

Beauty Is in the Eye of the Beholder ... and the IRS

~ Rose-Anne B. Frano

Because philanthropy and community service are based in diverse communities, philanthropy occurs in a variety of forms. One may provide community service and charitable contributions through public platforms such as established foundations, public charities, and corporate initiatives. Philanthropy also occurs on a personal, private, and individual platform built upon one's own passion, experience, and goals. It is exceptional that we live in a community supported by the fabric of philanthropy. As community service and charitable contributions reach across the distinct communities built within our society, philanthropy retains an intrinsic and esteemed value.

Recognizing the value of such philanthropic efforts by its own citizenry, the Internal Revenue Code (the "Code") allows some charitable contributions to generate certain tax deductions for the patrons of philanthropy. However, it is necessary that such tax benefits for charitable giving be carefully monitored by the Internal Revenue Service (the "Service") to ensure compliance with the rules set forth in the Code, its procedures, and its supporting regulations.

Focusing on one type of philanthropic donation, the Service created the Art Advisory Panel in 1968 to assist it in reviewing the assessment of value attributed to works of art reported on federal income, estate, or gift tax returns. Accordingly, when an audited federal tax return includes a work of art appraised at a fair market value equal to or exceeding \$50,000, the Service office reviewing the return must refer the return to its Art Appraisal Services unit. From the Art Appraisal Services unit, the valuation of the work of art may be referred further to the Art Advisory Panel for its advice and recommendation on the acceptability of the valuation of such work of art reported for federal tax purposes. The director of the Art Appraisal Services serves as the chairperson of the Art Advisory Panel, and the Art Appraisal Services staff provides support and coordination for the Art Advisory Panel meetings.

The Art Advisory Panel members include up to 25 renowned art experts not employed by the Service and who serve without compensation. As an example, in 2013, the Art Advisory Panel included 19 panelists from six states and the District of Columbia. The panelists' professions included directors of art galleries, curators of museums, professors of art, and other independent art professionals. The panelists' expertise encompassed modern art, decorative arts, painting and sculpture, prints and drawings, and fine arts. It is suggested that the Art Advisory Panel and the Art Appraisal Services unit both are necessary for the Service's enforcement of the Code related to the federal tax reporting of charitable contributions of works of art.

The Art Appraisal Services unit may research reported fair market value of works of art through publicly available resources and information, but only professionals within the art industry may provide insight through knowledge of private art sales, education, and industry norms developed through industry experience. Thus the Art Advisory Panel provides the Service cost-effective expertise to enforce the provisions of the Code related to valuing art transferred for charitable purposes—expertise not otherwise available within the existing resources of the Service.

To maintain objectivity and privacy, when the Art Appraisal Services unit refers appraisals to the Art Advisory Panel for review, the information it provides to the panel does not include the taxpayer's name, type of applicable tax, or possible tax consequences resulting from any adjustment to fair market value, or who prepared the appraisal under review. Additionally, the works of art may be categorically listed in some manner to try to preclude any panelist from recognizing a collection or owner by identification of works of art. If a conflict of interest occurs with a panelist, that panelist is recused from the process related to that particular work of art. Ultimately, the Art Advisory Panel's determination of value is advisory only and is not binding on the Service. The panel's work is summarized in an annual report that identifies the member panelists, the types of work they reviewed, and the recommendations they made. For example, the 2013 Annual Summary Report informs us that the Art Advisory Panel held meetings in New York City during December 2012 and April 2013, and in Washington, D.C. during June 2013. It further informs us that 291 items were reviewed, with an aggregate taxpayer valuation of \$444,288,500. The panel accepted 44 percent of the appraisals it reviewed and recommended adjustments to the remaining appraisals. (All information included regarding the substance of the annual report is set forth in the 2013 Annual Summary Report for Fiscal Year 2013, which you may find on the Internal Revenue Service website.)

It is not only the Service that may want assistance in assessing the value of a work of art that will be reported on federal tax returns. You, as a taxpayer, may ask the Service to provide an advance review of an art appraisal you will report on your federal income, estate, or gift tax return. If you do so, you will follow a certain procedure to request the Service provide you with a Statement of Value related to such work of art before you report it on a federal tax return. If you request and receive a Statement of Value, you may then rely on the statement in completing your federal tax return that first reports the transfer of that work of art. While taxpayers generally cannot ask the Service's opinion on the valuation of items reported on a tax return before filing a return, in this instance, an exception exists to request the Service's Statement of Value of a work of art before filing a tax return that reports its value.

As a patron of a charitable art donation, why would you ask the Service in advance for a Statement of Value? There may be many reasons; however, as an example, if you are reporting the fair market value of a work of art that is difficult to appraise for some reason—such as a limited market or unique medium (illustrated by an interesting history of the value for federal estate tax purposes of Robert Rauschenberg's collage “Canyon”)—then you may want to make sure the valuation

methods are acceptable to the Service before you file a tax return claiming the tax effects of such valuation. First, ensure that the appraisal of fair market value of the work of art satisfies the requirements of a “qualified” appraisal for the relevant federal tax purposes. Second, the Code imposes expensive penalties on taxpayers for the misstatement of value of property reported on a federal tax return. Moreover, if the undervaluation of property is determined by the Code’s defined thresholds to be “substantial” or “gross,” then the penalties (in addition to the additional tax and interest) may be up to 40 percent of the resulting tax underpayment. Exceptions to such penalties may, but do not always, apply. Third, the Statement of Value of the work of art you request from the Service may be one you can rely on in reporting the transfer of art on your federal tax return. However, it is not a mandate that you must rely upon the statement in reporting the value of the art for federal tax purposes. Thus, if you receive the Statement of Value and believe other relevant information applies to the appraised value of the work of art, you may obtain further research and assessment to support your alternative reported value.

You may only request a Statement of Value prior to filing the relevant tax return that first reports your charitable contribution. Additionally, you must pay a certain administrative fee (based on the number of works of art you wish to have reviewed). Finally, the work of art for which the Statement of Value is requested must have been appraised for at least \$50,000 and must have been transferred as a charitable contribution for purposes of federal income tax, by reason of death, or by inter vivos gift. Also, any taxpayer may also request a Statement of Value related to a work of art that has an appraised value of less than \$50,000 if the same request includes at least one other work of art valued at or above \$50,000 and the Service determines that granting the request would be in the best interests of efficient tax administration.

In the request you submit to the Service, you may be required to include some of the following supporting items, depending on the applicable federal tax return being filed:

- A copy of a qualified appraisal of the item of art (requirements of a qualified appraisal should be determined based upon what type of federal tax return you are filing)
- A completed appraisal summary that meets the relevant Code and tax return filing requirements
- Details of the work of art, including, but not limited to, a description of the item of art, the appraised fair market value, the cost, date, and manner of acquisition, the date of death or gift
- Disclosure of the District Office that will have examination jurisdiction over the return (not the service center to which the return is filed)

Upon notice from the Service that a request did not include the information necessary for the issuance of the Statement of Value, a short corrective period is allowed.

In addition, you must sign your request for a Statement of Value under penalties of perjury, with a declaration you have examined the request, including the accompanying documents, and to your best knowledge and belief, the facts presented in support of the request are true, correct, and complete. Once you have filed, you may at any time prior to issuance of a Statement of Value withdraw your request for a Statement of Value. The fee you pay will not be refunded if you withdraw the request and the district director of the Service will be notified.

After review, the Service will issue a Statement of Value approving your submitted appraisal or a Statement of Value providing the Service's own determination of value and the basis for its disagreement with your appraisal. You must then include the issued Statement of Value (or if not yet received, the request for a Statement of Value followed by an amended, or supplemental, tax return when the Statement of Value is received) with your tax return that reports the charitable contribution of the work of art. If you disagree with a Statement of Value, then you may include with the relevant tax return additional information to support the different determination of value.

We are fortunate to live in a community that values philanthropy and charitable giving. Even though all acts of philanthropy are not tax-deductible, the Service is tasked with careful enforcement of the tax laws related to charitable gifts. Likewise, philanthropists are tasked to comply (and demonstrate compliance) with all related federal tax laws and procedures when they file returns reflecting the charitable gift. Thus, all acts of philanthropy intended to create substantial federal tax consequences should be approached with careful planning between the philanthropist and his or her tax advisor and tax preparer. In the same manner that the Service utilizes the Art Advisory Panel to gather information not otherwise available to it for assessment of art valuation, it may be that a taxpayer will want to involve the Service itself in the assessment of value of a work of art given for charitable purposes. As with other matters of tax planning, knowing all the tools available to help you make an informed decision can only help you make the best decision from both philanthropic and tax planning perspectives.



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She is a board certified specialist in wills, trusts, and estates. Rose-Anne focuses on estate, gift, and generation-skipping transfer tax planning for individuals and their families and on the administration of estates and trusts. She earned her LL.M. in Taxation and her J.D. from the University of Florida College of Law and her B.A. from Tulane University.

