reduction Act of 1984 §§ 155, 156, which provide detailed rules regarding the qualifications of the appraiser, the appraisal format, and the sanctions that will be imposed if the regulations are violated.

<sup>118</sup> *See supra* note 2 and accompanying text.

The provisions of the Deficit Reduction Act of 1984,<sup>119</sup> which presented new requirements for the terms "qualified appraiser"<sup>120</sup> and "qualified appraisal,"<sup>121</sup> failed to fully define what is meant by "qualified appraiser." A clearer description mandating the degree of experience and education that an appraiser should possess before making valuations for tax purposes would help to reduce the amount of charitable contribution abuse that is attributable to incompetence.<sup>122</sup> A more rigid definition of appraiser might discourage the inexperienced from undertaking appraisals that they are not qualified to make.

One possible reform in the area of appraiser qualifications is to implement an accreditation system similar to that used by the Department of Education.<sup>123</sup> The Department of Education requires that institutions be accredited by nationally recognized associations in order to receive federal financial assistance.<sup>124</sup> In a similar fashion, appraisers could be required to have such national accreditation before they submit appraisals to the IRS.

The accreditation system has been criticized mainly on the grounds that such regulation would require an enormous bureaucracy for its maintenance.<sup>125</sup> Such a system would require testing, training, and certification as well as an extensive information network.<sup>126</sup> It is also feared that such regulation would discourage charitable donations by making the valuation process more complicated.<sup>127</sup>

Another alternative is to rely on the existing appraisal associations to develop their own certification programs.<sup>128</sup> Performance could be internally monitored by these groups, which would be responsible for guaranteeing a level of competence. Such certification could require a formal program of education and testing as a prerequisite, as well as complete appraiser independence. Any commercial or personal interest in the items being appraised would be grounds for immediate disqualification.

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<sup>119</sup> Deficit Reduction Act, *supra* note 102, § 155(a)(4), (5)(A).

<sup>120</sup> For the precise definition, see *supra* note 111 and accompanying text.

<sup>121</sup> See *supra* note 112 and accompanying text.

<sup>122</sup> See *Art Appraisers*, *supra* note 62, at 459.

<sup>123</sup> See Walker, *IRS Appraisal Rules Under Fire*, ART NEWS, Nov. 1985, at 21.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> See *Art Appraisers*, *supra* note 62, app. at 506-11 (discussion concerning a Proposed Model Fine Art Appraisal Act as another alternative to the current disorganized and irregular system).

Cooperation between the appraisal associations might also result in a more efficient system, including the adoption of uniform requirements and designations. Uniformity in preparation requirements and professional titles would help the client seeking appraisal services, particularly those unfamiliar with the art industry, and perhaps even foster public trust and goodwill which currently seem to be lacking.

Distrust of appraisers has been an influential factor in the courts' determinations of tax assessment disputes involving fine art. The appraiser who prepared the valuation that is being challenged by the IRS will often be called to testify as an expert witness on behalf of the taxpayer. Many of these cases thus become battles between the art experts.<sup>129</sup> However, courts recognize that the valuation of art is a subjective and difficult process, and in general are reluctant to resolve these types of disputes.<sup>130</sup> In response to this judicial reluctance, the IRS rarely takes art valuation cases to court. Less than two dozen art valuation cases are currently reported. Instead the IRS will often engage in settlement negotiations with the taxpayer, which usually result in a compromise.<sup>131</sup>

For the cases that do reach the courts, the credibility of the appraiser representing the collector is critical.<sup>132</sup> A prime example of how an appraiser's perceived incompetence can play a decisive role in the court's decision is *Farber v. Commissioner*.<sup>133</sup> In *Farber*, the Tax Court reduced the value of a donated painting claimed by the taxpayer to be \$150,000 to \$10,000 due to the expert's lack of preparation and knowledge regarding the subject matter. The court stated, "For various reasons . . . we were unable to put much confidence into any witness' study of the painting or his conclusions."<sup>134</sup> In discussing the painting which was attributed to Tintoretto, the appraiser failed to offer any information regarding the painting's historical significance, condition,

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<sup>129</sup> See Note, *Your Word Against Mine—Expert Testimony in the Valuation of Fine Art*, 5 COLUM.-VLA J.L. & ARTS 69 (1980).

<sup>130</sup> For example, in *Farber v. Commissioner*, 33 T.C.M. (CCH) 673, 674 (1974), the court stated, "We have previously made clear that the settlement process is obviously more conducive to the proper disposition of disputes . . . because a valuation issue is 'inherently imprecise and capable of resolution only by a Solomon-like pronouncement.'" (quoting *Messing v. Commissioner*, 48 T.C. 502, 512 (1967)).

<sup>131</sup> See *Art Appraisers*, *supra* note 62, at 488; *Purchasers of Art*, *supra* note 9, at 238.

<sup>132</sup> See *Art Appraisers*, *supra* note 62, at 491-95 (discussing cases where decisions were largely based on the perceived quality and character of the appraiser witness).

<sup>133</sup> 33 T.C.M. (CCH) 673 (1974).

<sup>134</sup> *Id.* at 675.

quality, or comparable sale prices.<sup>135</sup> The court suspected that the appraiser might be in collusion with the taxpayer, and thus completely discounted his testimony.<sup>136</sup>

Fear of collusion and lack of objectivity also dominated the court's attention in *Furstenberg v. United States*.<sup>137</sup> In this case, the court ignored the testimony of one art expert who was a long-time friend and close business associate of the donor taxpayer, despite the appraiser's excellent reputation and extensive experience as an appraiser of valuable oil paintings.<sup>138</sup> The court simply stated that "[d]espite his considerable experience, . . . Mr. Samuels' valuation must be substantially discounted because of his relationship with Mrs. Furstenberg."<sup>139</sup>

A bias against appraisers who testify can only cloud the information being presented at trial, making the valuation review process even more arbitrary. Stricter regulations and qualification standards for appraisers might reverse this trend, since more thorough training would prevent the problem of incompetence of expert witnesses to a large degree. Less focus on the issue of expert competence and character would allow the works to be evaluated on their merit—a more just and appropriate foundation upon which to base a judicial determination.

Further reform of the Art Panel's review process is necessary as well. The current system allows for a member of the Art Panel, if a recognized specialist for a particular artist or period, to dominate the valuation process for that type of work. The Art Panel is of limited size, so the number of experts in one particular area is usually limited.<sup>140</sup> The recognized expert is said to play a "key role" in deciding what the final price determination for the work will be.<sup>141</sup> It does not seem appropriate that a person who can derive a commercial benefit by adjusting the appraisal of a work of art should have so much influence in making a final price determination. Once the adjustment is recommended, it is very difficult for the taxpayer to have the original

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<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> 595 F.2d 603 (Ct. Cl. 1979).

<sup>138</sup> *Id.* at 608-09.

<sup>139</sup> *Id.* at 609.

<sup>140</sup> See *IRS Looks*, *supra* note 41, at 174 (describing the typical review process and stating that discussions of a work's value usually start with the opinion of the expert who knows the market for that artist or period); see also *Furstenberg*, 595 F.2d at 605 (The court stated in reference to the Art Advisory Panel that "there is only a relatively small number of experts qualified to evaluate the works of certain artists, and these are the individuals inevitably called upon to assist the panel.").

<sup>141</sup> See *IRS Looks*, *supra* note 41, at 174.

appraiser's value reinstated.<sup>142</sup>

The same conflict of interest problem exists for museum representatives who serve as members of the Art Panel. Museum curators are well aware that favorable determinations are more likely to lead to donations to their museums than are unfavorable ones. The implementation of the Tax Reform Act of 1986<sup>143</sup> resulted in a sharp decrease in the number of works being donated,<sup>144</sup> thus museum curators are now particularly anxious not to alienate or discourage potential donors by challenging submitted appraisals.<sup>145</sup>

An additional concern regarding museum officials is their possible unfamiliarity with the current art market.<sup>146</sup> The focus of the curator's work is primarily scholarly, not commercial.<sup>147</sup> In addition, museum curators are accustomed to seeing the highest quality paintings and sculpture and may have little experience handling lesser quality items. Pressure from potential donors and lack of knowledge of the current market may lead to inaccurate evaluations.

An example of possible abuse of discretionary power by a member of the Art Panel who is an active dealer, is found in a case submitted to the Art Panel for review in April of 1988.<sup>148</sup> One of the estates being evaluated contained a painting by John Singer Sargent entitled *Sleeping Arab Girl*, oil on board, measuring 13 1/2 x 10 1/2 inches, signed, inscribed, and dated 1879, "in good condition, although somewhat thinly painted," acquired through inheritance.<sup>149</sup> The Art Panel concluded that the correct

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<sup>142</sup> For a table of reported art valuation cases, see *Purchasers of Art*, *supra* note 9, at 237. For an analysis of this chart, see *Art Appraisers*, *supra* note 62, at 490 n.95, where the author states that "courts tend to side with the government's figures and revalue the art piece accordingly." An examination of the holdings in these tax cases reveals that the court has a strong tendency to substantially ignore the taxpayer's (plaintiff's) value, and to give great weight to the government's recommendations.

<sup>143</sup> Pub. L. No. 99-514, 100 Stat. 2085.

<sup>144</sup> See generally *Maintaining Incentives*, *supra* note 9.

<sup>145</sup> Many curators are forbidden to render opinions to anyone outside of the employer museum regarding the value of an art object or authenticity largely to avoid conflict of interest entanglements. The American Association of Museums states in its ethics code:

All employment activity must be undertaken within the fundamental premise that the employee's primary responsibility is to his institution; that the activity will not interfere with his ability to discharge this responsibility; and that it will not compromise the professional integrity of the employee or the reputation of the museum.

AMERICAN ASSOCIATION OF MUSEUMS, MUSEUM ETHICS (Mar.-Apr. 1978), *quoted in Art Appraisers*, *supra* note 62, at 467 n.31.

<sup>146</sup> See *Art Appraisers*, *supra* note 62, at 468.

<sup>147</sup> *Id.*

<sup>148</sup> Estate Appraisal, Meeting 46 of the Art Advisory Panel, I.R. code 2031, control no. 8A692A (April 14, 1988) [hereinafter Estate Appraisal].

<sup>149</sup> *Id.* at 1. The taxpayer's claimed value was \$30,000.

fair market value on December 8, 1986 was \$175,000.

In its analysis of the painting's worth, the Art Panel referred to a previous sale at auction of a similar painting by Sargent titled *A Bedouin Arab*, which sold for \$269,500.<sup>150</sup> The Art Panel asserted that *A Bedouin Arab* is more desirable for its historical value, and noted that it is twice the size of the subject picture. Due to these differences, the Art Panel assigned a value to *Sleeping Arab Girl* less than that of the comparable painting.

The Art Panel next cited another work by Sargent which was sold *privately* by one of the Art Panelists in 1986 for \$175,000.<sup>151</sup> The report failed to describe this work—no information regarding subject matter, medium, provenance, condition, or proof of sale was supplied. The report simply stated,

One of the Panelists had, in fact, sold a comparable Sargent of the same size for \$175,000 in 1986. The panelists maintained that *this private sale was indicative of the value* of the [estate name] picture . . . . A value of \$175,000 was determined to be correct for this lovely and desirable Sargent.<sup>152</sup>

In its summary, the Art Panel stated that “[t]he Panel is made up of some of the most experienced and widely acknowledged art experts. . . . The Panelists drew upon their combined professional expertise in dealing with art to assess the aesthetic quality, the historical importance, and the market value of the subject property.”<sup>153</sup> No further analysis was offered to support their conclusion.

The Art Panel's reliance on a private sale figure supplied by an active art dealer who currently specializes in the work of the artist being evaluated is extremely unfair to the taxpayer. In preparing a defense, the taxpayer or appraiser has no way to verify the private sale figure used as a comparable, and has no information from which to draw a comparison between the two works.<sup>154</sup> In addition, private sale or retail figures often fail to accurately reflect current market developments. Dealers who have well-established reputa-

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<sup>150</sup> Christie's, New York, June 1, 1984, lot 106. See II THE ART SALES INDEX 1983/84, at 1220 (16th ed.). The Art Sales Index (“ASI”) quoted a selling price of \$245,000 for this lot. ASI uses the hammer price, which is “the price called out at auction” and does not include the 10% buyer's premium charged by the auction houses. *Id.* at 9.

<sup>151</sup> The Panelist who sold the Sargent was not specifically identified in the appraisal report. However, one of the Panelists who participated during this session, is the director of a prominent gallery in New York, and is known to be the premier dealer for Sargent's works. A complete listing of the attending Panel members is attached to the IRS reports. See 1989 Annual Summary Report, *supra* note 2, at 835.

<sup>152</sup> Estate Appraisal, *supra* note 148, at 2 (emphasis added).

<sup>153</sup> *Id.* at 3.

<sup>154</sup> See *supra* note 12 and accompanying text.

tions can often demand artificially high prices for the paintings they sell. Private collectors will often pay considerably more for a painting purchased from a well-known dealer than its current market value as determined at auction, in order to gain the benefit of the dealer's experience, guidance, personalized service, and professional guarantee regarding authenticity. Therefore, the price achieved by the dealer may reflect these extrinsic factors.

This type of "inside" information regarding alleged private sales or retail figures does not allow for consistency, accuracy, or fairness in the valuation process, and thus should not be considered or relied upon by the Art Panel in the review process.

## VI. CONCLUSION

The legislature should adopt a more precise definition of the term fair market value, specifically auction value.<sup>155</sup> Challenges based on different interpretations of the term fair market value<sup>156</sup> cause delays in the disposition of estates. A more detailed and uniform definition would allow for greater consistency in appraisals, and would thus result in fewer challenges and less difficulty for both taxpayers and appraisers.

Most importantly, clearer guidelines would help curb the amount of discretionary power currently assumed by the Art Panel. The present definition allows the Art Panel to use private and retail sales figures that are not easily verifiable. By limiting the number of values that the Art Panel can choose from, and by specifying auction value as the official standard, the amount of discretion in the valuation review process would decrease. One expert, particularly a dealer, who may have a strong commercial interest in the paintings or sculpture by the artist being reviewed, should not have the power to largely determine the value of a work for IRS purposes.

Another mechanism to further check the Art Panel's power would be to require full disclosure of the Panel's meetings. Transcripts of the deliberations could be made available to the public quite easily. This information might prove helpful to the owner of a work whose appraisal was unfavorably adjusted. Members of the Art Panel should be held accountable for their specific input and should be required to justify their decisions.

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<sup>155</sup> See Treas. Reg. §§ 1.170A-1(c)(2) (as amended in 1984), 20.2031-1(b) (as amended in 1965).

<sup>156</sup> For a discussion of the differences between auction, retail, and private sale values, see *supra* note 10.

Any indication of improper motive or behavior by a Panelist could thus be exposed and corrected in this manner.

Stricter regulation of the appraisal industry would also provide greater consistency in art evaluations. The current system, which does not require any type of uniform accreditation, allows persons with little or no experience or training to make appraisals. Incompetent appraisers should not be allowed to submit inaccurate and unqualified appraisals to the IRS.

Presently, the burden of proving the value of a donated work is clearly on the collector.<sup>157</sup> To better protect the taxpayer from the current system of review and perhaps unfair and biased treatment, the burden should be shifted to the IRS when making substantial adjustments. Under a revised system requiring appraisal accreditation, only collectors who have obtained appraisals from reliable sources would be granted the benefit of this shifted burden. Valuations by unaccredited appraisers would not be recognized or accepted by the IRS. This benefit would provide the incentive for taxpayers to seek qualified appraisers, and would better equalize the bargaining positions of the taxpayer and the IRS.<sup>158</sup>

The current system does not provide adequate guidance or protection for either the appraiser or the taxpayer. Greater consistency and fairness can be achieved through legislation clarifying the definition of fair market value in the Treasury Regulation,<sup>159</sup> providing more uniform requirements in the appraisal industry, and by limiting the role of the Art Panel in the valuation process.

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<sup>157</sup> Temp. Treas. Reg. § 1.170A-13T(c)(2) (1984), *reprinted in* Deficit Reduction Act, *supra* note 102.

<sup>158</sup> See *Purchasers of Art*, *supra* note 9, at 238, where the author asserts that the IRS is at a great disadvantage when dealing with the taxpayer.

<sup>159</sup> See Treas. Reg. §§ 1.170A-1(c)(2), 20.2031-1(b).

