ART & ADVOCACY

The Art Law Newsletter of *Herrick, Feinstein LLP*

SPRING 2014 :: Volume 17

CONTENTS

Time to Take the Risk Out of Consignments { 1 }

Valuing Artwork for Federal Taxation Purposes: Income, Estate & Gift Tax Issues { 5 }

Art Law Events { 8 }

Time to Take the Risk Out of Consignments

By Stephen D. Brodie

"A picture imperfect" is how Hilary Jay, writing in the Duke Law Journal in 2009, described the application of the consignment rules in Article 9 of the Uniform Commercial Code ("UCC") to artwork. In her paper, Ms. Jay noted that most consignments of artworks to dealers may well fall outside the scope of a "consignment" as defined in revised Article 9 (effective in New York as of July 1, 2001). This means that the protections available to consignors under Article 9 (both the rights of a secured party and the ability to perfect a super-priority purchase money security interest in items they have consigned) are likely unavailable to consignors of art, potentially leaving them vulnerable to claims of an art dealer's/consignee's creditors. In and of itself, that seems to be an unjust result, but there is also a second problem caused by Article 9's apparent exclusion of most art consignments: potential working capital lenders to art dealers are unable to run a simple search of public records that will identify all encumbrances on the title to their borrowers' assets. I am advocating for a change in the UCC that will protect consignors from a risk that most of them do not even realize they are taking, and will enable lenders to easily determine which items of ostensible dealer inventory are, in fact, owned by third-party consignors.

The Problem

Under Section 9-102(a)(20) of the UCC, in effect in New York State, a consignment is defined as follows:

> "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and: (A) the merchant: (i) deals in goods of that kind under a name other than the name of the person making delivery; (ii) is not an auctioneer; and (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others; (B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery; (C) the goods are not consumer goods immediately before delivery; and (D) the transaction does not create a security interest that secures an obligation.

The problematic requirements, for our purposes, are (i) that the consigned goods not constitute "consumer goods" immediately prior to their delivery to the consignee, and (ii) that the consignee must not be generally known by its creditors to be substantially engaged in selling the goods of others.

No one knows with certainty if, or under what circumstances, art that is part of a personal collection constitutes consumer goods. Section 9-102(a)(23) of the UCC defines "consumer goods" as goods "used or bought primarily for personal, family or household purposes." Arguably, the ownership of any fine art of substantial value carries an investment dimension, whether or not the owner/consignor has a history of trading art. However, if art worth millions of dollars has been displayed in a family's home for decades, the "personal, family and household purposes" are surely present, as much as with some decorative fireplace tools or a wall sconce. One might say that at a certain price point the investment aspect becomes primary and that goods (art or

(story continues on page 2)

Time to Take the Risk Out of Consignments *(continued from page 1)*

otherwise) cease to be consumer goods. But the UCC offers no guidance on what that threshold would be, and the only meaningful way to determine if a particular item would meet such a value test, if there were one, would be to conduct an appraisal immediately prior to delivery to the consignee, however impractical that might be.[1]

If the question of value were all that was involved, there might be a reason to consider a price point test as a solution to the consumer goods problem. However, there are many collectors who buy and sell art with varying degrees of frequency. Determining how much trading is too much for an artwork to constitute a consumer good (as opposed to an investment or even inventory) is a question of fact that would have to be decided on a case-by-case basis. In short, few, if any, collectors/consignors can ever really know if a piece from their collection constitutes a consumer good immediately prior to delivery to a consignee/dealer. For this reason alone, no consignor can be certain whether or not any particular art consignment will fall under Article 9.

Moreover, as noted above, the consumer goods issue is only part of the problem. Aside from being impractical in general, because establishing the facts needed to meet the burden of proof (as a consignor would have to do) would be cumbersome, the requirement that the consignee not be "generally known by its creditors to be substantially engaged in selling the goods of others" plainly excludes most art consignments from the ambit of an Article 9 consignment, as it is widely known that consigned artworks constitute an important part of the inventory of most art dealers. Case law has established that being "generally known by its creditors" means being known by a majority in number (regardless of the amounts owing) of a consignee's creditors. The few reported cases in this area also indicate that the standard for being engaged "substantially" in selling the goods of others means 20% of the consignee's sales volume. It is generally believed that most art dealers in New York easily exceed that 20% threshold.

There can be no doubt that this picture is "imperfect" unless one chooses to say that Article 9 simply does not work for consignments of artworks. But the art business has no less need for a viable legal framework for consignments than other industries do. Indeed, there are few, if any, businesses where consignments are so common and the value of the consigned "goods" so high. And it is not as though insolvencies are unknown in the world of art galleries. In both the Berry-Hill and Salander-O'Reilly bankruptcies, consignors have struggled, often for long periods of time and at considerable expense, to recover the very art they owned.[2] In other cases, consignors have actually lost their art to the creditors of a bankrupt dealer.[3]

If Article 9's consignment rules are inapposite, then the filing of a UCC financing statement by a consignor will be of no legal effect. As a result, in the event of a dealer's insolvency, an art consignor is likely to find himself caught up in a legal imbroglio where the gallery's creditors will argue that Section 2-326 of the UCC should control. This section expressly exposes items delivered to a merchant, on a "sale or return" basis, to claims of the merchant's creditors. Some courts have accepted this argument, to the consignor's detriment, but others have rejected it. When a court finds that no Article 9 consignment was created and also holds that Section 2-326 is inapplicable, the common law of bailments will apply. This would very likely benefit the consignor. We need not come to a conclusion as to whether the Section 2-326 or the bailment analysis is correct (and the specific facts of each case may weigh heavily on the outcome of such an inquiry) to recognize the absurdity of all of this from the consignor's perspective.

Finally, we should note that in the unlikely event that an art consignment were found to be a proper Article 9 consignment, in order to have priority, the consignor must have (i) within five years prior to delivering the consigned art to its consignee, sent a written notice of its purchase money security interest to each creditor holding a security interest in the inventory of the consignor's dealer, and (ii) previously filed its own UCC financing statement. If the consignor did not take these steps, his security interest would come after any properly filed inventory lender to the dealer who had been granted a security interest in "after-appraisal property." This outcome would be at least as bad for the consignor as a court following the Section 2-326 line of reasoning.

The Point

The point is that exposure to claims of a gallery's creditors is not a risk that most art consignors even realize they are taking, and there is no need for the system to continue to work this way. The drafters of revised Article 9 were concerned with protecting working capital lenders from hidden liens against ostensible inventory. They, therefore, wrote consignment rules that effectively reduce or eliminate that risk for, as Hillary Jay noted, "the consignment of screwdrivers to a shop." Two unintended consequences of those rules, however, have been to

(i) deny similar protection to consignors of art to dealers, and (ii) deny lenders and dealers alike a system in which prospective lenders to those dealers can search public records and identify which of the works for sale in a gallery belong to third-party consignors.

Possible Solutions

A number of relatively simple solutions are available to fix these problems. For example, since 1995, New York's Arts and Cultural Affairs Law has protected artists from claims by the creditors of art gallery consignees and unscrupulous art dealers by deeming all monies owing from an art dealer to an artist from the sale of an original consigned work to be held in trust for the artist. In 2012, New York State amended that law, and the Estates, Powers and Trusts Law, to strengthen those protections. Massachusetts' law treats all consignments this way, whether the consignor is an artist or a collector. New York could do the same, but a better solution would be to amend the UCC to include a definition for an "art consignment" and to provide for a special kind of financing statement to be filed in the case of such a consignment.

The advantage of this kind of UCC amendment, over expanding the Arts and Cultural Affairs Law provisions to cover consignments from persons who are not artists, is that the public filing of a financing statement creates a record that can be searched by lenders interested in providing financing to art galleries. Herrick has substantial experience in representing commercial banks and niche lenders in making loans to art dealers. These lenders are aware of the possibility that what appears to be the inventory of a gallery may well belong to a third party, whether that third party is the gallery's principal owner or its foreign affiliate, or an independent collector/consignor. Determining the true ownership of art inventory is one of the real challenges on the credit side in lending to art dealers. Earlier this year, a senior credit officer at a prominent New York commercial finance lender told me that keeping track of title to gallery inventory is a "shell game." If New York had a system where consignors simply had to file a UCC financing statement in order to protect themselves from inventory lenders, I submit that, over time, it would become common practice to do so, even in the "handshake culture" of the art world. This, in turn, would encourage more potential inventory lenders to consider making credit facilities available to the galleries, because the lenders would no longer have to rely solely on their borrowers' representations as to which artworks constitute owned inventory eligible to serve as collateral against which money can be lent.

More about UCC Consignments

Article 9 of the UCC does not deal with "title" to goods that are consigned pursuant to its rules. Rather (as noted above), in the case of a consignment meeting the criteria of Section 9-102(a)(20), a consignor is given the *opportunity* to create a super-priority purchase money security interest in the consigned goods (e.g., screwdrivers) that is superior to that of a holder of a previously filed security interest in the inventory of the consignee (e.g., a hardware store). In order to realize that opportunity, however, the consignor must not only file a UCC financing statement, but must also send written notice to previously filed secured parties having an interest in the consignee's inventory within five years *before* the delivery of the consigned goods to the consignee.

Even though the UCC has been adopted in all 50 states, there are many relatively minor state-to-state variations found in Article 9 and elsewhere within the Code.

The amendment to the New York UCC that I am proposing would eliminate the requirement that consignors give notice in order to attain superpriority. It is one thing to ask art collectors to depart from the traditional paperless approach to the business of art by requiring them to file a simple "art consignment" financing statement; it would be unrealistic to also require them to run a lien search, interpret the results of that search, and then send a formal legal notice to pre-existing secured parties who have filed against "after acquired" inventory, merely to establish the consignors' right to something of value that they rightfully believe they own.

Amending the UCC

There is precedent for my proposal. Even though the UCC has been adopted in all 50 states, there are many relatively minor state-to-state variations found in Article 9 and elsewhere within the Code. For example, in 1988 New York amended Article 9 to provide that filing a special form of financing statement was the only way to perfect a security interest in the shares of stock and proprietary lease for a co-op apartment. Until then, there had been some confusion because there was no rule specific to co-ops, and the UCC required a lender to take possession of the certificate evidencing the shares in order to perfect the security interest. That was easy enough, but the question was what to do about the proprietary lease, which represented an interest in real estate, and was therefore outside the scope of Article 9. Under real estate law, a lender could acquire priority in a lease only by recording an assignment of that lease in the land records. Very few lenders actually took that step when lending on a co-op apartment, in part because the boards of New York co-op buildings disapproved of the recording of such assignments because they would be recorded against the title to the building itself (and would have also required the recording of the proprietary lease itself or a memorandum of such lease). This created unnecessary legal uncertainty at a time when the value of these apartments had been rising

 (continued from page 3)

rapidly as New York City rose from the depths of its financial difficulties of the 1970s. So the law was changed (and a non-uniform provision was added to the New York UCC) to provide a simple and straightforward system for co-op lenders to protect their interests by filing a special form of financing statement. I submit that the time has come for New York, with its relatively large number of art dealers and collectors, to take a similar step to facilitate a better – and fairer – working of the widespread practice of art consignments in the state.

What about Confidentiality?

Some people have expressed concern that requiring consignors to effect a public filing in order to protect their interest in a consigned artwork ignores the traditional – and understandable (to a degree) – desire of collectors to maintain strict confidentiality about their art and their addresses. My own view is that the same people routinely make public the same kind of information, without any particular hesitation, when it comes to co-op apartments and other real estate. In addition, simple devices used in real estate, such as putting record title into the name of a trust or another entity in order to maintain confidentiality, could be employed in the art world as well. The UCC itself provides an additional solution to this problem, in that it does not require great specificity with respect to a collateral description in financing statements. Rather, Article 9 provides for "notice filing," meaning, among other things, that for a financing statement to be legally effective it does not have to contain as much detail as the security agreement. There is some uncertainty as to exactly how much detail is needed for a legally effective collateral description in a financing statement, but the proposed UCC amendment could expressly provide that a description would be sufficient if it referred, for instance, to unspecified artworks set forth in a plainly identified but unfiled consignment agreement.

Time for the Business of Art to Join the Rest of the Commercial World

My bottom-line conclusion is that providing effective and practical legal protection for consignors would ultimately benefit everyone in the art world. As with title insurance, the traditional ways of doing business may have served many people well enough for a long time, but with increasing amounts of money being invested in art and the prevalence of a visual culture that seems more widely interested in art than ever before, it is high time for commercial common sense to supplant tradition and trust. There is, admittedly, something gracious about an environment where a person's word is his bond, and a "handshake culture" sounds refreshing, even to lawyers, in this respect. But those things have been true, at one time or another, in every sector of the commercial world, and people have nonetheless seen fit, over time, to superimpose laws on these systems. In general, there is nothing in particular about the commercial side of art that is different from the world of commerce. It is just a question of changing conventions to bring more reason and order to bear on a largely unregulated and opaque business. Some of the changes I envision, like title insurance,[4] cost money and are, in certain ways, complex. But others, like changing Article 9 to accommodate art consignments, should be easy and cost nothing.

Members of Herrick's Art Law Group are presently consulting with a major bar association about legislation to amend Article 9 of the UCC in New York State as proposed in the foregoing article. •

1 In *In re Morgansen's Ltd.*, 302 B.R. 784 (2003), the bankruptcy court seems to have assumed that art, jewelry, and other items having a value of $1,000 or more are not "consumer goods." But there is no statutory basis or legal precedent establishing such a bright line.
2 *See, e.g., In re Salander-O'Reilly Galleries*, 475 B.R. 9 (S.D.N.Y. 2012).
3 *In re Morgansen's Ltd., supra; Rayfield Investors Co. v. Kreps*, 35 So. 3d 63 (Fla. Dist. Ct. App. 2010).
4 For an in-depth discussion of the potential role of title insurance in the art market, see Stephen D. Brodie, *The Case for Title Insurance*, 15 Art & Advocacy 1 (Spring/Summer 2013).

On February 4, 2014, members of Herrick's Art Law Group were honored to have been invited to the world premiere of the movie "The Monuments Men" starring George Clooney, Matt Damon, Bill Murray, and John Goodman. The movie, which is based on a 2009 book by Robert Edsel of the same name, chronicles the story of a group of men and women from thirteen nations, who volunteered for service in a specially created division of the U.S. Army called the Monuments, Fine Arts, and Archives section, or MFAA. Most had expertise as museum directors, curators, art scholars and educators, artists, architects, and archivists. Their job was to save as much of the culture of Europe as they could during combat. The Herrick attendees were accompanied by Marei von Saher and her daughter Charlene, the heirs of the famous Dutch art dealer Jacques Goudstikker, whose artworks were looted by the Nazis and in some cases recovered by the Monuments Men.

Lawrence Kaye meets with George Clooney.

Valuing Artwork for Federal Taxation Purposes: Income, Estate & Gift Tax Issues[1]

By Nicholas R. Montorio

Introduction

Valuing artwork is inherently subjective. Appraisers can rely on objective factors to value artwork, such as comparable sales of similar pieces, but, clearly, two different appraisers can arrive at different values. There may also be a variety of subjective factors that affect the value an owner ascribes to a particular work of art, whether it is because the work is a family heirloom or because the work was recovered from the Nazis. On top of all this, the tax rules often motivate owners to overvalue or undervalue property, including artwork.

The Internal Revenue Code of 1986, as amended (the "Code"), and the Treasury Regulations thereunder, establish a labyrinth of rules and requirements regarding the taxpayer's burden to substantiate the value of property stated on a tax return. For federal tax purposes, the importance of valuing property is apparent in three common scenarios: (1) when an owner donates property to a charitable organization and wishes to claim a charitable contribution deduction under Section 170, (2) when a decedent's gross estate is valued for the purpose of calculating the estate tax, and (3) when a donor is subject to the gift tax under Section 2501.

The Code incentivizes taxpayers to choose a higher valuation for artwork in the case of a charitable contribution and a lower valuation in the case of the estate or gift tax. What is an owner to do if one appraiser values a work at $25 million, while another values it at $30 million? Considering that the highest individual income tax rate is currently 39.6% and the highest estate and gift tax rate is 40%, a taxpayer's preference for a low-side or high-side valuation of artwork may affect his tax liability by millions of dollars.

The tax law makes clear that the taxpayer has the burden of substantiating the value of the property. To this end, a taxpayer must not only comply with the procedural requirements for valuation, but must also persuade the trier of fact that his claimed valuation is correct.

What Is "Fair-Market Value" for Federal Tax Purposes?

The Treasury Regulations define "fair market value" 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."[2] Although this "willing buyer" and "willing seller" approach appears workable, the parties involved in a donation or gift, for example, are not forced to agree on a negotiated value the way an actual buyer and seller are. Accordingly, the only obstacle to using a particular valuation for artwork is often the Internal Revenue Service (the "IRS"), combined with the potential for penalties and interest in the case of a misstatement of value.

In an effort to assist taxpayers in valuing artwork, the IRS established the Art Appraisal Services division (the "AAS"). Prior to submitting an income, gift, or estate tax return, a taxpayer can request that the AAS provide a Statement of Value in which the IRS values the artwork for the taxpayer. A taxpayer must submit such a request to the AAS prior to filing the tax return that first reports the transfer of the item.[3]

The tax law makes clear that the taxpayer has the burden of substantiating the value of the property.

After receiving a Statement of Value from the IRS, the taxpayer must attach a copy of it to his income, gift, or estate tax return. A taxpayer who disagrees with the IRS's Statement of Value may submit with the tax return additional information in support of a different value. A taxpayer who submits a return prior to receiving the Statement of Value must indicate on the return that a Statement of Value has been requested and attach a copy of the request to the return. In such a case, upon receipt of the Statement of Value, the taxpayer must file an amended income or gift tax return, or a supplemental estate tax return, with the Statement of Value attached.

Pursuant to the Federal Advisory Committee Act, the Art Advisory Panel (the "Panel") was created in 1968 to assist the AAS in appraising works of art valued at $50,000 or more. The Panel's members are museum directors and curators, art dealers, and auction representatives so that differing views as to fair market value are provided. When a tax return selected for audit includes an art appraisal valued at $50,000 or more, the local IRS office refers the case to the AAS and orders a subsequent referral to the Panel when applicable. The Panel's recommendations are advisory. The AAS staff reviews all of the Panel's recommendations, which become the position of the IRS only with the AAS's concurrence. For Fiscal Year ("FY") 2012, the AAS adopted, in full, 96.5% of the Panel's recommendations, and adopted the rest in part. The Panel also reviews and evaluates the acceptability of property appraisals submitted by taxpayers in support of the fair market value claimed on works of art involved in federal income, estate, or gift taxes. In March 2014, the IRS renewed the Panel's charter for two years, explaining that the Panel serves the public's interest.

The Panel reviews appraisals without knowledge of whether the taxpayer is better served by a high valuation for a charitable contribution or a low valuation for estate or gift tax purposes. In its Annual Summary Report for FY 2012, released on January 23, 2013, the Panel reported that it recommended

accepting 51% of all art appraisals it reviewed for FY 2012 and proposed adjustments to the remaining 49%. During FY 2012, the Panel completed its review of 444 items with an aggregate taxpayer valuation of $281,859,200 on 43 taxpayer cases under audit. The average claimed value of a charitable contribution was $613,684, and the average claimed value of an estate and gift tax item was $628,890. The Panel recommended total net adjustments of $66,066,800, a net 52% reduction on the charitable contribution appraisals and a net 47% increase on items in estate and gift tax appraisals.

Charitable Contributions Pursuant to Section 170

There are several rules that a taxpayer must be aware of when claiming a charitable contribution deduction for a donation of art to a charity. Section 170(a)(1) generally allows taxpayers to claim as a deduction any charitable contribution made during the taxable year. Generally, the amount of the deduction is equal to the amount of money or the fair market value of the property contributed, determined at the time of the donation. However, the deduction must be reduced by the amount of gain that would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value. For example, if a taxpayer purchases artwork for $100,000 on January 1, 2001, then donates the artwork to a charity on December 31, 2001, when the property is valued at $300,000, the charitable contribution is limited to $100,000, determined as follows: $300,000 fair market value *minus* $200,000 non-long-term capital gain. Alternatively, if the taxpayer waits until January 2, 2002 to donate the artwork, the "non-long-term capital gain" limitation would not apply and the deduction would be $300,000, the artwork's fair market value.

Robert Rauschenberg's artwork "Canyon" created a complicated valuation dispute for the heirs of the Ileana Sonnabend estate.

The provisions of Section 170(f)(11) impose reporting obligations on taxpayers who claim charitable contribution deductions valued at more than $500. When the claimed donation is valued over $500 but under $5,000, the taxpayer needs to complete Section A of Form 8283 in order to provide the IRS with a description of the donated property and certain other required information. When the claimed donation is over $5,000, the taxpayer needs to attach a "qualified appraisal" to his tax return and complete Section B of Form 8283, known as the "Appraisal Summary." The Treasury Regulations contain numerous requirements for a "qualified appraisal" and for the definition of a "qualified appraiser."[4] The donee has no obligation to confirm or otherwise validate the donor's claimed valuation. For example, in 2004, the Smithsonian had no obligation to value the musical instruments it received from Herbert Axelrod, who claimed a tax deduction for $50 million on the donation. In 2005, Axelrod was sentenced to 18 months in jail for unrelated tax fraud.

Selected Valuation and Donation Cases

One of the most fascinating valuation disputes in recent memory involved the Estate of Ileana Sonnabend and Robert Rauschenberg's "Canyon." For estate tax purposes, the taxpayer valued "Canyon" at $0 because the collage contained a stuffed bald eagle, which meant the sale of the work would have been illegal under federal law and could have resulted in imprisonment for the seller.[5] The IRS, however, following the advice of the Panel, valued "Canyon" at $65 million and assessed a $29.2 million estate tax, plus $11.7 million in penalties. The IRS reasoned that someone may have wanted to purchase "Canyon" on the black market. In late November 2012,

the parties settled the tax dispute. The heirs agreed to donate the work to the Museum of Modern Art in exchange for the IRS dropping its deficiency claim. The heirs also agreed not to claim a charitable contribution deduction with respect to the donation.

A 2011 decision by the 11th Circuit highlights the problem when courts must decide between two different "reasonable" valuations. In *U.S. v. Reinhard*, 107 A.F.T.R.2d 2011-355, (11th Cir. 2011), the defendant failed to include certain sculptures in his bankruptcy estate in 2006. To measure the estate's loss as a result of such failure, the government argued that the sculptures should be valued at $40,000 each, based on a 2004 appraisal. The defendant, however, argued that a 2007 auction price of $24,000 more accurately reflected the value of the sculptures in 2006. Although the court acknowledged that "there is something to be said for" the defendant's argument, it determined that the lower court's acceptance of the higher 2004 appraisal was not clear error and was therefore affirmed.

Combining the difficulty of valuing artwork with the Code's incentives and complexity is a recipe for constant tax litigation.

In *Williams, III v. Comm'r*, 110 A.F.T.R. 2d 2012-6904 (4th Cir. 2012), *aff'g*, T.C.M. 2011-89 (Apr. 21, 2011), the tax court had to determine the date on which the taxpayer acquired artwork for the purposes of determining whether he owned the work for more than one year. The taxpayer had executed an "Art Purchase Agreement" that required him to pay 5% at signing, with the balance due at the time of the charitable contribution. The total amount payable by the taxpayer to the seller was limited to 24% of the artwork's fair market value at the time of the donation. The Tax Court found, and the 4th Circuit affirmed, that the "Art Purchase Agreement" did not grant taxpayer ownership of the artwork because, in substance, the agreement provided only an option to purchase artwork in the future. The Court determined that the taxpayer did not acquire the artwork until the time of the deduction. Accordingly, under Section 170(e)(1)(A), the taxpayer's deduction was limited to his basis because he did not own the work for more than a year. The *Williams* decision indicates that courts will consider the substance of the transaction before allowing a taxpayer's charitable contribution deduction. *Id.* at 2012-6912 (quoting *U.S. v. Heller*, 866 F.2d 1336, 1341 (11th Cir. 1989) "Federal tax law disregards transactions lacking an economic purpose which are undertaken only to generate a tax savings. Federal tax law is concerned with the economic substance of the transaction under scrutiny and not the form by which it is masked.").

Conclusion

The value of a particular work of art depends on various objective and subjective factors, which often lead to varying opinions as to the work's fair market value. The AAS and the Panel serve important roles in the administration of the tax laws by reducing some of the uncertainty and subjectivity of valuations, particularly in cases where a taxpayer may be stretching the boundaries of reasonableness.

Combining the difficulty of valuing artwork with the Code's incentives and complexity is a recipe for constant tax litigation. As highlighted in the discussion of recent case law, applying the tax law to art valuation issues is often extremely difficult. For example, although the IRS may have been unreasonable to value "Canyon" at $65 million, the IRS was not unreasonable to argue that the work had some value. In cases where a particular work of art may have a reasonable range of value, the taxpayer is likely to claim the value that is most tax favorable to him. The IRS is then forced to challenge the claimed valuations in an effort to protect tax revenues and prevent abuses, such as in *Williams*.

In deciding how to value a work of art for U.S. tax purposes, a taxpayer must consider all the various rules and procedural requirements. Appraisers and other experts may assist taxpayers in arriving at a reasonable valuation to use on tax returns; however, taxpayers may not blindly rely on such experts. As a guiding principle, taxpayers should always consider the price that a "willing buyer" would pay for the property reported on a tax return. •

1 IRS Circular 230 Disclosure: To ensure compliance with Treasury Department regulations, we inform you that any U.S. federal tax advice contained in this document (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

2 *E.g.*, Treas. Reg. 1.170A-1(c)(2) (for charitable contributions); Treas. Reg. 20.2031-1(b) (for estate tax purposes); Treas. Reg. 25.2512-1 (for gift tax purposes).

3 The request must include the following: (1) a copy of an appraisal of the item of art; (2) a check or money order payable to the IRS in the amount of $2,500 for a request for a Statement of Value for one, two, or three items of art, plus $250 for each additional item of art for which a Statement of Value is requested; (3) a completed appraisal summary (Section B of Form 8283, Noncash Charitable Contributions); and (4) the location of the District Office that has or will have examination jurisdiction over the return. *See* Rev. Proc. 96-15, 1996-1 CB 627, 12/28/1995.

4 *See* Treas. Reg. 1.170A-13(c)(3) and (5).

5 The Estate reportedly paid $471 million in state and federal estate taxes even with a $0 valuation for "Canyon."

HERRICK
Committed to Your Success.

New York | Istanbul | Newark | Princeton | Washington DC | www.herrick.com

Art Law Events

Upcoming Events Involving Herrick's Art Law Group

May 20, 2014

Frank Lord, Mari-Claudia Jiménez, and Michelle Bergeron Spell will speak on a panel entitled "Visual Art and Theater Law Essentials" for a class given by the Volunteer Lawyers for the Arts. Frank will be speaking on the subject of contracts with dealers and museums; Mari-Claudia will address the law of consignments; and Michelle will be discussing estate planning for artists. This event will take place at Herrick, Feinstein's offices in New York City.

May 20, 2014

Charles A. Goldstein will give a lecture entitled "Recovery of Jewish Art Confiscated During the Nazi Era" at Temple Israel of Great Neck in Great Neck, New York.

May 28, 2014

Frank Lord will speak on a panel entitled "Art in Trusts and Estates" sponsored by the Society of Trust and Estate Practitioners at Christie's in New York City.

June 10 & 12, 2014

Yael Weitz will speak on a panel addressing legal and practical issues confronting today's art collectors sponsored by RFG Wealth Management in New York City.

June 12, 2014

Lawrence Kaye will be honored with the S. Jeanne Hall Pro Bono award at the Volunteer Lawyers for the Arts Summer Benefit at C24 Gallery in New York City.

Recent Events Involving Herrick's Art Law Group

March 12, 2014

Howard Spiegler spoke on a panel entitled "Hot Topics in Art Law 2014" sponsored by the Art Law Committee of the New York City Bar. Howard discussed "Art Repatriation and Restitution."

April 30, 2014

Frank Lord, Mari-Claudia Jiménez, Charles A. Goldstein, and Yael Weitz spoke on a panel entitled "Rewriting History: Major Legal Developments Concerning the Restitution of Looted Art" for the Sotheby's Institute of Art at Herrick, Feinstein's offices in New York City.

May 12, 2014

Michael Kessel spoke on a panel entitled "Advanced Issues in Appraising" sponsored by the Appraisers Association of America. The event took place at Herrick, Feinstein's offices in New York City.

May 14, 2014

Lawrence Kaye spoke on a panel entitled "Nazi Stolen Art and Its Legacy" co-sponsored by the World Presidents' Organization New York Metro Chapter and Herrick, Feinstein at the Neue Galerie in New York City in conjunction with the Neue Galerie's exhibition entitled "Degenerate Art: The Attack on Modern Art in Nazi Germany 1937."

For questions about **Art & Advocacy,** please contact the Editor-in-Chief:

Darlene Fairman
dfairman@herrick.com
212.592.1436

For questions about upcoming events and other art law matters, please contact:

Lawrence Kaye
lkaye@herrick.com
212.592.1410

Howard Spiegler
hspiegler@herrick.com
212.592.1444

Additional information on Herrick's Art Law Group, including biographical information,news, and articles, can be found at **www.herrick.com/artlaw.**

If you would like to receive this and other materials from Herrick's Art Law Group, please visit **www.herrick.com/subscribe** and add your contact information.

© 2014 Herrick, Feinstein LLP.
Art & Advocacy is published by Herrick, Feinstein LLP for information purposes only. Nothing contained herein is intended to serve as legal advice or counsel or as an opinion of the firm.