

Appraising Personal Property and Fine Arts

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Abstract - The valuation procedures for personal property for purposes of determining tax liability in gift and inheritance cases is generally the same as those used for charitable deduction purposes. However, in the case of antiques and works of fine arts, the issues of the buyer's premium and blockage discount have to be taken into consideration. Typically, only art works with a value in excess of \$20,000 needs to be valued by a reputable appraiser. In such cases, the IRC stipulates that the donor or executor should provide the IRS with suitable documentation to support gifts or bequests made involving these works of art. IRS reviews of such appraisals tend to focus on six components: the state of the market for the property; the statement of comparable worth; photographs of the property; cost basis, date and manner of acquisition; provenance; and a detailed description of the property in question.

While no licensing of appraisers is presently in place, a Qualified Source list of the Department of the Treasury does exist. This is the "pre-approved" list of appraisers from which the IRS and other government agencies select their outside fee appraisers on a case-by- case basis or under yearly contracts. Certainly, a designation such as ASA (Senior Member of the American Society of Appraisers) which requires initial testing, and recertification every five years to maintain, is useful for consideration. Additional certifications from the Appraisers Association of America or international groups, such as the International Institute of Valuers in Zurich (SCV) are desirable. Educational background is given greatest weight while membership in any of the numerous minor, often self-serving, appraisal "societies" is not deemed significant. More than these designations, however, is needed to effectively serve the legal and accounting professions.

Why Appraise?

An appraisal of personal property and fine arts is virtually required if:

1. The property is transferred during life to a charitable donee;
2. The property is subject to gift tax;
3. The property is transferred to a non-charitable donee;
4. The property is subject to estate tax;

5. The property is to be included in a networth assessment;
6. The property is involved in a divorce action;
7. The property is to be sold by an executor or appointed agent; or
8. The property is material and should be insured.

Such appraisals are obtained in order to determine the fair market value of the property in question. This is defined as "the price at which such property changes hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having a reasonable knowledge of all relevant facts" Treas. Reg. 1.170A- 1(c)(2). The gift and income regulations contain identical language on this point.

IRS Valuation Guidelines

Two revenue procedures provide guidelines for this valuation of tangible personal property. Rev. Proc. 6519, 1965-2, CB 1002 allows the sale price of the property in question to be used, by either the appraiser or the accountant, as the basis for the reporting of fair market value. The sale must have taken place within a reasonable amount of time of the event that prompts it (i.e., the gift, the death etc.). In addition, there must not have been any substantial change in the market for that property between the event and its sale. When property is sold at some distance from the event--one year or more--comparables sold closer to the event must be substituted or actual sale price of the property must be adjusted back to the market conditions at the date of the event.

Rev. Proc. 66-49, 1966-2, C.B. 1257 lays out guidelines for the appraisal of tangible property in general. These guidelines should be used by the appraiser you select even if the property is to be, or has been, sold.

The IRS, in its initial reviews of submitted appraisals, often focuses on the following six elements:

1. A Complete Description of the Property. This is perhaps the most important of all the guidelines. Inexperienced or "part-time" appraisers, particularly those practicing away from large metropolitan areas, tend to be extremely brief in their inventories and descriptions for estate or gift tax purposes. This may be caused by lack of knowledge, which most frequently tends to be the case, or it may be the result of the way estate appraisals were conducted in the past--as an adjunct to the real estate evaluation.

Single-line generic descriptions of property such as "english chest of drawers" or the lotting of large groups of items of an unrelated character, in addition to the lotting of items of a similar nature-- which is permitted--may trigger an IRS review. Appraisers who perform appraisals for donation purposes may be overly descriptive of the property in an attempt to support its value. In either case what should be indicated for each item described is date; medium; size; name of artist

(where applicable); subject matter (where applicable) and value. Condition of the property should also be discussed where this impacts on value.

2. Provenance. This refers to the source of the item. It may be a dealer, auction company, or it may have been inherited or purchased from a major collector. Provenance rarely impacts on the value of any items except those already considered to be valuable tangible assets.
3. Cost Basis, Date, and Manner of Acquisition. While essentially the same as the provenance of the piece, this information is required for the gifting of property and the correct filing of Form 8283 (Non-cash Charitable Contributions.) This form was first issued in February 1985, with the latest revision coming in March of 1990, in response to Reg. Sec. 1.170A-13(c)(4) requiring that an "appraisal summary" be attached to a donor's income tax return.
4. Photographs of the Property. Photographs are essential for donated items, but less critical for estate and other inventories. The IRS may well ask for photographs of estate property to assist in its review.
5. A Statement of Comparable. A major mistake made by inexperienced appraisers is to value the property, for any of the purposes noted, without reference to the sale of comparable items. These sales should have occurred on or around the valuation date. This is of utmost importance for donated or gifted property and can be of great assistance in the valuing of estate property. The IRS may require the submission of such sale records during the course of its review of any appraisal.
6. State of the Market for the Appraised Property. This requirement is necessary in any donation or gift appraisal. It becomes unwieldy in large inventories, such as estate property, save for major collections of similar items within that estate inventory. The details should focus on the market in which the property under consideration is most commonly sold to the general public.

Choosing An Appraiser

It is obvious from the brief overview presented above that choosing an appraiser is a most critical consideration. Rev. Proc. 66-49 refers to an appraisal by a "qualified person" and requires that the appraiser include a summary of his or her qualifications as an addendum to any document prepared. IRS Publication 561 also provides guidelines for choosing an appraiser. This publication also states that where required, a signed copy of the appraisal should accompany any tax return filed. An appraisal that closely follows the guidelines will draw less attention from IRS in its review. Even if the descriptions are complete and the provenances noted, where possible, the valuation of the property can be challenged if it is not based upon an intelligent interpretation of the facts. The appraisal of personal

property and fine arts is generally described as a "matter of opinion," but if that opinion is not supported, it is likely to be given little or no weight by the IRS.

The \$5,000 Limit

After December 31, 1984, any charitable contributions made by an individual, closely held corporation, personal service corporation, partnership, or S corporation exceeding \$5,000 in total are subject to the guidelines. This applies to single items or groups of similar items donated in the same calendar year. Such items may be considered in the aggregate by the IRS, even when they are gifted to separate charitable donees. These rules apply whether the property is capital gain or ordinary income property and whether the property has appreciated or depreciated since its date of acquisition.

The IRS Review

An "Art Advisory panel" was established by the IRS in 1968 in order to review submitted appraisals of property to determine if an intelligent assessment of fair market value has been placed upon works of art and antiques. Generally, only those items whose value exceeds \$20,000 are reviewed by the panel. The Valuation Division of the IRS also maintains a staff of valuation technicians who review the balance of either contributed, gifted or estate property. They are assisted in this effort by individuals under contract to the IRS. Once reviewed, a report is issued by either the panel, or the Valuation Division. This report will include any changes (up or down) in value and the reasons for these changes.

IRC Sec. 7517 stipulates that the IRS must provide, upon the request of the donor or executor, a written statement explaining any changes in the value of the property suggested by the above reviewing bodies. This statement must be furnished within 45 days of the date of the request or the date of its determination, whichever is later. This was instituted in order to promote the resolution of valuation disputes at the earliest possible time and at the lowest possible level. IRC Sec. 7517 is effective for all transfers made after December 1976.

If no agreement can be reached at the lowest level, the donor or executor may ask for the matter to be reviewed by the Appeals Division. If no resolution at that level is possible the case may ultimately end up at the District Counsel level in preparation for a hearing in Federal Tax Court. Most valuation disputes are resolved well before the Federal Tax Court level as the costs and hazards of litigation become evident to both sides.

Important Points Frequently Overlooked

Two issues of critical importance in the valuation of property that are most frequently overlooked or misunderstood are blockage discount and buyer's premium.

1. The chosen appraiser should consider blockage discount when a substantial block of the same type of property is to be found in an estate, contribution, or gift. The concept of blockage is derived from stock and securities cases but applies when the "simultaneous marketing of (such property) would substantially depress the market" see *Skripak v. Commissioner* 84 T.C. No. 22 (1985). The IRS Valuation Guide for Income, Estate and Gift Taxes, CCH Fed. Est. & Gift Rep. No. 115 (October 15, 1955) pg. 30 discusses this concept including a rough guide to estimating what the applied blockage discount should be. I have found the concept of blockage particularly useful in the valuing of the estates of artist's and collectors. Most of the landmark decisions in this area have come about as the result of the review of such estates. The current litigation over the estate of Andy Warhol is just the most recent example of this on-going process. Ultimately, the agreed upon blockage, whether flatly applied or stepped, as in *The Estate of Georgia T. O'Keefe v. Commissioner* 63 T.C.M. (CCH) 2699 (1991), will come as a result of negotiation based upon the market as of the appraisal date and the nature of the material appraised.
2. The second issue, almost universally overlooked by appraisers, is that of Buyer's Premium. The IRS has recently issued a Technical Advice Memorandum (Priv. Ltr. Rul. 9235005) that requires an estate that sells works of art at auction to use the hammer price plus the buyer's premium when reporting the fair market value of the property, even though the estate has no access to such a premium. It has been suggested that this ruling may have little effect on most estates, since the additional premium may be deductible under Reg. Sec. 20.2053-3(d)(2) as an administration expense.

The various circuit Courts of Appeals have reached different conclusions regarding the issue of premium deduction as an estate administrative expense. It is wise for the accountant or attorney to be sure that the buyer's premium on any material sold or comparable used to determine fair market value is included in the appraised value of that property.

Since it has been recognized that the valuation test for estate and gift tax purposes is generally the same as that used for charitable deduction purposes, the inclusion of the buyer's premium in the valuing of contributed property is therefore a dividend to be enjoyed under the contribution rules.