VALUING ART IN AN ESTATE: NEW CONCERNS[♦]

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INTRODUCTION

When noted art dealer and collector Ileana Sonnabend died in 2007 at the age of 92, her estate included works of art valued at more than

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$800 million.[1] Robert Rauschenberg's 1959 *Canyon* was one of them.[2] *Canyon* is a Rauschenberg "combine"—a three dimensional wall-hung work of art incorporating distinctive and uncommon found items with painting and other mediums.[3] In *Canyon*, an actual taxidermied bald eagle with its wings fully extended juts outward from the bottom of the canvas. For the art world, combines are among Rauschenberg's most important works, but for Sonnabend's estate and the Internal Revenue Service (IRS), *Canyon* raises important questions for federal estate tax purposes.

Property included in a decedent's estate is valued for estate tax purposes at its fair market value as of the date of death,[4] with the relevant market being "that in which such item is most commonly sold to the public."[5] Selling *Canyon*, however, would be a federal crime, subjecting the seller and buyer to jail and fines because sales of bald eagles or their parts, whether dead or alive, are in violation of the Bald and Golden Eagle Protection Act.[6] That is why, based on three separate independent appraisals, the estate valued *Canyon* on its estate tax return at $0.[7] The IRS, however, has reportedly valued *Canyon* at $65 million and issued a deficiency notice claiming $29.2 million in taxes and $11.7

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[1] Patricia Cohen, *Art's Sale Value? Zero. The Tax Bill? $29 Million*, N.Y. TIMES July 22, 2012, http://www.nytimes.com/2012/07/22/arts/design/a-catch-22-of-art-and-taxes-starring-a-stuffed-eagle.html?pagewanted=all; Eileen Kinsella, *Rauschenberg Eagle Ruffles Feathers*, ARTNEWS, May 1, 2012, http://www.artnews.com/2012/05/01/rauschenberg-eagle-ruffles-feathers/; Janet Novack, *Even Rich Heirs Deserve a Fair Shake From the IRS*, FORBES, Feb. 23, 2012, http://www.forbes.com/sites/janetnovack/2012/02/23/even-rich-heirs-deserve-a-fair-shake-from-the-irs/.

[2] Robert Rauschenberg (1925-2008), an American artist, was highly influential in the development of many of the movements in mid-to-late twentieth century art.

> Rauschenberg's legacy begins with the combines . . . Artists who change the way other artists look at art—that happens very infrequently. Pop art, Fluxus, Arte Povera, the performance art of the sixties, conceptualism in the seventies, environmental art, installation art, political art—all that erasure between the art object and the person who made it began with the combines.

Calvin Tomkins, *Everything in Sight: Robert Rauschenberg's New Life*, NEW YORKER, May 23, 2005, http://www.newyorker.com/archive/2005/05/23/050523fa_fact_tomkins (quoting Paul Schimmel, then chief curator for Museum of Contemporary Art in Los Angeles).

[3] "Combine" is a term used by Rauschenberg for many of the works that he created between 1954 and 1964. *See* Mark Stevens, *Collage Education*, N.Y. MAGAZINE, Dec. 18, 2005, http://nymag.com/nymetro/arts/art/reviews/15332/. "He'd put anything in art: . . . even stuffed animals. Especially stuffed animals." Contemporary artists (famous and otherwise) continue their fascination with animals. British artist Damien Hirst is well-known for his conceptual piece, *The Physical Impossibility of Death in the Mind of Someone Living*, which is a shark floating in a tank of formaldehyde. On the other hand, lesser-known Miami artist Enrique Gomez de Molina is now serving a twenty-month sentence in federal prison for smuggling endangered species into the U.S. His art consists of combining taxidermy parts of different exotic animals to create "hauntingly beautiful hybrid creatures." Lydia Martin, *From Toast of the Art World to Guest of Federal Pen*, MIAMI HERALD, May 20, 2012, http://www.miamiherald.com/2012/05/19/2808170_p2/how-an-artists-pursuit-of-originality.html.

[4] I.R.C. § 2031 (2006).

[5] Treas. Reg. § 20.2031-1 (2012).

[6] Bald and Golden Eagle Protection Act, Pub. L. No. 87-884, 76 Stat. 1246 (1962). *See* discussion *infra* Part I.A.

[7] Cohen, *supra* note 1.

million in penalties.[8] While valuation disputes over works of art are commonplace in tax matters, the Sonnabend scenario is more than a routine valuation dispute. It shines a spotlight on the estate tax meaning of fair market value, forces recognition of *Canyon's* novel restricted ownership status, and raises concerns about the valuation process for works of art.

Part I will first examine how the Bald and Golden Eagle Protection Act, as a regulatory restriction, impacts the concept of ownership. This restricted ownership will then be viewed within the contours of Section 2033 of the Internal Revenue Code, the basic inclusion section for estate tax purposes.[9] Part II will delve into the fair market value standard for *Canyon*. The fallacy of the parties' extreme positions—the IRS's red herring of the illicit art market and the taxpayer's assertion of zero value—will be addressed. Part III will consider the *Canyon* controversy in the context of IRS protocols for art valuations, including the role of the Art Advisory Panel and Art Appraisal Services. Part IV will conclude with three recommendations. The first is that the relevant market for estate tax purposes should not include the illicit market absent a decedent's prior activities or intent to enter that market. Second, if works of art are subject to regulatory restrictions, those restrictions should be fully disclosed on the estate tax return, along with a positive statement indicating the extent of the decedent's ownership interest. Third, the protocols for IRS art valuations should be fully examined to ensure competency, objectivity, and transparency of process.

I. IMPACT OF THE BALD AND GOLDEN EAGLE PROTECTION ACT ON OWNERSHIP RIGHTS IN *CANYON*

A. *Bald and Golden Eagle Protection Act*

In 1940, the Bald Eagle Protection Act was passed to protect the bald eagle, the nation's symbol, from extinction.[10] This Act provided

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8 Kinsella, *supra* note 1. There is no official IRS statement regarding this controversy; consequently, all assertions of facts are as presented by the Estate. Interestingly, in a post to the Novack blog, Joseph Bothwell wrote "[t]his was an interesting problem. While not addressing it directly, let me point out a few issues." Joseph Bothwell, Comment to Novack, *supra* note 1. He then proceeds to mention Robson v. Commissioner (*see infra* note 88), United States v. Meador (*see infra* note 70), and the possibility of a later charitable deduction (discussed *infra* note 120). Joseph Bothwell was the chair of the IRS Art Advisory Panel during the relevant time and is now retired from the IRS. I assume that the Joseph Bothwell who posted the comment is the same person as the former IRS employee.

9 I.R.C. § 2033 (2006).

10 Bald Eagle Protection Act, ch. 278, 54 Stat. 250 (1940); see Roberto Iraola, *The Bald and Golden Eagle Protection Act*, 68 ALB. L. REV. 973 (2005) for a thorough discussion of the Act. There are other related federal statutes that may also be of concern. *See, e.g.*, the Migratory Bird Treaty Act, 16 U.S.C. § 703 (2006). At one time the bald eagle was protected under the Endangered Species Act, 16 U.S.C. §§ 1531–43, but it has since been delisted. *See* Removing the Bald Eagle in the Lower 48 States from the List of Endangered and Threatened Wildlife, 72 Fed.

for a maximum criminal penalty of $500, six months imprisonment, or both for anyone who shall "take, possess, sell, purchase, barter, offer to sell, purchase or barter, transport, export or import . . . any bald eagle . . . alive or dead, or any part, nest or egg thereof".[11] There was a limited exemption for bald eagles taken before enactment: "nothing herein shall be construed to prohibit possession or transportation of any such eagle . . . lawfully taken prior to the effective date of this Act [June 8, 1940] . . . ."[12]

The Act has been amended three times since 1962. First, in 1962, the Act was amended to provide protection for golden eagles, with the Act becoming popularly known as the Bald and Golden Eagle Protection Act (BGEPA).[13] Ten years later, BGEPA was further amended, in four primary ways.[14] First, the mens rea necessary for the criminal offense was amended from "willfully" to "knowingly, or with wanton disregard for the consequences" of the act.[15] Second, the criminal penalties were increased to $5,000 and one year imprisonment, with an increase to $10,000 and two years imprisonment for a repeat offender.[16] These amounts were increased significantly by the Criminal Fines and Improvement Act of 1987 ($100,000 and $250,000 for an individual with a misdemeanor and a felony conviction, respectively, and $200,000 and $500,000, respectively, for an organization).[17] Third, a new civil penalty of $5,000 was added for those who, without authority, do any of the above described acts or who violate any permit or regulation.[18] Fourth, the taking, possession or transporting of golden

Reg. 37346 (July 9, 2007). "The ESA provides the broadest protection for eagles and their habitat of any conservation law. The ESA provides a federal agency consultation requirement, habitat protections, and a citizen suit provision that neither BGEPA nor the MBTA contain. Because delisting takes these important protections away, . . . BGEPA and the MBTA will be even more important to the survival of bald eagles . . . ." Amie Jamieson, *Will Bald Eagles Remain Compelling Enough to Validate the Bald and Golden Eagle Protection Act After ESA Delisting? The Ninth Circuit's Analysis in United States v. Antoine*, 34 ENVTL. L. 929, 941 (2004). For purposes of this essay, only the Bald and Golden Eagle Protection Act will be considered.

[11] 54 Stat. 250. The term "take" was defined to include "pursue, shoot, shoot at, wound, kill, capture, trap, collect, or otherwise willfully molest or disturb." *Id.*

[12] *Id*. There was also an exception for "the Territory of Alaska." *Id*.

[13] Bald and Golden Eagle Protection Act, Pub. L. No. 87-884, 76 Stat. 1246 (1962) [hereinafter BGEPA]. The 1962 amendment also provided an exception for the taking of golden eagles to protect livestock and provided the Secretary of the Interior the regulatory power to exempt takings "for the religious purposes of Indian tribes." *Id*. There has been a robust discussion about BGEPA's impact on the First Amendment rights of members of Indian tribes. *See* Iraola, *supra* note 10, at 977–84 for general case discussion.

[14] Act of Oct. 23, 1972, Pub. L. No. 92-535, 86 Stat. 1064; *see generally* Iraola, *supra* note 10, at 975–77.

[15] The change was intended "to lessen the degree of knowledge required to be proven in order to convict violators." S. REP. NO. 92-1159, at 5 (1972), *reprinted in* 1972 U.S.C.C.A.N. 4285, 4289.

[16] BGEPA, *supra* note 13.

[17] 18 U.S.C. § 3571 (b)-(c) (2006).

[18] *See* 86 Stat. 1064.

eagles for falconry in certain areas was permitted.[19] Finally in 1978, BGEPA was amended to authorize "the taking of golden eagle nests which interfere with resource development or recovery operations."[20]

The legislative equivocation on golden eagles stands in sharp contrast to the clear and steady message of protection for bald eagles found in BGEPA and its amendments. That legislative message, however, was not effectively communicated to the population at large.

B. *Rauschenberg's Creation, and Sonnabend's Acquisition, of Canyon*

Canyon is one of Rauschenberg's most famous works[21] and was created by him in 1959, clearly after the 1940 passage of the Bald Eagle Protection Act. According to a statement signed by Rauschenberg in 1998 for the Fish and Wildlife Service (FWS), the bald eagle was acquired from the wild and taxidermied prior to 1940.[22] Rauschenberg acquired the eagle in 1959 from a fellow artist, who herself retrieved it from the trash of a recently-deceased elderly neighbor. As a found object, this bald eagle fit within Rauschenberg's artistic vision of the time, and as a pre-1940 bald eagle, Rauschenberg's acquisition was most likely not in violation of BGEPA.[23] Nor did his use of the bald eagle in his art present a legal issue for him. The subsequent transfer of *Canyon* to Ileana Sonnabend in 1959 may have been a different matter.

While news accounts differ as to how and from whom Sonnabend acquired *Canyon* in 1959,[24] the dividing line between a violation of BGEPA and its exception for pre-1940 bald eagles is the nature of the acquisition. If it was a commercial transaction—a sale, for example, that would be a violation of BGEPA—but a gift, on the other hand, would not. Of all the acts prohibited by BGEPA, there was a narrow exception for the possession or transporting of pre-enactment bald eagles or their parts.[25] In *Andrus v. Allard*,[26] the Supreme Court held

[19] 16 U.S.C. § 668(a) (2006).
[20] Fish and Wildlife Improvement Act of 1978, Pub. L. No. 95-616, §9, 92 Stat. 3114.
[21] *See, e.g.*, Kinsella, *supra* note 1 ("The dispute centers on Robert Rauschenberg's seminal 1959 'combine' work *Canyon* . . . .); *see also* Tomkins, *supra* note 2 ("I can't think of an image that has more power than 'Canyon,' Jeff Koons, an artist who freely acknowledges his debt to Rauschenberg, said recently.").
[22] *See* Kinsella, *supra* note 1 ("[H]e recounted that an artist Sari Dienes lived in the building above Carnegie Hall . . . during the 1950s. Among the other tenants was a member of Teddy Roosevelt's Rough Riders. . . . The man, who was not named, 'acquired from the wild, a bald eagle, which he had taxidermied prior to 1940,' the statement said. After the man died in 1959, Dienes retrieved the eagle from the trash and offered it to Rauschenberg.").
[23] I equivocate here for two reasons. First I am assuming that Rauschenberg received the bald eagle gratuitously from his fellow artist. See discussion *infra* Part I.D. Second, I am also assuming that the retrieval of a pre-1940 bald eagle from the trash is not a taking. *See* Bald Eagle Protection Act, *supra* note 10.
[24] Some reports say Sonnabend "bought 'Canyon' . . . from Castelli." Novack, *supra* note 1. Others say she acquired it "from a show at the gallery of her former husband, Leo Castelli." Kinsella, *supra* note 1.
[25] 16 U.S.C. § 668(a) (2006); *see supra* notes 10–12 and accompanying text.
[26] 444 U.S. 51 (1979); *see* discussion *infra* Part I.D.

that Congress intended to prohibit all commercial activities involving bald eagles, regardless of whether those eagles were taken pre- or post-enactment. Consequently, if Sonnabend bought the work from Rauschenberg or from her former husband's gallery, it would have been a sale in violation of BGEPA. Conversely, if *Canyon* was a gift to Sonnabend directly from the artist Rauschenberg, all would be well.[27]

C. *Sonnabend's Ownership and Use of Canyon*

Canyon was reportedly part of Sonnabend's personal art collection, and she rarely parted with the works she chose for herself.[28] Consequently, a sale of *Canyon* by Sonnabend was unlikely. She did, however, regularly lend her personal works to museums and for exhibitions here and abroad. It was as a result of the 1981 return of *Canyon* from a European exhibition tour that federal FWS agents first became aware of the combine *Canyon*.[29] In turn, FWS notified Sonnabend of the restrictions imposed on the work by BGEPA. A special permit was applied for, and later issued to, Sonnabend that allowed her to retain possession of the work.[30] It was noted that the work could not be sold here or abroad, its whereabouts had to be made known to the authorities, and if the work were to travel abroad for an exhibit, Sonnabend would need to apply for a special export permit.[31] With this issue seemingly resolved, *Canyon* was lent to the Baltimore Museum of Art from 1982 until 2003, although *Canyon* would sometimes be lent to other museums or exhibitions in accordance with the outlined procedures. In preparing for one such foreign loan in 1998, a request for the special export permit was denied because of a new belief that the 1981 permit had been erroneously issued.[32] More importantly, the FWS was considering revoking the 1981 permit.[33] It

27 Another possibility is two successive gift transfers, i.e., Rauschenberg gave *Canyon* to Castelli, who then subsequently gave it to Sonnabend. As a practical matter, the 1959 transfers were presumably not done "willfully" as then required for a violation. *See supra* text accompanying notes 15–16.

28 Novack, *supra* note 1.

29 Kinsella, *supra* note 1.

30 Pursuant to BGEPA § 668a, one may apply for a permit to allow the "taking, possession, and transportation" of eagles for "scientific or exhibition purposes of public museums . . . or for the religious purposes of Indian tribes." According to regulations issued by the Secretary of the Interior, "we may . . . issue a permit authorizing the taking, possession, and transportation [domestically or foreign] of lawfully acquired bald eagles." 50 C.F.R. §22.21 (2012). *Compare* BGEPA's exception on pre-1940 taken eagles ("that nothing herein shall be construed to prohibit" the possession and transportation of pre-enactment eagles) *with* the regulations requiring a permit for possession of lawfully possessed eagles, which seems limited to the purpose of exhibition. *See infra* text accompanying notes 47–54 regarding the Supreme Court's interpretation of the property rights of an owner of a pre-enactment eagle.

31 *See* 50 C.F.R. §22.21 (2012). The application for foreign travel would also need to comply with the Convention on International Trade in Endangered Species of Wild Fauna and Flora. *See* 50 C.F.R. §23 (2012).

32 Kinsella, *supra* note 1.

33 *Id*. Under BGEPA, a violation can result in forfeiture of the eagle to the United States. 16 U.S.C. § 668b(b) (2006). Forfeiture raises many interesting and quite practical questions. An

was the submission of Rauschenberg's written statement that the bald eagle had been taken before 1940 that allowed Sonnabend to retain *Canyon*'s ownership, albeit as restricted by BGEPA.[34] Since the time of her death in 2007, no serious question has apparently been raised as to Sonnabend's ownership of *Canyon*; the questions have focused on its valuation for estate tax purposes.

D. *Canyon's Inclusion in Sonnabend's Gross Estate*

Section 2033 of the Internal Revenue Code is the basic inclusion section for the federal estate tax.[35] It provides that "[t]he value of the gross estate shall include the value of all property *to the extent of the interest therein of the decedent* at the time of his death."[36] The language of this section is decidedly general, and there is no doubt that Sonnabend's ownership of *Canyon*, however restricted, is a section 2033 interest requiring inclusion. Yet the language commands that value is "to the extent of the interest," underscoring that property can have multiple interests, not all of which are held by the decedent, and that value can thereby be affected.[37] What is Sonnabend's interest in *Canyon* for purposes of the federal estate tax? To answer that question, one must first address another question. What ownership interest or interests in *Canyon* did Sonnabend have or retain at the time of her death because of BGEPA?

With its listing of prohibited acts and its exception for the "possession or transportation" of pre-1940 bald eagles or parts, BGEPA is the starting point in determining the ownership restrictions placed on *Canyon*.[38] The protective thrust of BGEPA for bald eagles is clear, but

initial question is whether only the bald eagle would be forfeited or whether *Canyon* would be forfeited. The removal of the eagle from *Canyon* would destroy Rauschenberg's artistic work and could raise serious intellectual property and copyright questions. The safer route is to forfeit *Canyon*, but what would the U.S. do with it?

The normal procedure for dead eagles in the government's possession is to place the eagle in the National Eagle Repository, the FWS's collection point in Denver for dead eagles. After its condition is noted, "[t]he bird is then stored in a freezer until it is ready to be shipped" to a member of an Indian tribe who has made an application for an eagle for "religious purposes." U.S. FISH & WILDLIFE SERVICE, *How Can I Obtain Eagle Feathers or Parts?*, http://www.fws.gov/news/featherfaq.html (last visited Sept. 30, 2012). There is a backlog of such requests. *See* U.S. FISH & WILDLIFE SERVICE, *National Eagle Repository*, http://www.fws.gov/le/national-eagle-repository.html (last updated Aug. 15, 2012). This process seems inappropriate and assumedly unlikely for *Canyon*. Rauschenberg's work would probably be placed in a museum, as it is now. The question may be who gets to control *Canyon's* museum location. See *infra* text accompanying notes 124–25. There is another aspect that deserves mention: it is a reality of the political process. *Canyon* is currently subject to BGEPA, but laws can be changed, or special legislation could be enacted exempting *Canyon*. The publicity surrounding *Canyon* may be the impetus to free *Canyon* from BGEPA in the future. *See* discussion *infra* Part II.B. of the impact this possibility could have on value.

34 Kinsella, *supra* note 1.

35 I.R.C. § 2033 (2006).

36 *Id*. (emphasis added).

37 I.R.C. § 2033 (2006).

38 *See supra* notes 10–21 and accompanying text.

interpretive questions have been raised as to the scope of the exception for pre-enactment bald eagles. In 1979, the Supreme Court upheld an expansive interpretation of BGEPA's commercial ban in *Andrus v. Allard*.[39]

Allard, an enrolled member of the Confederated Salish and Kootenai Tribes, and others had been engaged for a period of time in the trade of Native American artifacts.[40] Many of the items they sold were partially composed of eagle parts that were from pre-enactment eagles.[41] When they were convicted and fined for those sales, they challenged the validity of the regulations issued by the Secretary of the Interior that banned commerce in all eagle parts, regardless of when the eagle had been taken.[42] Allard also alleged that if the regulations were deemed valid, they were a violation of the Fifth Amendment takings clause.[43] The three-judge District Court agreed with the plaintiffs.[44] On appeal to the Supreme Court, the decision was reversed on both claims.[45]

First, the Court upheld the regulations banning all commerce in eagle parts as being fully consistent with the statutory language.[46] The statutory listing of prohibitions was characterized as "sweepingly framed" and as an "exhaustive and careful enumeration," while the exception for the possession or transporting of pre-enactment eagle parts was "narrow."[47] This precision in language was deemed intentional and fully consistent with the legislative history. Moreover, the ban on all commerce in eagle parts was "fully consonant with the purposes" of BGEPA.[48] Because of the difficulty in determining the age of eagle feathers, Congress could impose a total ban on commerce rather than risk evasion (and consequent loss of protection) through an exception for pre-enactment eagle parts.

Second, and more directly related to *Canyon*, the Court declined to hold this regulatory ban on commerce, which it described as a "simple prohibition" of sale,[49] as a taking requiring just compensation under the Fifth Amendment.

> The regulations challenged here do not compel the surrender of the artifacts, and there is no physical invasion or restraint upon them. Rather, a significant restriction has been imposed on one means of

[39] *Andrus*, 444 U.S. 51 (1979).
[40] *Id.* at 54.
[41] *Id.*
[42] *Id.* at 54–55.
[43] *Id.*
[44] *Id.*
[45] *Id.* at 68.
[46] *Id.* at 60–64.
[47] *Id*. at 56.
[48] *Id*. at 58.
[49] *Id*. at 67.

> disposing of the artifacts. But the denial of one traditional property right does not always amount to a taking. At least where an owner possesses a full "bundle" of property rights, the destruction of one "strand" of the bundle is not a taking, because the aggregate must be viewed in its entirety. In this case, it is crucial that appellees retain the rights to possess and transport their property, and to donate or devise the protected birds.[50]

This last sentence is important for three reasons. First, it informs us of four rights—possess, transport, donate, and devise—that an owner of a pre-enactment eagle retains. Second, in doing so, it emphasizes that rights or interests in property is a concept much larger than the statutory and regulatory listing of prohibitions and exceptions. Owning property gives the owner certain rights that have developed over centuries, even though the parameters of those rights defy precision, precisely because property and rights in property evolve over time.[51] Third, the Court confirms for the defendants that the eagle parts remain "their property," and labels the retention of these four rights as "crucial" to its determination that there was no taking for Fifth Amendment purposes.

The Supreme Court's use of the bundle of rights metaphor to analyze the takings issue is instructive.[52] Under the general bundle of rights approach, owning property includes the right to exclusive use, the right to income, the right to transfer in whole or in part during lifetime, and the right to transfer at death.[53] Set within this analytical framework, the Court viewed the regulatory ban on commerce as a "significant restriction . . . on one means of disposing of" property.[54] The Court followed up by noting that, even though the ban forecloses the "most profitable use" of the property, "it [was] not clear that appellees [would] be unable to derive economic benefit from the artifacts; for example, they might exhibit the artifacts for an admissions charge."[55] The rights to income and to transfer during lifetime are compromised by the ban

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50 *Id.* at 65–66 (citations omitted).

51 *See* Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163 (1999). "Where does this leave Andrus? Three Justices concurred in Hodel solely to say Andrus is still good law and to limit Hodel to its facts; another three Justices concurred solely to state the opposite and limit Andrus to its facts. There the matter lies." *Id.* at 1216 (footnotes omitted).

52 *But see* Garrett Power, *Regulatory Takings: A Chronicle of the Construction of a Constitutional Concept*, 23 BYU J. PUB. L. 221, 239 (2009) ("use of [this] metaphor proved more obfuscatory than explanatory.").

53 *Id*. at 239.

54 *Andrus*, 444 U.S. at 65.

55 *Id.* at 66. The Court did not explain why it minimized the right to income. *See* Power, *supra* note 52, at 241. While the Court's statement about charging admission to view the artifacts sounds a bit off, it may not be completely off the mark in the context of *Canyon*. For example, if the copyright is also part of *Canyon*'s ownership, licensing *Canyon*'s image could provide an income interest. Similarly, loans of art works to a museum are not necessarily wholly gratuitous. It is reported that the Metropolitan Museum of Art in New York currently provides insurance coverage—of an undisclosed amount—for *Canyon*. Cohen, *supra* note 1.

but are not wholly destroyed or taken. Consequently, there is no taking for Fifth Amendment purposes. The right to exclusive use and the right to transfer at death appear to be unaffected by BGEPA's "simple prohibition of sale."[56]

Andrus has generated withering criticism in the takings literature,[57] and has been unsuccessfully challenged in court as being inconsistent with more modern theories on takings.[58] Nevertheless, as the only Supreme Court case to address the retained property rights of an owner of a pre-enactment eagle, it is an important case to understand "the extent of the interest" for estate tax purposes.

II. FAIR MARKET VALUE OF *CANYON* FOR ESTATE TAX PURPOSES

Inclusion of an asset in the gross estate is the first step in determining a decedent's federal estate tax liability; valuing the asset is the necessary second step. The valuation standard for estate tax purposes is fair market value, 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 to sell and both having reasonable knowledge of relevant facts."[59] Fair market value as the valuation standard is nearly as old as the estate tax.[60] The Sonnabend scenario raises basic questions about fair market value, including determining the relevant market in which to value.

The relevant market is the one in which the item "is most commonly sold to the public, taking into account the location of the

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[56] Regulations concerning permits for Indian religious purposes confirm inheritability or descendability, stating that eagles possessed under those permits "are not transferable, except such birds . . . may be handed down from generation to generation or from one Indian to another in accordance with tribal or religious customs." 50 C.F.R. § 22.22(b)(1) (2012). The division of a decedent's tangible personal property among a decedent's beneficiaries can sometimes look like a bartering transaction, as, for example, when the decedent's children divide the tangible personal property among themselves in shares of substantially equal value. Presumably, this normal estate administration process would not be considered a "purchase, barter, offer to sell, purchase or barter" under BGEPA. See *infra* text accompanying note 125 for a concern regarding right to exclusive use and possession.

[57] *See, e.g.*, James Gordley, *Takings*, 82 TUL. L. REV. 1505, 1509 (2008) ("In Andrus v. Allard, the Court upheld environmental regulations intended to prevent the killing of eagles by prohibiting the sale of artifacts made with eagle parts. The majority claimed that collectors of Native American artifacts containing eagle feathers had not lost all economic value of their property because, conceivably, they could exhibit it to the public and charge a fee. That argument borders on the mendacious.").

Professor Power labels *Andrus* as "problematic" and "some would say—unprincipled and unfair." Power, *supra* note 52, at 240.

[58] In United States v. Kornwolf, 276 F.3d 1014 (8th Cir. 2002), the defendant sold an inherited eagle headdress to an undercover agent. The defendant argued that recent takings cases demonstrated "a greater solicitude to the burdens placed on property owners by governmental regulations and less willingness to assume a justifying nexus between those burdens and public purpose." *Id.* The Eighth Circuit held that *Andrus* was controlling and the court declined to overturn a Supreme Court case directly on point. *Id.*

[59] 16 C.F.R. § 20.2031-1(b) (2012).

[60] United States v. Cartwright, 411 U.S. 549, 551–52 (1973).

item wherever appropriate." [61] The determination of the relevant market is a question of fact. For some assets, the relevant market may be a hypothetical market.[62] Tax valuation cases consider the auction market and the dealer-gallery market as the primary choices for art valuations and, within that binary system, there are nuances. For example, is the gallery market the high end, tourist, or museum gift shop? Foreign or domestic?[63] For original unique works by known established artists, the auction market is commonly used in valuation controversies in large measure because of the availability of public sales records. Dealers have no obligation to release actual sales prices from private sales, and, to the contrary, may have contractual confidentiality agreements.[64]

It is clear that with *Canyon*, the parties have taken extreme positions on value,[65] neither of which is fully supportable under tax law or policy. Those extreme positions may be based on different understandings of the relevant market. The Service's extreme position may be based upon valuing in an illicit market, while the estate's extreme position may rest upon rejecting the use of a hypothetical market.

A. *Fallacy of the Illicit Market*

Reports suggest that the IRS may have based its $65 million value on a sale in the discreet or illicit market.[66] Despite some Treasury and

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[61] § 20.2031-1(b).

[62] *See* discussion *infra* Parts II.A, II.B; *see, e.g.*, Bank of Cal. v. Comm'r, 133 F.2d 428 (9th Cir. 1943) (holding that a claim for an income tax refund, which is a non-assignable chose in action, had value even though it could not be sold). The court noted that the forerunner of § 2033 includes "all" property, making no distinction between assignable and non-assignable property. *Id.* at 433. "It is idle, therefore, to say that nonassignable property could not have any fair market value." *Id*.

[63] *See, e.g.*, Perdue v. Comm'r, 62 T.C.M. (CCH) 845 (1991), which determined that for certain coins recovered from a Spanish galleon sunk in 1622, the "glamour market" was more appropriate than the numismatic market. *Id.* This was due to the romance factor of the shipwreck.

[64] *See* 1 RALPH E. LERNER & JUDITH BRESLER, ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS 237 (3d ed. 2005), for a contractual confidentiality provision in a private sales agreement. For a discussion on why confidential agreements appeal to buyers and sellers, see ANNE-MARIE RHODES, ART LAW & TRANSACTIONS 28 (2011).

[65] This is not an uncommon tactic for taxpayers or the IRS, as many judicial decisions seem to split the difference. For example, in Estate of David Smith v. Comm'r, 57 T.C. 650 (1972), the fair market value of 425 sculptures created by the decedent were at issue. At one point, the Estate argued these works were valued at zero because they remained unsold at his death, and the IRS argued they were valued at $5,256,918. *Id.* at 655. The parties had adjusted the values for litigation—$714,000 for the taxpayer, and $4,284,000 for the I.R.S. *Id.* The court's "ultimate determination of value will necessarily constitute a 'Solomon-like pronouncement'", and it was. *Id*. At $2,700,000, it was virtually midway between the two extreme positions. 3 LERNER, *supra*, note 64 at 1749.

As one commentator puts it: "It is not at all unusual for parties in a valuation case to do the "valuation dance": where the "positions begin at substantial distances from one another, and then . . . get closer as the case ages on its way to trial." L. PAUL HOOD, VALUATION: GENERAL AND REAL ESTATE 830 (2nd T.M. (BNA) A-2 (2003)).

[66] Kinsella, *supra* note 1 ("Lerner [the Estate's attorney] says when he talked to . . . the interim head of the [IRS] Art Advisory Panel, 'he told me there could be a market for the work . . . . [A]

case law precedent, there are policy reasons why using the illicit market in this case should be rejected.[67]

In Technical Advice Memoranda (TAM) 9152005,[68] the Service addressed the estate tax consequences of stolen property held by a decedent for the first time. It determined that stolen art treasures were to be included in the thief's estate and were to be valued in an illicit market. According to the TAM, that market "includes the discreet retail markets of the international network of traffickers in stolen art as well as the legitimate retail art markets consisting of international auction firms . . . and legitimate art and antiques dealers."[69] This TAM is generally considered to involve the estate of Joseph T. Meador, a World War II veteran from Texas who stole works of art and cultural property, most notably the medieval treasures from Quedlinburg, Germany.[70] He died in 1980, leaving his estate to his brother and sister.[71] His estate filed a Texas inheritance tax return that did not include the stolen works.[72] After a few years, his brother and sister had the stolen objects appraised.[73] In 1986, the siblings were told by an appraiser that the medieval manuscript they had offered for appraisal was stolen.[74] Nevertheless, they moved the manuscripts to Switzerland and continued to offer them for sale.[75] In 1990, one was sold in Switzerland for $3 million.[76] By this time, Quedlinburg was able to trace the sale back to Meador's estate in Texas and commenced legal action for recovery of its treasure.[77] Consequently, a decade after Meador's death, the IRS became involved in his estate. At several places, the TAM noted that the decedent had apparently sold works in this discreet market during his lifetime,[78] and following his death, his siblings also entered that

recluse billionaire in China might want to buy it and hide it.").

67 For a thorough and critical analysis of the two TAMs discussed here, *see* William J. Turnier, *The Pink Panther Meets the Grim Reaper: Estate Taxation of the Fruits of Crime*, 72 N.C. L. REV. 163 (1993).

68 I.R.S. Tech. Adv. Mem. 91-52-005 (Dec. 27, 1991).

69 *Id*.

70 *See* Turnier, *supra* note 67, at 165–69; *see also* United States v. Meador, 138 F.3d 986 (5th Cir. 1998); WILLIAM H. HONAN, TREASURE HUNT: A NEW YORK TIMES REPORTER TRACKS THE QUEDLINBURG HOARD (1997).

71 I.R.S. Tech. Adv. Mem. 91-52-005 (Dec. 27, 1991).

72 *Id.*

73 *Id.*

74 *Id.*

75 *Id.*

76 *Id.*

77 *Id.*

78 Since the time of Meador's death in 1980, international cooperation in identifying stolen or looted art and cultural property has become the ethical norm of the art industry. *See, e.g.*, Convention on Cultural Property Implementation Act, 19 U.S.C. §§ 2601–2613 (2006). For example, in the well-known case of Autocephalous Greek-Orthodox Church of Cyprus v. Goldberg & Feldman Fine Arts, Inc., 917 F.2d 278 (7th Cir. 1990), an American dealer offered fourth century Byzantine mosaics to the Getty Museum in 1988. These mosaics had apparently been taken from a Greek-Orthodox church in Cyprus when the area was under the control of a Turkish invasionary force. The Getty "explained to the dealers that [the Getty] had a working relationship with the Republic of Cyprus and that [the Getty] was duty-bound to contact Cypriot

market.

Shortly after this TAM on stolen property, the IRS issued a TAM concerning the estate taxation of illegal drugs. In TAM 9207004,[79] the decedent was a drug smuggler who died while attempting to land his plane that was fully loaded with marijuana.[80] Once at the crash site, the police confiscated the 662.5 pounds of baled marijuana, which was later destroyed.[81] The IRS determined that the forfeited baled marijuana should be included in the decedent's estate and its value should be the "retail street value" of average grade marijuana sold in the Florida city near the crash site.[82]

Like many tax valuation disputes, neither of these two TAM estates went to a judicial determination of value, and thus, the TAMs are internal IRS interpretations untested by the judicial process. The cases cited in the TAMs as support for using an illicit market for valuation were income tax cases, not estate tax cases. Most significantly, these TAMs involved decedents who had knowingly and voluntarily entered into an illicit market and who regularly sold there. These two elements of voluntariness and regularity provided the contextual support for using the illicit market for stolen art or illegal drugs. Without those elements, however, the use of an illicit market for legally owned, but restricted property violates judicially-voiced norms of common sense and reasonableness.

In *United States v. Cartwright*,[83] the Supreme Court struck a Treasury Regulation mandating the use of the public offering market for shares in a mutual fund for estate tax purposes. The Court called the regulation "unrealistic and unreasonable,"[84] while noting the taxpayer's "argument has the clear ring of common sense."[85] The central difficulty in the fair market value determination for *Cartwright* was that the "shares once issued are not subject to disposition in a market of 'willing buyers' and 'willing sellers.'"[86] The Court invalidated the regulation, noting that even if the regulation was not "technically inconsistent with § 2031 . . . , it is manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act created and regulates. Congress surely could not have intended § 2031 to be

officials about" the mosaics. *Id.* at 283. That contact led the Church to the defendant, from whom it successfully recovered its looted treasure. *Id.* at 294.

79 I.R.S. Tech. Adv. Mem. 92-07-004 (Feb. 14, 1992).

80 *Id.*

81 *Id.*

82 *Id.*

83 411 U.S. 546 (1973).

84 *Id.* at 550.

85 *Id.* at 551.

86 *Id.* at 559 (Stewart, J., dissenting). Under the Investment Company Act of 1940, the only buyer for the mutual fund shares "once issued" was the issuing company itself.

interpreted in such a manner."[87] Likewise, it is hard to imagine that Congress intended an interpretation of fair market value for estate tax purposes that requires an honest taxpayer to use an illicit market, when by enacting BGEPA, Congress allowed for the continued possession of pre-enactment bald eagles but prohibited all sales. It is one thing to imagine a hypothetical market and another to require a hypothetical illicit market. And yet, when faced with an honest taxpayer and a for-him illicit market, one court seemed to force the taxpayer's use of the market.

In *Robson v. Commissioner*, the Tax Court had to determine the fair market value of various wild game animal trophy mounts for charitable deduction purposes.[88] Taxpayers were accomplished hunters, who made hunting trips to various locations around the world. They displayed their trophy mounts in their California homes, and from 1990 to 1993, they donated several of these mounts to charitable organizations, for which they claimed charitable deductions on their income tax returns.[89] Under California state law at the time, it was illegal to sell these mounts.[90] The taxpayers consequently argued that because they as California residents could not legally sell in California or in another state,[91] the proper method of valuation was replacement cost,[92] not evidence of value through comparable sales. The court noted replacement cost is generally used where "the property is unique, the market is limited, and there is no evidence of comparable sales."[93] That was not the case here. The court found that while it was illegal to sell in California, neighboring Western states had "relatively few sales restrictions."[94] Because "an active market exists throughout the United States for substantially comparable items,"[95] as a practical matter, the California restrictions did not "materially affect the value"[96] of the donated items. In essence, California's prohibition on sales was an irrelevancy for the legitimate national market.

On appeal, the Ninth Circuit affirmed noting the fair market value test is objective, and there is no requirement that "taxpayers themselves actually be able to sell the" property.[97] Citing precedent, the court observed that under the fair market value test, one is "to assume the existence of a willing buyer and a willing seller, regardless of whether

87 *Id*. at 557.
88 Robson v. C.I.R., 73 T.C.M. (CCH) 2574 (1997), *aff'd*, 172 F.3d 876, at 1 (9th Cir. 1999).
89 *Id.* at 1.
90 *Id.*
91 *Id.* at 2.
92 Replacement cost here is essentially the taxpayers' cost to travel on their hunting trips plus their taxidermy costs.
93 *Supra* note 88, at 3 (quoting Estate of Palmer v. Comm'r, 839 F.2d 420, 424 (8th Cir. 1988)).
94 *Id.* at 1.
95 *Id.* at 3.
96 *Id.*
97 Robson v. Comm'r, 172 F. 3d 876, at 1 (9th Cir. 1999).

they actually existed or not, and to assume that the property could and would change hands, even though such a change could not in fact occur."[98] *Robson* confirms the hypothetical nature of the willing buyer – willing seller test, and concludes that the use of comparables from the "active market . . . throughout the United States" was appropriate in the context of the charitable deduction.[99]

There are three aspects of *Robson* that distinguish it from *Canyon*. First, the issue in *Robson* was the method of valuation (replacement cost or comparable sales) and not the relevant market. Second, to the extent that a market was implicated in the choice of method, the market for comparables used by the court was an "active market . . . throughout the United States." That market was by and large a legitimate one; and in the actual California market, there was no impact on price because of California's sales prohibition. It was an irrelevancy. Third, in choosing a national market for comparables, the court may have been "taking into account the location of the item."[100] That national market was an open market for a United States resident, with no state border controls.[101] In *Robson*, animal mounts were legally saleable in that national market, just not by Californians. It is the status of the seller, a California resident, that determined the legality of the transaction. By contrast, *Canyon* cannot be bought or sold legally anywhere in the United States by anyone, and it cannot leave this country or be exported for sale. In this context, "taking into account" *Canyon*'s location suggests either using a national art market that does not allow a sale or using an international art market that *Canyon* can not physically enter. Neither market is suitable.

Fair market value is the standard for estate tax valuation; as a standard, its application depends on the particular facts before it. Whenever facts are extreme, a blind or rigid application of the standard may harm the system more than support it.[102] As the Court noted in

[98] *Id*. at 1 (quoting Bank of California v. Comm'r, 133 F. 2d 428 (9th Cir. 1943). At issue in that case was the estate tax valuation of a claim for refund of income taxes).
[99] *Supra* note 95.
[100] Treas. Reg. § 20.2031-1(b) (2012).
[101] It is important to note that an interstate sale in violation of California law was itself a federal offense. *See Robson*, 73 T.C.M. at 2.
[102] *See, e.g.*, Alice G. Abreu & Richard K. Greenstein, *Defining Income*, 11 FLA. TAX REV. 295 (2011). Professors Abreu and Greenstein argue that in the context of the income tax, judicial and administrative deviations from the widely-accepted definition of income cannot be attributed to lawlessness or ignorance. Rather, they posit that "economics is not everything" and that non-economic values, such as administrability, including popular or social opinion, may provide an apt interpretation of the meaning of income. A recent example of an apt interpretation was the nontaxability of catching Mark McGwire's record setting homerun baseball. Most tax scholars and tax attorneys viewed the newly caught ball as an "undeniable accession[] to wealth, clearly realized, and over which the taxpayers have complete dominion", the standard set forth by the Supreme Court for income in Comm'r v. Glenshaw Glass, 348 U.S. 426, 431 (1955). The IRS Commissioner at the relevant time was Charles Rossotti, a businessman, not a tax specialist. When first asked about the tax implications, an IRS spokesperson said it would be taxed; "a firestorm of controversy erupted." Abreu & Greenstein, *supra*. Rossotti said the fan "deserves a

Cartwright, the Treasury Regulation that ignored the Congressionally-created bifurcated market for mutual funds was unreasonable and unrealistic, in contrast to the common sense approach of the taxpayer. *Robson* is distinguishable because as a one-state-only prohibition against sale, there was nevertheless an active legitimate market for comparables in the United States. Robson was not forced into a completely illicit market. In the absence of a strong showing of voluntariness and regularity in the decedent's use of the illicit market, requiring an illicit market as the relevant market is inapt. Moreover, because no legal market exists anywhere in the United States for *Canyon*, forcing an honest taxpayer into a foreign market—that might be legal if the taxpayer could export the item—is unreasonable and similarly inapt when one takes "into account the location of the item." From a policy perspective, the better course is to value by using a hypothetical market that takes into account the four interests retained by Sonnabend.

B. *The Fallacy of Zero Value*

Because *Canyon* cannot legally be sold in the United States nor legally exported for sale outside the United States, the estate argues the legitimate art market—whether auction or dealer—values *Canyon* at zero. That is undoubtedly true and it has a clear and direct appeal. That argument, however, focuses solely on the sales prohibition, ignores the value of Sonnabend's four retained interests to possess, transport, donate, and devise, and similarly ignores the hypothetical nature of the willing buyer-willing seller test for fair market value.

The estate tax is a tax on the transfer of the decedent's property at death.[103] When a decedent's property is subject to a restriction, the traditional approach is to include the interest in the decedent's estate and then to value that interest taking into account the restriction.[104] Stock and real property are two types of property that commonly have restrictions that impact value for estate tax purposes. The IRS officially acknowledges those restrictions as a discount factor in valuation.[105]

round of applause, not a big tax bill" demonstrating that "real people work[] at the IRS." *Id*. at 342–43.

103 I.R.C. § 2001 (2006) ("A tax is hereby imposed on the transfer of the taxable estate of every decedent. . . . "). *See, e.g*., Estate of McClatchy v. Comm'r, 147 F.3d 1089, 1091 (9th Cir. 1998). "The federal estate tax is a tax on 'the transfer of the taxable estate of [the] decedent.' *Id.* at 1091.

104 *See, e.g*., Rev. Rul. 77-287, 1977-2 C.B. 319 (dealing with restricted securities).

105 *See, e.g*., I.R.S. Business Valuation Guidelines § 2.2.1 ("In developing a valuation conclusion, Valuators must . . . determine the scope of work necessary to identifying . . . Restrictions . . . that may influence value."). And, "the Valuator should separately consider . . . the effect of relevant contractual and legal restrictions." *Id*. at § 2.3.6.1.

Similarly for real estate, *see* I.R.S. Valuation Training for Appeals Officers Course Book, Training 6126-002 (Rev. 05-97), *Lesson 3, Real Estate* ("In a typical real estate valuation, the appraiser will consider general social, economic, governmental and environmental conditions and

Revenue Ruling 77-287 addressed the valuation of securities restricted from immediate resale under the federal securities law.[106] While eschewing any automatic discount formula for the sales restriction, the ruling states: "[t]he . . . elements of time . . . bear upon this discount; the longer the buyer . . . must wait to liquidate those shares, the greater the discount."[107] *McClatchy v. Commissioner* shows the importance of this type of sales restriction in an estate tax case.[108] The parties agreed that the value of the restricted stock was $12.337 a share, while the unrestricted stock was valued at $15.56 a share, an approximate 21% discount solely for the restriction of an immediate sale, not a total prohibition of sale.[109] On appeal, the IRS argued against any discount because the stock in the hands of the estate (as opposed to the decedent) was not actually subject to the sales restriction.[110] This was because of the fortuitous circumstance that McClatchy's executor, as it turned out, was not considered an affiliated party under the securities law.[111] The Ninth Circuit reversed the Tax Court and upheld the discount, noting that the decedent's death did not, in and of itself, extinguish the sales restriction.[112] It followed the convention that estate tax value does not depend on the identity of a particular recipient; instead, it is based on hypothetical buyers and hypothetical sellers.[113] The court applied the fair market value standard consistent with its objective and hypothetical nature.

The fair market value of real property for charitable deduction purposes was at issue in *Thornton v. Commissioner*.[114] Taxpayers paid $15,000 for a cemetery that was near the University of Nevada.[115] A year later, they donated the land to the University, claiming a $503,000 charitable deduction on the theory that the highest and best use of the land was as a multi-unit residential property, such as married student

trends, as they affect property values."). Examples of governmental restrictions include "zoning laws, . . . deed restrictions," and environmental concerns. "An extremely important factor to consider in 'today's world' is the impact on value of any pertinent environmental features . . . that can . . . substantially impact the [fair market value] of properties affected by them" *Id.* The Endangered Species Act is a critical environmental issue which "has, in some areas, severely restricted use of certain properties." *Id.* Moreover, the lists of restrictions is not exclusive: "In other words, anything that affects the value of the property being appraised . . . should be considered." *Id.*

106 Rev. Rul. 77-287, 1977-2 C.B. 319.

107 *Id.*

108 Estate of McClatchy v. Comm'r, 106 T.C. 206 (1996), *rev'd*, 147 F.3d 1089 (9th Cir. 1998).

109 *Id.* at 208.

110 McClatchy v. Comm'r, 147 F.3d 1089, 1091–92 (9th Cir. 1998).

111 *Id.*

112 *Id.* at 1093.

113 *Id*. at 1094. *See also* Estate of Bright v. United States, 658 F.2d 999 (5th Cir. 1981) (en banc) (the Fifth Circuit firmly rejected the IRS's attempt to incorporate a "family attribution" approach to valuing assets in a decedent's estate, reasoning that it would be against the hypothetical nature of the buyer and seller).

114 Thornton v. Comm'r, 56 T.C.M. (CCH) 395 (1988), *aff'd,* 908 F.2d 977 (9th Cir. 1990).

115 *Id.* at 400.

housing.[116] One factual problem was the existence of significant legal hurdles to get the necessary state and local permissions to develop the property from a cemetery into multi-unit housing. In theory, the court agreed with the taxpayers' approach:

> We agree with petitioners that in determining the value of property on a given date a potential highest and best use for the property can be considered even though the potential use is prohibited on the valuation date by some restriction in a deed, statute or zoning regulation. We also agree that in such a case the proper approach is to value the property at its highest and best use . . . then to proceed to reduce or discount such value by a reasonable estimate of the cost of removing the restriction and for the time needed to accomplish such removal. However, the projected highest and best use must have a strong possibility of achievement. In other words, it should not be remote, speculative or conjectural.[117]

In considering all the facts, however, the court found that, at the time of the donation, the potential highest and best use of the cemetery land as housing was "too remote, too speculative and too conjectural" to allow that potential use to determine value.[118]

What do these principles suggest for the valuation of *Canyon*? First, that *Canyon* cannot be sold does not mean it has zero value for estate tax purposes. Second, the restriction on its sale must be considered in valuing the property for estate tax purposes. Third, the valuation approach should value *Canyon* without the restrictions imposed by BGEPA and should then proceed to consider a discount to that value because of those regulatory restrictions.[119] It is that last step, of course, that bears the weight of the conflict. It is at this point that a hypothetical market comes into play. What is the market value of being *Canyon*'s owner if the only ownership rights are to possess, transport, devise or donate in the United States? Faced with this less-than-robust ownership, a hypothetical willing buyer and willing seller might consider the possibility of two future-oriented actions: lobbying to overturn BGEPA (or more narrowly its application to *Canyon*) or a donation to charity. If the possibility of moving a cemetery was to be ignored, then certainly the possibility of changing a federal law that protects the nation's symbolic bald eagle is equally "remote, speculative or conjectural." The possibility of a charitable donation is a different matter. Donating a work of art to an art museum can qualify for a

[116] *Id.* at 402 (citations omitted).
[117] *Id*. at 404.
[118] *Id.*
[119] Instead of using the subtractive approach, one could probably also use an accretive method, i.e., value the four retained interests directly. The subtractive approach is the more usual valuation method, and because of that familiarity, it is the one I recommend.

charitable deduction for income tax purposes of fair market value for the donor.[120] This charitable donation possibility may be another factor lurking behind the IRS valuation of $65 million.[121] The concern would be the possible whipsaw effect to the federal fisc, that is, the taxpayers would value *Canyon* at zero for estate tax purposes, but would value it, say, at $10 million as a charitable deduction for income tax purposes.[122] While this concern is legitimate, there are significant practical and doctrinal limitations that would reduce the value of a charitable donation.[123]

Beyond the possibilities of a law change or charitable donation, the rights to possess during life and devise at death also have value to many people; one needs only to think of family heirlooms as an example. A troubling aspect of *Canyon*, however, is the reported insistence of FWS that *Canyon* must be on display at a public museum.[124] If that is the case, it raises another question on the meaning of "possess" under BGEPA, as explicated by *Andrus*. The Court noted that there was "no physical invasion or restraint" on the artifacts because of the regulation, and deemed it "crucial" that the defendants retained the rights to possess, transport, devise and donate.[125] If *Canyon*'s owners do not in fact have the right to exclusive possession, another discount to its value should be taken, one that could be as significant as the discount for the sales prohibition. Of the four rights deemed retained under the *Andrus* analysis, it may be that only the right to devise is free of regulatory interference from BGEPA.

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120 I.R.C. § 170 (2006).

121 *See, e.g*., Joseph Bothwell, Comment to Novack, *supra* note 1.

122 It is beyond the scope of this article to consider all the issues that a charitable donation of *Canyon* could involve.

123 One practical limitation is the quantitative cap on the amount of a charitable deduction a taxpayer may claim in any particular year, with the excess being a carry forward for up to five years. *See* I.R.C. § 170(b),(d). Lerner, the estate's attorney, estimated it would take his clients seventy-five years to fully use the charitable deduction, quipping, "my clients would have to live to 140 or so." Cohen, *supra* note 1.

One doctrinal limitation may be the principle of consistency, under which courts will sometimes deny a taxpayer's current tax position because it is inconsistent with a position previously taken by the taxpayer. For example, in Janis v. Comm'r, 87 T.C.M. (CCH) 1322 (2004), *aff'd*, 461 F.3d 1080 (9th Cir. 2006) and 469 F.3d 256 (2d Cir. 2006), two brothers inherited an art gallery upon their father's death. They valued the works of art and claimed a blockage discount for estate tax purposes. When they sold various works of art after their father's death, they reported their gain on their income tax returns using the undiscounted values. The Tax Court held that the discounted values were to be used for income tax purposes because of the tax principle of consistency.

124 *See, e.g.*, Cohen, *supra* note 1 ("Mrs. Sonnabend was then able to retain ownership as long as the work continued to be exhibited at a public museum.").

125 Andrus v. Allard, 444 U.S. 51, 65 (1979); *see supra* notes 44–52.

III. Consideration of Process in Art Valuation

A. *Overview*

If a tax return that has been selected for audit includes an appraisal for a single work of art valued at $50,000 or more, the case must be sent to the Art Appraisal Services (AAS) unit of the IRS Office of Appeals.[126] AAS will independently review the appraisal and refer the case to the Art Advisory Panel (the "Panel") when applicable.[127]

Created in 1968, the Panel is a volunteer board of about twenty-five art dealers, scholars and curators.[128] Their charge is to assist the IRS in reviewing and evaluating taxpayer submitted art appraisals on a work's fair market value. There are two subcommittees, one for Fine Arts and one for Decorative Arts.[129] Before each meeting, the AAS will send the panelists photographs of the art works and written materials concerning the work's size, medium, physical condition and provenance, and sales data on relevant art work.[130] No indication of the taxpayer's or appraiser's identity or the tax consequences of any adjustment is provided. The panelists review the material, and panelists do "our own research," and "bring notes" on the objects to the meeting.[131]

The closed-door meetings are held generally in Washington once or twice a year as needed. Objects are presented alphabetically by artist. Discussions are "lively, but serious"[132] without "hostilities, but there are differences of opinion,"[133] with the Panel's goal being to reach a consensus on value. If the Panel rejects the taxpayer's valuation, it

126 Art Appraisal Services Overview, IRM 4.48.2.1 (Dec. 14, 2010); *see also* Art Appraisal Services Assistance, IRM 8.18.1.3 (Dec. 14, 2010). Prior to 2011, the monetary threshold was $20,000. Art Advisory Panel, *Annual Summary Report for 2010*, 2 (2010), http://www.irs.gov/pub/irs-utl/annrep2010.pdf [hereinafter "Summary Report for 2010"].

127 IRM 4.48.2.1.

128 For an explanation of the Art Advisory Panel's origins set within the context of creating a similar panel for valuing conservation easements, see Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach*, 31 ECOLOGY L.Q. 1, 87–91 (2004).

The number of panelists has varied over the years. In 2009, there were twenty-one non-IRS panelists; in 2010 and 2011 , there were nineteen. *See* Art Advisory Panel, *Annual Summary Report for 2009*, (2009), http://www.irs.gov/pub/irs-utl/annrep2009.pdf [hereinafter "Summary Report for 2009"]; Summary Report for 2010, *supra* note 126; Art Advisory Panel, *Annual Summary Report for 2011*, (2011), http://www.irs.gov/pub/irs-utl/annrep2011.pdf [hereinafter "Summary Report for 2011"].

129 *See* Summary Report for 2011, *supra* note 128, at 3.

130 *Id*. at 2.

131 Judith Dobrzynski, *Taxing Matters: The Powers Behind the IRS Art Advisory Panel*, ART + AUCTION, Aug. 15 2008, http://www.judithdobrzynski.com/4641/taxing-matters (describing the art valuation review process from the panelists perspective). The Panel's knowledge of private sales based on their personal experiences and from information gleaned "from other members of their relatively small industry" provides essential information not readily available to the AAS. Summary Report for 2011, *supra* note 128, at 2.

132 Summary Report for 2011, *supra* note 128, at 2.

133 Dobrzynski, *supra* note 131.

makes a recommendation as to value. That recommendation is advisory and becomes the IRS position "only with AAS concurrence."[134] An AAS written report with supporting evidence is provided to the requesting IRS office and the taxpayer.

Undoubtedly, the volunteer Panel has provided cost-effective expertise for decades to the AAS in "the potentially high abuse area of art valuation";[135] but in a unique, high-profile case like Sonnabend's *Canyon*, fault lines in the art valuation protocol become more visible. There are four interrelated issues that cause concern: market expertise, objectivity, comparables, and the evidentiary use of Panel notes. The first three issues implicate the appraisal norms of competency and conflicts, and the last, procedural fairness.

B. *Concerns on Valuation Protocol*

1. Market Expertise

The sole inquiry before the Panel is the fair market value of a particular work of art on a particular day. The emphasis is on fair market value (what a willing buyer would pay, and a willing seller would accept, for the sale of the property) and not artistic value. The Panel is composed of "art experts"; but not all art experts are art market experts. Moreover, panelists with art market expertise may not have the relevant specialized art market expertise. These are two distinctions that courts find relevant in determining the weight to be given an expert's opinion.

Courts routinely evaluate an expert on his or her art market expertise—the depth of experience and knowledge in the public auction market, as well as in the private dealer market. For a work like *Canyon*, both markets would be possible sales venues, and therefore, both markets should be explored. One practical issue on valuation is how to document or verify sales data for auctions, as well as for private sales. If an art expert has no direct experience in buying or selling art, then public auction records become the resource by default. In *Biagiotti v. Commissioner*, for example, the Tax Court found the taxpayer's expert "most reliable" because as a dealer in pre-Columbian art "his sales and pricing experience" was far greater than the other experts whose experience was generally academically-based.[136] On the other hand,

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134 Art Advisory Panel, IRM 4.48.2.1.1 (Dec. 20, 2010). There has apparently been some internal confusion as to the weight of authority accorded the Panel's recommendations. *Cf, e.g*., Summary Report for 2010, *supra* note 126, at 3 ("The determinations of the Art Advisory Panel became the position of the Internal Revenue Service") *with* Summary Report for 2011, *supra* note 128, at 3 ("The Panel's Recommendations are advisory.").

135 *See* Summary Report for 2011, *supra* note 128, at 2.

136 52 T.C.M. (CCH) 588 (1986). *See also* Williford v. Comm'r, 64 T.C.M. (CCH) 422, at 10, (the court determined one expert was the "least persuasive" expert because he relied exclusively on auction data, noting "[h]is reluctance to rely on private sales appeared primarily to be a result

including private sales data is not necessarily determinative. In *Mitchell v. Commissioner*,[137] the court adopted the appraisal report prepared by the taxpayer's expert because it was based on exhaustively researched public sales. In contrast, the appraisal prepared by the IRS's expert had incorporated some private sales. That would generally be perceived as a fuller appraisal,[138] but given that those sales were not documented or verifiable, the expert admitted at trial he did not put "great weight" on those undocumented private sales.[139] Neither did the court.

In some situations, the expert may have art market expertise, but not expertise in the particular specialized area of the art market. *Mitchell*[140] is again a good example. The issue was the valuation of two American Western oil paintings, *Casuals on the Range* by Frederic Remington and *Creased* by Charles Russell. Both artists are recognized masters of American Western Art. There were three appraisals before the court in addition to the Panel's appraisal.[141] At trial, the estate's expert valued the Remington at $1.2 million and the Russell at $750,000.[142] The IRS trial expert valued the works significantly higher, at $2.2 million and $1.8 million respectively, while the IRS examination expert determined the highest values, being $2.3 million and $2 million respectively.[143] In contrast to these definite values, the Panel determined a range of values being $600,000 to $850,000 for the Remington and $300,000 to $1 million for the Russell.[144] What is particularly pertinent here is that the IRS examination expert, who was the staff appraiser assigned to the case, rejected the Panel's valuations because of the "disparate and wide-ranging valuations" which the expert attributed to the Panel's "inexperience in American Western art."[145] With a note of irony, the court stated that the taxpayer's expert was the only expert with American Western art experience.[146] The court, of course, carefully reviewed all the experts' appraisals and their credentials and, in doing so, found that the appraisals prepared by the

of his lack of familiarity with those sales.").

137 101 T.C.M. (CCH) 1435 (2011).

138 *See*, *e.g*., Williford, 64 T.C.M. at 9 ("The parties agreed that only auction sales and private sales which are documentable or verifiable should be considered in valuing [the] paintings.").

139 Mitchell, 101 T.C.M. at 13. The expert "failed to provide the exact sale prices, exact sale dates, identities of buyers or sellers, information on the condition of the paintings or discussions on provenance." *Id*.

140 *Id.*

141 *Id.*

142 *Id.* at 12.

143 *Id.* at 13–14.

144 *Id.* at 13.

145 *Id.*

146 *Id.* at 14. The IRS examination expert "expressed suspicions about the Art Panel report because the panelists were not experts in American Western art. If this were the only criterion, then the Court would only rely upon [taxpayer's expert] as no trial or examination expert for respondent has expertise in valuing American Western art." *Id.*

taxpayer's expert were "the most reasonable and well-supported,"[147] and the "better indicator of value."[148]

The Panel is composed of art experts who assuredly have an "extraordinarily high degree of expertise."[149] Cases suggest, however, that with respect to any particular item under examination, the art experts may not have the requisite art market expertise or may not have expertise in the particular area of art that is under consideration. Applying this perspective, the Panel's specific art market expertise—as opposed to its general art expertise—may not be as deep as many believe.[150]

2. Objectivity

To ensure the objectivity of the Panel, no taxpayer identifying details are included when the AAS sends information to the panelists.[151] Courts recognize the importance of competency and objectivity by referencing the Panel's expertise as well as its neutrality. Consequently, Panel valuations are seen as "extremely credible" and "unbiased." [152] Into this perspective, an acknowledgement of reality must be injected.

By sending materials in advance for the panelists to consider, it should be assumed that independent research will be done, at the very least, by those panelists whose expertise encompasses the work under review, and probably as well by those panelists outside the particular field.[153] With *Canyon*, research would quickly yield Ileana Sonnabend's name as the owner, and with Sonnabend's name, research would just as quickly reveal news of her death. In truth (and aside from the obvious tax inference of zero value), research for these two details may be unnecessary for many of the panelists. Almost all of the non-museum members of the 2009 Panel[154] were from New York, where Ileana Sonnabend was a legend in the art world and in the art market for

[147] *Id.* at 15.
[148] *Id.* at 14.
[149] Art Appraisal Services Coordination, IRM 8.18.1.3.3 (Dec. 14, 2010).
[150] In this regard, it is interesting to note the IRS statement: "[t]he panelists' knowledge is particularly beneficial in the authentication of works of art." Summary Report for 2011, *supra* note 128, at 2.
[151] *See, e.g.*, *id.*
[152] Stone v. United States, No. C06-0259 TEH, 2007 WL 1544786, at *2 (N.D. Ca. May 25, 2007), *aff'd* No. 07–17068, 2009 WL 766497 (9th Cir. 2009).
[153] *See, e.g*., Summary Report for 2011, *supra* note 128, at 2 ("During their meetings, the panelists review the information provided, along with the research and findings of both the Panelists and staff appraisers.").
[154] Of the twenty-one panelists for the 2009 Art Advisory Panel, nine had museum or scholarly affiliations. Of the twelve non-museum members, only one was listed as not being from New York; and he was from Philadelphia. *See* Summary Report for 2009, *supra* note 128, at 8–9. The Panel's Summary Report for 2009 is the only Sonnabend post-death report that has a Panel adjustment to estate tax values sufficient to include a $65 million upward adjustment. *Id.* at 6. In that report, the aggregate taxpayer claim for the 309 works which were adjusted upward for estate and gift tax purposes was $135,278,012. *Id.* The Panel's aggregate valuation was $225,055,370, an increase of $89,777,358 or sixty-six percent. *Id.*

decades. Moreover, some of the museum members, although more geographically dispersed, would also likely be familiar with *Canyon*, Sonnabend, or both.[155] In short, one cannot be an art expert and simultaneously not know about significant works of art or their owners, especially if one does research. From this angle, the IRS statement on its steps to ensure objectivity and taxpayer privacy, while allowing for research, is internally flawed, and all the more so, for a high-profile case like *Canyon*.

In all appraisal work, objectivity of the appraiser is a basic and important norm; and in reviewing appraisals involved in tax returns, taxpayer privacy is required. There can be slippage in the Panel's achieving these two aims that may not be fully appreciated or recognized by the IRS, courts and taxpayers. The steps taken to ensure objectivity and taxpayer privacy are important; however, they are not one hundred percent effective.

3. Comparables

There are multiple approaches to valuation, but for most works of art, an appraisal based on sales of comparable works is common.[156] When an artist has a history of documented sales, that is generally the most relevant valuation information.[157] Yet, references to sales by other artists can be useful for market trends or in cases where sales by the pertinent artist are thin. Choosing the comparable works and deciding whether to use other artists' sales are basic decisions in the valuation process. Courts will listen to the parties' explanations on the relevance of any particular comparable used in the appraisal process.

For artists whose works sell at auction, public auction data is the most commonly used sales data for the simple reasons of availability and reliability.[158] Use of private sales data is also considered if the sales

155 *E.g.*, Stephanie Barron, a member of the Panel, is the senior curator at the Los Angeles County Museum of Art, which held a Rauschenberg exhibition in 2006.

156 *See, e.g.*, Williford v. Comm'r, 64 T.C.M. (CCH) 422 at 10 ("Generally, comparable sales of similar properties that are reasonably proximate in time represent the best evidence of fair market value."). This approach was reportedly echoed by panelist Stephanie Barron: "[w]hen you come up with a valuation you look at comparable works and what they have sold for at public or private sales." Cohen, *supra* note 1.

157 The Internal Revenue Manual lends credibility to this in listing "sales and analysis of similar works by the artist" as an information item to be included in an internal IRS request for valuation assistance from AAS. *See* Information Needed for Art Valuation Requests, IRM 4.48.2.3.1 (Dec. 14, 2010).

158 Yet not all auction prices can be believed. In Cristallina S.A. v. Christie, Manson & Woods Int'l Inc., 502 N.Y.S.2d 165, 170 (N.Y. Sup. Ct. 1986), Christie's issued a formal press release advising that three works of art had been sold, when only one had actually been sold. The "explanation for this deception [was] that it was for 'the benefit of [the plaintiff] and the art market.'" *Id*. at 170. Christie's was fined $80,000 by the New York Department of Consumer Affairs, and tighter auction regulations were put in place. *Id.* at 173. *See* Patty Gerstenblith, *Picture Imperfect: Attempted Regulation of the Art Market*, 29 WM. & MARY L. REV. 501 (1988). The new Chinese art auction market may also have compromised auction price data, for example, the practice of reporting winning bids as sold even though the ostensibly successful bidder did not

information is documented and verifiable.[159] Rauschenberg's high auction price before Sonnabend's death was $10.6 million in May 2007 for *Photograph* from the 1959 combines.[160] That auction record was broken a year later on May 14, 2008, when Rauschenberg's cityscape *Overdrive* sold for $14.6 million.[161] With an auction record of $10.6 million pre-death and $14.6 million seven months after death, it is logical to question a $65 million valuation as of death. Two aspects of comparables valuation could provide explanations—private sales and other artists' sales. Each, however, comes with a significant caveat for art valuations in general and for *Canyon* in particular.

Private sales of significant art often make the news. Rauschenberg was no exception. In 2005, it was reported that MOMA had finally acquired *Rebus*, a Rauschenberg combine painting from 1955 that MOMA had tried to purchase in the 1960s.[162] The work, the identity of the buyer and seller, the approximate sales date, and the provenance are stated in the news reports; the sales price is not. The "price is believed to be about $30 million."[163] The use of qualifiers undermines the piece's documented and verifiable status for comparables purposes and would therefore be rejected as a comparable.[164] But if a panelist has information on the comparable's transaction, would that make the private sale documented or verifiable?

pay. More sinister is the concern that government involvement in auction house control has led to practices that inflate reported auction data for political purposes. *See* Abigail R. Esman, *China's $13 Billion Art Fraud—And What It Means for You*, FORBES, Aug. 13, 2012, http://www.forbes.com/sites/abigailesman/2012/08/13/chinas-13-billion-art.

[159] *Williford*, 64 T.C.M. at 9 ("The parties agree that only auction sales and private sales which are documentable or verifiable should be considered in valuing paintings.").

[160] *Rothko Painting Sells for Record* US$72.8m, HONG KONG STANDARD, May 17, 2007, http://www.thestandard.com.hk/news_detail.asp?we_cat=6&art_id=44599&sid=13643858&con_type=1&d_str=20070517&fc=7.

[161] Kelly Crow, *Drama and Delight at Sotheby's $362 Million Sale*, WSJ BLOGS (May 15, 2008, 12:24 AM), http://blogs.wsj.com/ontheblock/2008/05/15/drama-and-delight-at-sothebys-362-million-sale ("Another dramatic moment came mid-way through the sale when only two bidders went after Robert Rauschenberg's cheerful cityscape, 'Overdrive.' A telephone bidder won it for $14.6 million, still a record . . . ."). Rauschenberg died on May 12, 2008, just two days before the Sotheby's auction. *Id.* Some expressed concerns about his death's impact on the three Rauschenbergs that were up for auction. *See* Kelly Crow, *Rauschenberg's Death Could Affect Auction of Works by Sotheby's*, WSJ BLOGS, (May 13, 2008, 4:01 PM), http://blogs.wsj.com/ontheblock/2008/05/13/rauschenbergs-death-could-affect-auction-of-works-by-sothebys/.

[162] Carol Vogel, *The Modern Buys 'Rebus'*, N.Y. TIMES, June 17, 2005, http://www.nytimes.com/2005/06/17/arts/design/17voge.

[163] *Id*. *See also* Calvin Tomkins, *Everything in Sight*, NEW YORKER, May 23, 2005, http://www.newyorker.com/archive/2005/05/23/050523fa_fact_tomkins (Indicating that "the purchase price is said to be as much as thirty million dollars."); Emmanuelle Soichet, *MoMA Acquires Rebus, A Key Early Work by Rauschenberg*, ARTINFO, (Jan. 23, 2007), http://www.artinfo.com/news/story/560/moma-acquires-rebus-a-key-early-work-by-rauschenberg (Indicating that the work was acquired "for an undisclosed amount most likely around $30 million.").

[164] *See supra* text accompanying note 139. In addition, one needs to consider the reliability of reports of a private sale at a certain price. Dealers have also been known to inflate sales prices. See RICHARD POLSKY, I SOLD ANDY WARHOL. (TOO SOON) (2009) for an entertaining insider's look at the art market.

The Panel's protocol requires a panelist to recuse herself "[i]n the event of a conflict of interest involving a Panelist and a work of art under review."[165] Three conflicts scenarios come to mind. The clearest application involves a panelist who herself was involved in the sale of the work under review to the taxpayer. In this case, recusal is required for obvious reasons. A second conflicts scenario occurs when a panelist is involved in a private and confidential sale of a comparable work of art. The third conflicts scenario involves the trusted source scenario, meaning a panelist was not involved in a private sale of the work or a comparable work, but has information from a trusted source who was so involved. Recusal may not be required by the Panel's conflicts protocol for the latter two scenarios, yet use of undocumented and non-verifiable sales information in the Panel's valuation, to any extent, is problematic.[166]

The second possible explanation for the $65 million valuation is using sales data from another artist for comparables. Andy Warhol is mentioned as a possibility.[167] At the time of Sonnabend's death, Warhol's then auction record was $71.7 million for *Green Car Crash* in May 2007.[168] Is it appropriate to use Warhol? Rauschenberg did influence Warhol; however, Warhol has far eclipsed Rauschenberg at auction, as well as virtually all twentieth century artists.[169] The choice of Warhol, clearly and unquestionably one of the top twentieth century artists selling at auction, as a comparable for Robert Rauschenberg or virtually any other twentieth century artist is inappropriate and not defensible. Warhol is truly in a class by himself for auction sales. Moreover, because Rauschenberg has a documented sales history, using another artist for comparable sales purposes—as opposed to showing trends in the market—is unnecessary, and therefore, equally inappropriate.[170]

Finally, there is another consideration that might help explain the

[165] Summary Report from 2011, *supra* note 128, at 2.

[166] If a panelist merely mentions a rumored price, it is hard, but not impossible, to unring the bell when considering a work's value.

[167] Ralph Lerner, the estate's attorney, is quoted as saying of the Panel's valuation: "[t]he valuation is based on the price made by Andy Warhol's 'Car Crash'—$71.7 m . . ." Georgina Adam, *The Art Market: In a Flap Over an Eagle*, FIN. TIMES, Mar. 9, 2012, http://www.ft.com/cms/s/2/4db1c8fe-678a-11e1-b6a1-00144feabdc0.html#axzz26TTpPyGT.

[168] *Id.*

[169] *See* Kelly Crow, *Bets in '11: Pop, Calder, Chinese Coins*, WALL STREET J., Jan. 8, 2011, http://online.wsj.com/article/SB10001424052748704415104576065961534171834.html ("This season, expect collectors to spend heavily on art made since 1950, a primary-colored pantheon of Pop, abstract and contemporary artists led by Andy Warhol. Last year, 1,256 Warhols sold at auction for a combined $367 million, up from 983 of his works for $125 million a year earlier . . . . (Only Pablo Picasso pops up more often at auction these days.)"); see also Sarah Thornton, *The Wizards of the Warhol Market*, ECONOMIST.COM, May 17, 2011, http:www.economist.com/blogs/prospero/2011/05/contemporary_art_sales/ for a discussion of the auction market process involving the skewing effects of irrevocable bids and the thin but passionate group of dealers and collectors who support the market.

[170] *See supra* note 157.

Panel's $65 million valuation for *Canyon*. The Panel could simply have rejected the comparables approach altogether. Instead of using comparables as the valuation method, an appraiser might instead use the "appraiser's own judgment."[171] Faced with the taxpayer's assertion of $0, a panelist said the Panel "just cringed at the idea of saying that [*Canyon*] had zero value."[172] Consequently the Panel may have used its own aesthetic judgment and valued *Canyon* "solely on its artistic value, without reference to any accompanying restrictions or laws."[173] As the standard is fair market value, not artistic value, and because restrictions are part of a normal approach to market value, this approach must be categorically rejected.[174]

4. Discoverability of Panel's Notes

A taxpayer bears the burden of proof for fair market value; therefore, the taxpayer needs to establish the correctness of the taxpayer's art valuation and the incorrectness of the IRS's valuation. A requesting taxpayer is entitled to a written statement providing the basis for an IRS determination of value for estate, gift or generation skipping

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171 Williford v. Comm'r, 64 T.C.M. (CCH) 422, at 9 (1992).

172 Cohen, *supra* note 1.

173 *Id*. *See also* Felix Salmon, *When Museum Curators Confuse Price and Value*, REUTERS, July 22, 2013, http://blogs.reuters.com/felix-salmon/2012/07/23/when-museum-curators-confuse-price-and-value (quoting Panel member Stephanie Barron).

This valuation approach is similarly indefensible, as well as standing in contrast to the market valuation norm that limitations and restrictions are to be considered when valuing property for fair market value. An interesting practical question is whether the sales restriction was actually in front of the Panel. *Canyon* is a novel situation for art valuation precisely because it has a clear sales prohibition. Sales restrictions are not the norm in art ownership. Going forward, restrictions on art ownership may be more common. *See, e.g.*, Visual Artists Rights Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (1990), that grants visual artists certain ongoing nonpecuniary rights to the integrity of their artistic creations even after the works have been sold. *Compare* Mass. Museum of Contemp. Art Found., Inc. v. Büchel, 593 F.3d 38 (1st Cir. 2010) *with* Kelley v. Chi. Park Dist., 635 F.3d 290 (7th Cir. 2011) for two judicial interpretations as to VARA's scope and breadth. In addition, newer art market norms as to proving provenance (though not legal restrictions) can also impact value. *But cf.* Ralph Blumenthal, *The Curse of the Outcast Artifact*, N.Y. TIMES, July 12, 2012, http://www.nytimes.com/2012/07/15/arts/design/antiquity-market-grapples-with-stricter-guidelines-for-gifts.html?n=Top%2fReference%2fTimes%20Topics%2fSubjects%2fA%2fAntiques (the depressant impact on auction value of antiquities when the owner cannot prove that the antiquity entered the U.S. before 1970, or perhaps 1983).

174 *See* Salmon, *supra* note 173:

> The assumptions baked in to this are both jaw-dropping and entirely unsurprising at the same time. Barron is the senior curator of 20th-century art at Lacma, which puts her at the pinnacle of the non-profit art world, the place where art is supposedly valued just for its own sake and not because it's worth lots of money. And yet, faced with a *literally* priceless work of art, Barron and her fellow panelists "just cringed" at ratifying precisely that concept. . . .
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> . . . .
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> For Stephanie Barron, a work's financial value is defined by its artistic value. But for people like Robert Rauschenberg and Ileana Sonnabend, that was never the case. They both died wealthy, thanks to the art world. But I think they would have been genuinely horrified at Barron's idea—the concept that if *Canyon* is worth nothing financially, then it must be worth nothing aesthetically. It's a dangerous and invidious notion . . . .

tax purposes.[175] Given the concerns expressed on market expertise, objectivity, and comparables, a taxpayer's access to notes and other documentation that the IRS and Panel considered in reaching their valuations can be very important. In *Bernardo v. Commissioner*,[176] the Tax Court ordered the IRS to produce the Panel's notes regarding its valuation of the taxpayer's art. It rejected the IRS's claim of executive privilege, noting that the Panel's meetings are closed because of the statutory requirement on preserving confidentiality of taxpayer's tax returns, "and not to insure the candor of intragovernmental communications."[177]

More than a decade later, in *Proctor & Gamble Co. v. United States*,[178] a judge similarly rejected the IRS assertion of the deliberate process privilege. The court also summarily rejected IRS's assertion that Panel members valued the secrecy of the process and would not otherwise serve on the Panel, by wondering "why Panel members assume the proceedings are secret when the Tax Court ruled 14 years ago" they were not.[179] The P & G court similarly ordered the production of the Panel's notes to the requesting taxpayer.[180] In essence, the two lower courts have determined the Panel's meetings may be behind closed doors, but they are not secret from the taxpayers whose art is being valued.

It is apparent that the Panel's notes may be a useful source of information for the taxpayer who is required to show the inaccuracy of the Panel's valuation. The reluctance of the IRS to produce Panel notes is troubling because it raises concerns regarding accountability and transparency of process, critical elements for citizens and good government.

The foregoing discussion on market expertise, objectivity, comparables, and Panel notes raises concerns on the IRS's valuation protocol. An acknowledgement of the practical realities underlying IRS art valuations is not cause to scrap the IRS art valuation protocol. It does suggest that any approach that gives a thumb-on-the-scale in favor of the Panel's valuation may not be appropriate, whether or not it is articulated. Mostly, it is a reminder that not all art valuation cases can be reviewed completely objectively, and that a review of the art valuation protocol may be overdue.A recent governmental report has raised an analogous concern.

175 I.R.C. § 7517 (2006).
176 104 T.C. 677 (1995).
177 *Id.* at 694.
178 No. 1:08-CV-608, 2009 WL 5219726 (S.D. Ohio Dec. 31, 2009).
179 *Id.* at *4.
180 *Id.*

C. *GAO Recommendations for AAS*

The Government Accountability Office (GAO) has recently raised organizational concerns over AAS art valuations.[181] Valuation abuses and misstatements by taxpayers have long plagued the tax system, and Congress has addressed valuation abuses periodically.[182] In 2006, Congress adopted section 6695A, a new civil penalty for appraisers whose appraisals result in substantial or gross valuation misstatements for tax purposes.[183] In response to a Congressional request to review IRS enforcement efforts with respect to appraisals, the GAO issued a report in June 2012. One aspect of that report was an assessment of IRS procedures for ensuring that its own appraisal experts are qualified. The IRS employs appraisal experts in two areas—engineering and art. GAO deemed engineering fully compliant, while GAO found AAS to be fully compliant only with respect to the hiring standard but not with respect to the training and quality control standards.[184] This creates a "risk that staff may not be performing quality work."[185]

AAS is part of the Office of Appeals (Appeals), which requires annual continuing education for its staff. Appraisal skills, however, are not specifically identified as a subject for training. Even though there is a standard of providing training relevant to specific job duties, the "Appeals training guidance does not mention any relevant skills that appraisers must maintain."[186] According to the GAO, this creates the possibility that art appraisers are not keeping up their skills and thus not evaluating art appraisals as well as they could.[187]

A similar gap appears in AAS performance quality review. Because AAS is housed within Appeals, but most of the AAS cases are not Appeals cases, the Appeals case review system does not squarely cover AAS work.[188] The GAO report notes that this lack of a group-wide summation or tracking of ad hoc reviews does not provide "assurance that AAS staff are performing well specifically in regard to their appraisal work."[189] "Without systematic evaluation, erosion of the quality of AAS's work could occur unobserved."[190] Moreover, "the

181 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-608, APPRAISED VALUES ON TAX RETURNS: BURDENS ON TAXPAYERS COULD BE REDUCED AND SELECTED PRACTICES IMPROVED (2012) [hereinafter "GAO APPRAISED VALUES ON TAX RETURNS"].

182 *See, e.g.*, Weil v. Comm'r, 26 T.C.M. (CCH) 388 (1967); Vander Hook v. Comm'r, 36 T.C.M. (CCH) 1394 (1977); and Rose v. Comm'r, 88 T.C. 386 (1987) (a trio of cases spanning three decades that involve charitable deductions for donated art and demonstrate how art donations morphed into sophisticated tax shelters involving lawyer-drafted and appraiser-friendly business models).

183 I.R.C. § 6695A (2006).

184 GAO APPRAISED VALUES ON TAX RETURNS, *supra* note 181, at 16.

185 *Id.*

186 *Id.* at 17.

187 *Id.*

188 *Id.*

189 *Id.* at 19

190 *Id.*

quality of potentially high-value appraisal cases involving art [are] at risk" by these internal lapses in training and evaluation.[191]

These gaps in training and evaluation may be due to AAS's specialized and unique organizational status within Appeals. Without an organizational structure that mandates pertinent training requirements and ongoing system-wide evaluations, it is likely that AAS has developed a degree of organizational autonomy. That autonomy in conjunction with highly specialized work done behind closed doors can undermine accountability and transparency.[192] GAO's critique of AAS in conjunction with its concrete and realistic recommendations is a positive development for AAS and for taxpayers.

IV. RECOMMENDATIONS

Canyon is a unique work of American art, and it presents a unique tax valuation situation. That uniqueness provides an opportunity to reconsider and clarify the process for art valuations going forward. More specifically, the following three recommendations should be considered in clarifying the process for art valuations for tax purposes.

First, the use of an illicit market, hypothetical or otherwise, as the relevant market for fair market value in estate tax cases should be rejected, unless the decedent was an active participant in the market. Good governance does not require honest citizens to break the law, hypothetically or otherwise.

Second, because the inclusion of property in a decedent's estate is to "the extent of the interest," whenever the ownership of property is subject to a valid and enforceable governmental restriction at the time of death,[193] specific appraisal rules in the Internal Revenue Manual must

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191 *Id.* at 20. These training and evaluation concerns were behind the only recommendations made by GAO to the Commissioner. *Id.* The first is to implement a more comprehensive quality review system for AAS, and the second is to develop more specific and documented appraisal training requirements for AAS. *Id.* The IRS agreed with the GAO recommendations. *Id*.

192 See e.g., Paul F. Levy, *The Nut Island Effect: When Good Teams Go Wrong*, 79 HARV. BUS. REV. 51 (2001), for a discussion of the "Nut Island Effect." This unfortunately-named destructive organizational dynamic

> begins with a homogenous, deeply committed team working in isolation that can be physical, psychological, or both . . . . [S]enior management, preoccupied with high-visibility problems, assigns the team a vital but behind-the-scenes task. This is a crucial feature: the team carries out its task far from the eye of the public or customers. Allowed a great deal of autonomy, team members become adept at organizing and managing themselves, and the unit develops a proud and distinct identity.

Id. at 52. Over time, the highly specialized team is left to look after itself, and may resent interference from senior management. The isolation allows the team to develop its own internal rules, without the benefit of outside practices or perspectives. *See* Michael Harris, *The Nut Island Effect*, HEALTH SCI. REV. 5 (May 2010) (discussing two case studies from public service organizations). Harris opines that public service organizations may be more prone to this dynamic because the "bottom line" is not quantitative, but qualitative, in which measurement and assessment are difficult, and therefore management relies more heavily "on trust and the dedication of team members." *Id.* at 7.

193 This recommendation is limited to governmental restrictions; private restrictions can be manipulated for tax valuation purposes. *See* I.R.C. §§ 2701–2704.

charge the appraisers to consider the impact of that restriction on valuation. The approach of recognizing regulatory restrictions on stock and real property should be specifically extended to art appraisals.

Third, the protocol for the AAS and the Panel should be thoroughly reexamined to insure that norms of competency, objectivity and transparency are paramount. To the extent that comparables are the basis of the AAS and Panel's valuation determinations, AAS and the Panel must only use comparables that are verifiable and documented. If the artist has a time-relevant, verifiable and documented sales record, use of other artists' sales records is to be discouraged, except perhaps for trend purposes. Panel members should be informed that pertinent notes from the Panel discussion are discoverable by the taxpayer, and the IRS should develop a retention policy for such notes.

Valuations of high quality, unique works of art are vexing, and often come with enormous valuation variances from reputable and knowledgeable art market experts. The costs involved in preparing and defending art valuations can be significant for the taxpayer and the IRS alike. Paying attention to norms of competency, objectivity and transparency will not end disputes, but may lessen the number and range of disputes, allowing the taxpayer and IRS to turn square corners with each other.[194]

[194] Oliver Wendell Holmes, Jr., famously wrote, "[m]en must turn square corners when" dealing with the government. Rock Island A. & L. R. Co. v. United States, 254 U.S. 141, 143 (1920). Others would extend that, *see* Fed. Crop Ins. Corp. v. Merrill, 332 U.S. 380, 387–88 (1947) (Jackson, J., dissenting) ("It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one-way street.").