

Lesson 13: Legal Issues Affecting the Appraiser

As with any profession, it's good practice for the personal property appraiser to be conversant in legal issues that have impacted on the profession in the past and/or which act as guideposts to help appraisers avoid legal pitfalls as they practice their profession. Having said that, appraisers are not attorneys or paralegals. Nor are they legal researchers or law consultants. Just as it is not the appraiser's responsibility to advise clients on legal matters, draft legal documents, or represent clients, neither is it the appraiser's responsibility to spend time conducting legal research in law libraries or on Internet law sites. But being familiar with landmark cases which have impacted our profession and understanding the issues raised and the decisions concluded make for a better all-around professional.

In this Lesson 13 we discuss legal issues which impact the individual who is acting in the role of an appraiser. We will briefly address the issues and present summaries of interesting cases that have had an impact on the personal property appraisal profession. But appraisers also perform in other roles outside that of an appraiser. As examples, many appraisers are also dealers, auctioneers, restoration specialists, and estate liquidators. When wearing those other hats, appraisers may be faced with legal issues which do not normally attach when performing strictly as an appraiser.

We will not spend time discussing legal matters which normally do not apply to the personal property appraiser, regardless of how significant they may be to other types of professionals. For instance, there are issues of contract, commercial and agency law with which other professions must be aware but which do not normally impact the appraiser. Included are commercial transactions, consignment sales, auction sales, warranties, fraud, disparagement, and performing as an agent on a principal's behalf. Instead, we will limit our discussion to the legal issues with which the appraiser might become involved. These most commonly include issues relating to bailment, title, negligence and malpractice, fraud by a dealer/appraiser, and appraiser liability to third parties. Several tax court cases will also be summarized to help us better understand issues to which the IRS is sensitive such as choice of appropriate market, fair market value, and valuation discounts.

Bailment

Bailment is a matter of property law. A bailment occurs when an individual (the bailor) in lawful possession of a piece of personal property gives over possession to another individual (the bailee) for a specific purpose, with the understanding that once the purpose has been achieved, the personal property shall be surrendered back to the bailor.

Bailments apply to items which have been borrowed or loaned, items being transported by couriers, even customer goods in the possession of a restoration specialist. And on occasion, appraisers take property from the client to get it authenticated. Doing so is an example of bailment.

A bailee has a duty to exercise reasonable care to protect the property, and to return the property promptly when the task has been completed. Duty of care is the standard of legal duty that a reasonable person owes to others. Failure to use reasonable care could expose an individual to liability for negligence which is defined as conduct that is culpable because it falls short of what a reasonable person would do to protect another individual from foreseeable risks of harm.

Bailments are divisible into three kinds. The degree of care that must be taken by the bailee to avoid being negligent varies depending upon who benefits from the bailment. The three kinds of bailment scenarios are:

Those bailments in which the bailor benefits (such as the bailor storing valuables at a neighbor's house while on vacation.) In this case, the bailee owes a low degree of care. In order to be held liable for damages done to the bailment, the bailee must be found **grossly** negligent.

Those bailments in which the bailee benefits (such as the bailee borrowing a china dinnerware service for use at a dinner party from a neighbor). In this case, the bailee owes a high degree of care. The bailee must be very careful with the borrowed property because he or she could be found liable for any damages arising from even **slight** negligence.

Those bailments in which both bailor and bailee benefit such as when a client allows the appraiser to take possession of a painting in order to get it authenticated. In this case the bailee owes an ordinary degree of care. This is the type of bailment scenario in which an appraiser might become involved. In such a scenario the appraiser would be well-advised to, at a minimum, take a reasonable amount of care when the item is in the appraiser's possession in order to prevent the property from being lost or damaged. To apply less than reasonable care could expose the appraiser to liability for negligence should damage or loss occur.

Having Good Title

Title is a legal term for the bundle of rights in a piece of property in which a party owns a legal interest. For some properties, such as a home or car, the conveyance of a document (i.e., the "title") may be required in order to legally transfer ownership in the property to another person.

Title is not the same as possession. One may be the rightful owner of a property, but may not possess it. Possession is the actual holding of a thing, whether or not the possessor has any real right to do so. But possession does not prove ownership. Indeed, one might possess a property but not be its rightful owner.

Suppose A steals from B, what B had previously bought in good faith from C, which C had earlier stolen from D, which had been an heirloom of D's family for generations, but had originally been stolen centuries earlier (though this fact is now forgotten by all) from E. Here A has the possession, B has an apparent right of possession (as evidenced by the purchase from C), D has the absolute right of possession (being the best claim that can be proven), and the heirs of E, if they knew it, have the right of property, which they cannot prove. Good title consists in uniting possession, right of possession, and right of property in the same person(s). The extinguishing of ancient, forgotten, or unasserted claims, such as E's in the example above, was the original purpose of statutes of limitations. Without such limitations, title to property would always be uncertain.

What does all this have to do with the appraiser?

USPAP requires that the appraiser identify and state within the appraisal report the ownership interest being valued. (If there are no co-owners and it title is enjoyed solely by the client, then ownership interest is 100%.) In order to comply with USPAP, the appraiser typically makes certain assumptions regarding ownership — and that usually is to take at face value the client's assertion that he or she is the sole and rightful owner of the subject property.

Are assumptions to title and ownership interest sufficient to comply with USPAP?

See [Autocephalous Greek-Orthodox Church v. Goldberg & Feldman Fine Arts, Inc.](#) below. This case has caused some to be of the opinion that, like the defendant dealer, when faced with appraising valuable works of art, an appraiser should be alert to the possibility that the work has been stolen and should use due diligence in attempting to find out whether or not that is, indeed, the case. Often times keeping abreast of the art market and making inquiries at such organizations as the International Foundation for Art Research (IFAR) (www.ifar.org) and the Art Loss Register (www.artloss.com) may suffice.

Others, however, do not feel it is the appraiser's responsibility to research whether or not an item has been stolen. Perhaps for a well known artist, but certainly not for a round oak table! Regardless, in order to make it very clear that they are guaranteeing neither ownership interest nor title, most appraisers make use of assumptions and disclaimers to that effect in their appraisal reports, to wit:

- *Unless otherwise stated herein, the appraised values are based on the whole ownership and interest of the owner undiminished by any liens, fractional interest or any other form of encumbrance or alienation.*
- *This appraisal is not an indication or certificate of title or ownership. The identification of the interest of the owner is simply that represented to the appraiser by the client and no inquiry or investigation will be made nor is any opinion to be given as to the truth of such representation.*

The International Foundation for Art Research provides a significant amount of material online to assist people making informed decisions about the ethical and legal issues involved in the collecting of art. Included are resources regarding:

- World War II-Era/Holocaust Related Art Loss (U.S. and international civil and criminal cases relating to art believed to be looted or otherwise misappropriated during and after World War II.)
- Cultural Property (Antiquities) Disputes Over Non-United States Property (Includes claims, primarily by foreign countries, for art or objects said to be part of their cultural heritage under patrimony or export laws that restrict the ownership or export of certain types of objects; also includes U.S. Customs Actions or other Cases regarding cultural property brought into the U.S. in violation of U.S. law; and includes some international cases not involving people or property in the U.S.)
- United States Cultural Property (Includes claims concerning U.S. cultural property said to be owned in violation of the Native American Graves Protection and Repatriation Act (NAGPRA) and of laws governing archaeological objects found on federal land.)
- Art Theft (Other than World War II and Cultural Property Looting) (Includes civil and criminal cases of theft and replevin.)
- Other Ownership Title Disputes/Claims Including Conversion and Breach of Contract (Includes disputes over auction and gallery sales; voidable title; estate claims.)
- Art Fraud, Attribution, Authenticity, Forgery, Libel, Defamatory Statements (Includes civil and criminal cases of art fraud and forgery; disputes over expert opinion and catalogues raisonnés and authentication boards; disputes over attribution and authenticity.)
- Valuation/Appraisal (Cases concerning U.S. tax court decisions; estate valuations and other valuation issues.)
- Copyright, Moral Rights and Other Issues (Cases concerning an artist's moral right to his art; copyright violations; and disputes over art commissioned for display in public places.)

Case Note: Having Good Title

Autocephalous Greek-Orthodox Church v. Goldberg & Feldman Fine Arts, Inc., 717 F. Supp. 1374 (S.D. Ind. 1989), aff'd 917 F.2d 278 (7th Cir. 1990) (mosaics). A number of Byzantine mosaics were looted from an Orthodox church in Cyprus sometime after 1974. The Church of Cyprus learned of the theft in 1979. The Republic of Cyprus and the Church immediately began an extensive campaign to recover the mosaics by publicizing the theft to a wide variety of international agencies, foreign governments, museums, and experts in Byzantine art.

In 1988, an Indiana art dealer, Peg Goldberg, purchased four of the mosaics for over \$1M from a Turkish art dealer living in Germany. Cypriot authorities learned of the mosaics' location when Marion True, then curator at the J. Paul Getty Museum, notified them that the works were being offered for sale by an American art dealer. Goldberg refused requests to return the works.

In 1989, the Church of Cyprus and the Cypriot government brought a legal action in which the original owner seeks to recover possession of property wrongfully taken or retained by another party. In light of the actions taken by Cyprus in publicizing the theft of the mosaics, the court concluded that the plaintiffs had exercised due diligence in attempting to recover the stolen mosaics and thus rejected Goldberg's claim that the suit was beyond the statute of limitations. Despite Goldberg's (unsubstantiated) allegations that she had contacted the International Foundation for Art Research (IFAR) and other organizations to confirm the propriety of the sale, the Court rejected Goldberg's argument that she was a good faith purchaser concluding that she failed to exercise due diligence in determining whether or not title on the property was clouded.

Fraud by a Dealer/Appraiser

In the broadest sense, a fraud is a deception made for personal gain or to cause harm to another individual. The specific legal definition varies by legal jurisdiction. Defrauding people of money is a crime and is probably the most common type of fraud. Fraud is a crime, but it could also be a civil law violation which, like negligence and malpractice (negligence by a professional), is a type of civil law violation known as a tort.

A tort is a civil wrong for which the law provides a remedy. A civil fraud typically involves the act of intentionally making a "false representation" of a material fact with the intent to deceive which was reasonably relied upon by another person to that other person's eventual detriment.

A "false representation" can take many forms, such as:

- A false statement of fact, known to be false at the time it was made
- A statement of fact with no reasonable basis to make that statement
- A promise of future performance made with an intent, at the time the promise was made, not to perform as promised
- A statement of opinion based on a false statement of fact
- A statement of opinion that the maker knows to be false
- An expression of opinion that is false, made by one claiming or implying to have special knowledge of the subject matter of the opinion. "Special knowledge" in this case means knowledge or information superior to that possessed by the other party, and to which the other party did not have equal access.

For the appraiser, the leading case on civil fraud is **Goldman v. Barnett** (see summary below) in which case the dealer/appraiser Barnett was found guilty of intentionally making a false statement of material fact for the purpose of causing Goldman to make purchases of works of art Barnett knew to be worth less than the value he represented to Goldman. There is a brief summary of Goldman v. Barnett elsewhere in this Lesson.

Granted, this is a case involving a dealer, but it is of interest to us because it involves the dealer trying to act simultaneously in the role of an appraiser. Not a good idea. What can be learned from Goldman? In brief: avoid conflicts of interest; clearly state the type and definition of value and the intended use of the report; be qualified to appraise the subject property.

Case Note: Dealer/Appraiser Fraud

Goldman v. Barnett 793 F. Supp 28 (D. Mass 1992) (art). This is a leading case on art fraud. David Goldman was a Massachusetts businessman. In 1988, he decided to purchase artwork to decorate his home and his office. On the recommendation of one of his employees, Goldman met with David Barnett, the owner of an art gallery in Milwaukee, Wisconsin.

Between May and August of 1988, Barnett convinced Goldman to purchase 66 works of art, including 12 which Barnett held on consignment from the estate of the late 20th Century American Artist Milton Avery. These works had been consigned directly to Barnett by Sally Avery, Milton Avery's widow. In nearly every instance, Mrs. Avery set a price for the works she consigned to Barnett and expected him to ask that price as the selling price.

Before selling the artwork to Goldman, however, Barnett told Goldman that he would give him a "fair market value" appraisal of each work of art. He therefore provided Goldman with an appraisal of each work of art with an appraised value and a purchase price. In fact, Barnett wrote Goldman that "I spoke with Mrs. Avery ... and did the best I could for you regarding price and payment schedules. I am pleased to be able to offer a 14% discount off of the appraised value of \$1,028,035.00, or \$886,185.00." Based on Barnett's representations regarding the art's "fair market value," and the discount Goldman was getting from that value, Goldman accepted the deal. He made a substantial down payment and agreed to pay \$100,000 monthly until his debt was paid off.

After making several monthly payments, Goldman came to believe that his paintings were worth substantially less than their appraised value, and even less than the price he had agreed to pay. In fact, according to at least one expert, the art had a fair market value of less than a quarter of Barnett's appraised value, and less than a third of the amount Goldman agreed to pay. For example, Barnett sold Goldman one Avery painting called Mandolin With Flowers for \$160,000, based on his appraisal of the work at \$200,000. Ultimately, Goldman's expert located Barnett's actual purchase price for the work from Christies in December of 1987, just 6 months before he had sold it to Goldman, for \$45,000. This was one quarter of Barnett's appraised value of \$200,000 and one third of his selling price of \$160,000.

Therefore, Goldman stopped making payments and filed his suit. Goldman based his suit on eight counts, each count brought against both Barnett and the Avery Trust. Among these counts was a claim for fraud.

The Avery Trust, believing that even if the facts were as Goldman claimed them to be, Goldman would still lose his case, moved for summary judgment. The Court denied

summary judgment with regard to seven of the eight counts, ruling that if Goldman was able to prove the facts he had presented, a reasonable jury could find in his favor.

Less than three weeks after the decision came down, the case settled.

The significance of this decision for art dealers and appraisers is that it is one of the first decision to subject those persons to potential liability for fraud when their appraisals are found to be inaccurate. Although prior cases had found appraisers liable for negligence, liability for fraud may pose serious consequences for the appraiser. In many jurisdictions, liability for fraud subjects an appraiser to liability for triple or even punitive damages.

In Goldman, the judge ruled that there was sufficient evidence for a jury to find Barnett and the Avery Trust liable for fraud. This claim required a finding that Barnett, both individually and as an agent for the Avery Trust, made false statements of fact upon which Goldman relied in deciding to buy the art.

In so ruling, the Judge dismissed the Avery Trust's argument that Barnett's appraisal of the works of art was merely his opinion. Instead, the judge ruled that, because Barnett held himself out to be an expert art appraiser, with a specific expertise in Milton Avery, his representations that the art had a fixed "fair market value" could be viewed as a representation made by one possessing knowledge rather than opinion. In this way, it could be treated as a misrepresentation of fact rather than opinion, and subject Barnett to potential liability for fraud.

Fraud also requires a finding that Barnett made his representations to Goldman either knowing that his valuations were false or with the intent to deceive him so that Barnett could make a higher profit. In the Goldman case, the court found enough circumstantial evidence for a jury to conclude that Barnett knew that his representations were false, and that he made them in order to encourage Goldman to purchase the art. The judge made this finding based on the evidence that (1) Barnett's appraisals were, on average, four times higher than the fair market value, according to at least one expert; (2) Barnett received a commission on his sales, inducing him to inflate the purchase price; and (3) Barnett held himself out as an expert appraiser, indicating that he did know the "true fair market value." Therefore, the judge concluded that such appraisals by an interested party constitute circumstantial evidence of intent. With sufficient evidence to prove intent, Goldman had enough evidence to go to the jury on the issue of fraud.

From the Goldman several suggestions for the appraiser can be gleaned:

- **Avoid conflicts of interest:** Do not appraise items you are selling. Dealers must avoid the potential conflict of interest that arises when a dealer appraises works of art for his buyer or seller. Suffice it to say, dealers should not appraise items they are buying, selling, or that they own.
- **Clearly state the type and definition of value and the intended use of the report.** Dealers must avoid any question about the type of valuation (i.e. the fair market vs. the replacement value) which is being applied. Barnett may have intended to give Goldman an insurance appraisal, since on some, but not all, of the appraisals, it stated that they were for insurance purposes. But Goldman claimed that Barnett had orally told him that these were "fair market value" appraisals. Even though not one of the appraisals stated that they were based on the fair market value of the works, because many of the appraisals did not state a valuation basis, Goldman's oral testimony was enough to get to the jury. Always state the objective of your appraisal and your valuation basis in writing to avoid confusion or potential liability.

- **Be qualified to appraise the subject property.** An appraiser must make sure that he has the requisite expertise and information to render an appraisal upon which a buyer or seller may rely. Don't appraise anything where you lack the knowledge or expertise — it can only get you into trouble.

Malpractice (Professional Negligence)

A tort is any wrongful act, damage, or injury done willfully, negligently, or in circumstances involving strict liability, but not involving breach of contract, for which a civil suit can be brought. (Websters)

Negligence, along with its professional counterpart, malpractice, are torts.

In brief, negligence is the failure to use such “due care” as a reasonably prudent and careful person would use under similar circumstances to avoid injuring someone. In order to show that one acted negligently, the plaintiff needs to show that 1) the defendant had a duty, 2) the defendant did breach that duty, 3) the breach caused the plaintiff harm, and 4) the harm resulted in damages.

But when it comes to professionals, “due care” is no longer based on what a reasonable person would do, but rather on what a reasonable professional would do under similar circumstances. Malpractice typically arises from a professional's misconduct or failure to use adequate levels of care, skill or diligence in the performance of the professional's duties and as a result harm is caused to another.

There are several typical theories of malpractice (many of which involve medical malpractice), but the primary theory affecting the personal property appraiser involves the lack of due care. In other words, the professional did not live up to the governing standards of professional care and conduct.

Malpractice typically occurs if a professional fails to exercise his or her professional skills at the level of care, skill and learning applied in similar circumstances by the average reputable member of the profession. Comparison of performance is based upon the standard of care for the professional in the "community" — what other professionals in the same field do for their clients. The nationally-accepted Uniform Standards of Professional Appraisal Practice Societal combined with personal property appraisal societal standards have largely established what today is considered the standard of care expected of the professional personal property appraiser.

The impact of this increased professionalism has effected a dramatic improvement in the quality and accuracy of appraisals. It has, however, also brought with it increased exposure and liability for appraisers. Having set a standard of professionalism and care for appraisers to follow, it is now much easier for plaintiffs' attorneys to impose liability upon appraisers for failure to follow these standards. As a result, appraisers who often appeared as expert witnesses, now find themselves in the dubious position of visiting the court room wearing the label of defendant.

Several factors determine whether an appraiser is liable for a negligently-prepared appraisal. First, what is the extent to which a personal property appraiser is considered a "professional"? Professionals are those who undertake any work calling for a special skill. A professional is required not only to exercise reasonable care in what he does, but also to possess a minimum standard of special knowledge and ability. Most cases involving professionals have dealt with physicians and surgeons. But the same standard applies to dentists, pharmacists, psychiatrists, attorneys, architects, engineers, accountants and even many skill trades. There is a growing tendency in the law to require those who practice in the appraisal profession to adhere to the

professional's standard of care. See **Soderberg v. McKinney** below for a California case which recognized appraisers (albeit real property appraisers) as a category "information-supplying professionals" not unlike accountants, lawyers and public auditors. As such, the appraiser can be held liable for negligence not only to the client but also to third party users of the report even if those users were not identified as intended users by the appraiser.

Be aware that potential claimants for a malpractice action could include clients, the owner of the property, a prospective purchaser, a prospective lender (such as for a collateralized loan appraisal), other identified intended users, or even third parties who were not intended to rely on the appraisal.

To help minimize claims for third party liability, it is essential that you include in your appraisal report the identities of the client and intended users, a prohibition of use of the appraisal by others not so identified, limiting conditions encountered and extraordinary assumptions made, and any limitations on your competence and the steps taken to overcome those limitations.

Elements of a Suit

In order for malpractice to be actionable, injury, loss or damage must be suffered by the person who retained the professional's services, or by those otherwise entitled to benefit from or rely upon the professional's services, such as identified "intended users" of an appraisal report.

Perhaps the most publicized forms of the tort are medical malpractice and legal malpractice by medical practitioners and lawyers respectively, though malpractice suits against accountants, investment advisors, real estate and business appraisers have also made the headlines recently. Actions against personal property appraiser for malpractice actions are seldom encountered, though the leading case of **Estate of Querbach v. A & B Appraisal Serv.** (summarized below) demonstrates the severity of the issue when they do.

As with negligence, in order for a malpractice case to be actionable, the following elements must be in place:

- Duty: A duty was owed by the professional to the plaintiff.
- Breach: There was a breach of that duty by the professional.
- Causation: There was injury to the plaintiff that was caused by that breach of duty, and
- Damages: There were damages to the plaintiff which resulted from the injury sustained. (Damages are usually considered to be an essential element of a malpractice claim. That is to say, even if a plaintiff can prove malpractice, a plaintiff is usually unable to sustain a suit unless the malpractice actually caused the plaintiff to suffer damages.)

Appraisers Depend on Societal Standards and USPAP for Guidance

Unlike doctors or attorneys who have structured educational requirements, there are generally no similar requirements for personal property appraisers. There is no appraisal state bar to join or state appraisal examination to pass. States have no licensing or certification requirements for personal property appraisers.

Although an individual appraiser may have no required methodology and the appraisal conclusion may depend on many factors, the appraiser's commitment to and compliance with recognized professional standards enhances the appraisal report as well as the overall appraisal discipline. It is this utilization of high standards of competence in a specialty, a distinct body of knowledge, and a code of ethics that serves to identify an appraiser as a professional. As such, he or she will be judged in court not by the standard of a reasonably prudent person utilizing the skills of

everyday experience, but rather by the experience, skill, training and learning of a professional. Thus, it is not enough that your appraisal was done with more care than a lay person would do it. It must be done with at least the minimum standard of care expected of a professional personal property appraiser.

In view of the relatively few cases involving appraisers, the courts have not had an opportunity to set forth judicially-derived standards of conduct for the personal property appraiser. Thus, the courts are more likely to draw on standards formulated by The Appraisals Foundation's USPAP and by professional societies as was the case in Querbach when determining whether a particular appraiser's performance falls below the level of skill ordinarily possessed and exercised by the profession.

Case Note: Appraiser Malpractice

Estate of Querbach v. A & B Appraisal Serv. No. L-089362-85 (N.J. Sup. Ct. 1987) (art). Eleanor Querbach died on February 9, 1985, leaving a home furnished with antique clocks, antique furniture, paintings, Oriental rugs, and other unusual household furnishings. One of the residuary legatees was the Sturbridge Village Museum in Massachusetts, who expressed an interest in acquiring some of Mrs. Querbach's antiques for its collection at the appraised fair market value of the antiques, which sum Sturbridge agreed would be credited against its interest in the estate.

Therefore, the executor hired an appraiser, Benjamin Davis, of the ISA, who worked for a company called A&B Appraisal Service, to evaluate the individual personal property of Mrs. Querbach. Mr. Davis made a room by room, item by item appraisal of Mrs. Querbach's personal property. Three of the items he listed in the living room were what he called small unframed oil paintings, and he valued them at \$50 each.

After receiving the appraisal from Mr. Davis, the executor sold one of the paintings to an acquaintance for \$50. The acquaintance then took the painting to be framed, and the framer advised him to go and get the artwork appraised. The second appraiser found the value of the painting to be \$14,800, and the acquaintance, in delight, told the executor. The executor sued Mr. Davis for damages.

The executor and his new appraiser claimed that the painting was by J. F. Cropsey, a renowned American artist of the Hudson River Valley School. They said that authenticity was established by the following cumulative evidence:

- The signature on the painting was J.F. Cropsey, 1882;
- The technique and pigments were typical of the Hudson River Valley School painters of the late 19th century;
- The stretch frame of the painting was typical of the artist;
- The back of the painting had a remnant of a paper label typical of the artist stating "St. Lourdes, J.F. Cropsey, 57 West..." and the artist was known to have a studio at the partial address shown on the label; and
- The subject matter of the painting was typical of the artist.

Based on this evidence, the court found that the painting was an authentic J.F. Cropsey, painted in 1882.

The court then went on to find that Mr. Davis was liable for the approximate difference between the fair market value of the painting, at \$14,800, and the amount the executor sold it for, or \$50. The court made this determination based on the fact that:

- Mr. Davis represented himself to be a member of the International Society of Appraisers, which had adopted a code of ethics and professional conduct with certain standards to be observed by their members, which apparently were not observed here;
- Mr. Davis was advised that the appraisal would be used for Internal Revenue purposes, and he had not followed Revenue Procedure Rule 66-49;
- The public has a right to expect that persons holding themselves out to be appraisers of fine art are competent to recognize or utilize accepted professional procedures to identify and evaluate fine art; and
- Mr. Davis failed to meet his professional responsibilities as an appraiser when he neither recognized J.F. Cropsey as being a noted American painter, nor determined whether the artist's name had any significance in the art world, nor determined that the painting was a fine example of the Hudson River Valley School of Art, and obviously made no close examination of either the painting or the reverse side of the painting, which would have led him to this conclusion.

The Court acknowledged the lack of cases stating the professional standards and procedures for appraising fine art, but looked at the International Society of Appraiser's code of ethics and professional conduct in determining the standards an appraisal should meet. An appraisal should include a complete description, acquisition information, history of the item, photograph, and statement of factors on which the appraisal was based. The Court found that the defendant had failed in his professional responsibilities when he failed to see the artist's name on the painting and recognize the painting's value. The Court thus found the defendant was negligent and had breached his duty to the plaintiff.

The Court thus found the defendant was negligent and had breached his duty to the plaintiff. The court entered judgment in favor of the plaintiff and against defendant in the amount of \$14,700, plus prejudgment interest.

This case shows the danger to those of you who do large scale appraisals of estates that you must be very careful. Don't try to do more than you are capable of doing. Look carefully at the works you are appraising, and make sure to look for signatures on the front of paintings, labeling on the back of paintings, and then research the names you find. Querbach indicates that your failure to do so may lead to liability for malpractice.

It might be the case that it may not be enough in such instances to state that for the limited amount of money paid, a more thorough appraisal with full research could not be done. At the very least, it is essential that you advise the client that you have noted certain telltale signs about the item you are appraising, and ask them whether they want you to do further research. If they decline, then you should note that in your appraisal, since this may help to shield you from liability.

However, cases like Estate of Querbach may indicate that such a limiting statement may not be enough. Mr. Davis argued at trial that he was not paid enough to have done that kind of research, but his argument did not succeed.

Case Note: Appraiser Liable to Third Parties

Soderberg v. McKinney 44 Cal. App. 4th 1760, 52 Cal. Rptr. 2d 635 (1996). California Court of Appeals. Deals with real estate appraisers but has an impact on all information-supplying providers including personal property appraisers.

Appraisal reports are an ordinary part of real estate transactions. Lenders follow certain criteria in connection with making loans secured by real property, particularly including the requirement of a “cushion” of equity to protect the lender in the event of foreclosure. Thus, if the property does not “appraise” at a specified value, the lender will not make any loan to the borrower.

In *Soderberg*, the court held that a real estate appraiser could be liable to investors for misrepresentations contained in its appraisal, even though the appraiser had been retained by a mortgage broker rather than by the investors themselves. In *Soderberg* the investors sued the appraiser for negligent misrepresentation. Negligent misrepresentation is a state of tort - a tort is simply a form of harm.

Soderberg increases the legal exposure of "information-supplying professionals" such as accountants, lawyers, public auditors, and appraisers.

Before *Soderberg*, the law has been that no duty existed when unspecified third persons relied upon the appraisal and therefore there could be no liability of the appraiser to third persons.

In *Soderberg*, the appellate court held that an appraiser who prepares an inaccurate appraisal report could be held liable for negligent misrepresentation to third party investors who make loans in reliance on the report. According to the appellate court, the appraiser need not even know the name or specific identity of the potential investor or the details of the contemplated transaction; liability may be appropriate where the appraiser “knows with substantial certainty that plaintiff, or the particular class of person to which plaintiff belongs, will rely on the representation in the course of the transaction.”

Appraisers can take measures to circumvent liability within the appraisal report. Expand usage of terms and conditions clauses. Give notification clauses which are unintended third party users rely on the appraisal to their peril.

Negligent Referral

Appraisers are frequently asked by a client (or a non-client) for a referral to someone capable of providing personal property related services such as an auctioneer, estate liquidator, restoration specialist or consignment service. Appraisers may also find themselves in a position of having to decline an appraisal and refer their client to a specialist appraiser for appraisal services of property outside the referring appraiser’s specialty area.

Appraisers must be knowledgeable about the types of referrals they might be asked to make and be prepared to reply knowledgeably regardless of whether or not they choose to make a specific recommendation.

Examples of the types of services to which the appraiser might be asked to refer a client include:

- Real property appraisers for associated real property appraisal needs
- Repair or restoration specialists
- Conservators
- Specialist appraisers
- Appraisal societies when seeking a local appraiser
- Specialist grading services (coins, stamps, sport cards, gems)
- Authenticators
- Laboratories for scientific testing to prove genuineness

- Auction services to liquidate property
- Insurance specialists to discuss coverage needs
- Attorneys, financial advisors, estate planners, or visual arts advisors for issues relating to lifetime and testamentary ownership of high-worth assets
- Museums or historical societies as potential donees
- Museum curators
- Accountants and tax specialists
- Wholesale buyers
- International Foundation for Art Research (www.ifar.org) regarding stolen art

The issue of referrals was briefly addressed in the Lesson 8 section entitled “*Fees Paid to Procure an Appraisal Assignment vs. Finder’s (Referral) Fees*” where the topic of referrals was addressed but only to the extent of noting that **while performing as an appraiser**, accepting a finder’s fee (a.k.a. referral fee) when referring an **appraisal** client to another **appraiser** was prohibited, there were no prohibitions to accepting finder’s fees when referring non-appraisal clients to non-appraisers. Nor were there prohibitions against accepting finder’s fees when performing in a capacity other than as an appraiser, such as while functioning as an auctioneer or estate liquidator.

In this section, we will elaborate on the issue of making referrals in general. And, though largely an insignificant issue for the appraiser (I have never heard of an appraiser being charged with much less found guilty of the tort), we will caution against making referrals negligently.

The doctrine of **negligent referral** comes in two flavors. One involves an employer and a former employee. The second involves providing an individual with a referral to another service provider who, subsequently, performs at a substandard level.

The first type of negligent referral does not involve the appraisal profession but should nonetheless be briefly brought to your attention. In this first form of negligent referral, an employer can be held liable for not revealing important information about a former employee — for instance failing to reveal truthful information as to why the former employee was fired to another company that is conducting a pre-employment investigation to determine the former employee’s suitability for employment at the new company. This definition of negligent referral does not impact the appraiser.

But an appraiser could (although highly unlikely) become liable when considering the second type of negligent referral which involves the act of referring someone to one who is not properly qualified, licensed or certified to perform a specific service. The referral of someone by an appraiser to another appraiser (or to other professionals such as an auctioneer or estate liquidator) could be deemed negligent if the referring appraiser knew or should have known that the appraiser or third party service provider to whom the referral was made would perform in a substandard manner. Although referrals generally improve the quality of service the person receives, it is possible that the person can instead be harmed if referred to a service provider known to be unqualified due to a lack of skill or judgment. (Negligent referral can be very difficult to prove in cases where the referring appraiser had no prior knowledge about the referral appraiser’s lack of skill or judgment. For this reason, negligent referral is not a frequent cause of action.)

Appraisers might respond to telephone inquiries by referring prospective clients seeking work the appraiser doesn’t provide, or existing clients who need other types of personal property related services. Referrals also can occur in a dinner conversation, after a presentation made to the general public, in response to an inquiry over the phone, in emails and via Web site links. (If your Web site provides links to other sites, your web page should prominently display an appropriate

link disclaimer. The disclaimer essentially should state that by simply providing the links, your firm does not intend the links to be a client referral to, or an endorsement of, the linked entities.)

The most dangerous type of referral is one that results in a referral fee. That is why we discourage appraisers from accepting referral fees when referring an appraisal client to another appraiser. It does not matter if the fee was expected or simply offered as a gift. Accepting the fee can make the referring appraiser liable for the receiving appraiser's work. If the appraiser to whom you refer an appraisal client offers you a fee, you should decline it or suggest that the appraiser instead give the fee amount to the client.

So, what are the appraiser's options regarding giving out referrals? The appraiser could refuse to give referrals. But telling the client to look in the phone book could cause the client to feel slighted by the appraiser's lack of knowledge about possible candidates for referral or by the appraiser's refusal to provide referrals. "What do you mean you don't know anyone? Isn't that what you are supposed to be able to do?"

Use good judgment when selecting appraisers, specialists or consultants for referrals and avoid referring clients to any professional who fails to practice according to the recognized standard of care. If possible, provide more than one name, make no promises regarding the receiving person's qualifications or work, and, finally, do not accept referral fees when performing as an appraiser.

Tax Court Cases: Most Appropriate Market

Anselmo v. Commissioner 80 T.C. 872 (1983), aff'd 757 F.2d 11208 (11th Cir. 1985) (gemstones). The dispute in this case focused on establishing the most appropriate market for a large number of loose, unmounted, low-quality Bolivian gemstones for the purpose of determining the stones' fair market value. The Tax Court found the most common market for low quality, unmounted gems was to jewelry manufacturers and jewelry stores who would use them to create jewelry items. The major issue of contention revolved around markets the experts assumed when valuing the stones. The Anselmo's experts valued the gems as though they were mounted in typical finished jewelry items and sold in retail stores. They valued each gem by determining the portion of a piece of jewelry's retail price that represented the value of the gem. The IRS's experts, on the other hand, valued the gems on the assumption that the stones would be sold together as a bulk to a single jewelry manufacturer or retail jeweler who would use them in the manufacture of finished pieces of jewelry. The IRS contended that such a large bulk sale would require a discount from the usual price. The court rejected the taxpayer's proposition that the most common market was the market in which the individual member of the public made a purchase at the jewelry store. Instead, the court ruled that the most common purchaser would be a jewelry manufacturer or a jewelry store. The court rejected the IRS's that a discount should be applied because the items would be sold as a group. Instead the court ruled that the gems should be appraised individually.

This case states that the word "public" in the Treasury Regulation definition of fair market value refers to the customary purchasers of an item and not all purchasers. Thus the customary purchasers of a large quantity of unmounted low-quality gemstones are jewelry manufacturers and not individuals.

Engel v. Commissioner 66 T.C.M. (CCH) 378 (1993) (animal trophy mounts). The court was faced with valuing wild game trophy mounts donated to a museum where there was not an active sales market for the donated property. The court noted that "based upon the record in this case, there is not sufficient showing of an active market and comparable sales to warrant exclusive reliance upon that method of valuation as respondent (the IRS) would have us do. On the other hand, there also is not a total lack of market as to require the use of replacement cost alone as the

donor's expert advocates." In effect, the court said that when a market has little activity, it should not be relied upon exclusively as a basis for fair market value. But neither does a market with minimal activity warrant the use exclusively of the replacement cost approach.

Biagiotti v. Commissioner 52 T.C.M. (CCH) 939 (1986) (pre-Columbian art). The best valuation of pre-Columbian and Mayan art price was price collectors paid private dealers, not what they paid at auction. Collectors of properties of potentially dubious provenance, such as pre-Columbian and Mayan art, most often prefer private dealers, who offer guarantees of authenticity, and special connoisseurship in their specialty. Thus, in this case auction sales would not be the most appropriate market place for determining fair market value because such markets would not be representative of the majority of sales of such art in the United States and would not be indicative of the average sale prices of this type of property. In view of this, the Tax Court found that using Sotheby's auction sales as a basis for value was not appropriate. The court limited the appropriate market place to private dealer sales which was a better measure of the market in which collectors of such items most commonly make their purchases.

Ferrari v. Commissioner 58 T.C.M. (CCH) 221 (1989) (pre-Columbian art). This is another case that found the best indication of fair market value for pre-Columbian art would be a range of prices (not a single price point) from the retail gallery market and not from auction sales. Based on the testimony of both experts, the Tax Court determined the applicable market for pre-Columbian art to be the retail market at art galleries where buyers typically want to rely on the guarantee of authenticity and the connoisseurship of the dealer. The court further found that galleries have no uniform way of pricing such art. Rather, pricing is essentially a question of judgment, experience, the price paid by the gallery to obtain an object, and the gallery's level of mark-up. Thus, it concluded that the fair market value with respect to pre-Columbian art is not a single price but a range of prices.

Quedlinburg Treasures. In 1945 WWII medieval treasures were stolen and shipped home to Texas by the decedent who was a soldier at the time. Upon the soldier's death, the treasures were considered as part of decedent's estate because under section Estate Tax regulations ownership is based "upon a decedent's possession of the economic equivalent of ownership, rather than upon the decedent's possession of a technical legal title." Estate attorney's argued that since there was no market for stolen art, value was zero. The IRS argued that there were individuals in the "discreet retail market" who would purchase the items and so concluded that the fair market value of the art objects was "the highest price that would have been paid, at the time of the decedent's death, whether in the discreet retail market or in the legitimate art market." This issue resulted in the IRS issuing **Priv. Ltr. Rul. 9152005** stating that fair market value of stolen art objects was the highest price that purchaser would have paid whether in the illicit or legitimate art market.

Skripak v. Commissioner 84 T.C. 265 (1985) (books). The taxpayer purchased a large number of scholarly reprints of professional books from the publisher for one third of the list price and later donated them. The taxpayer claimed a deduction of the full catalog list price. The court allowed only the deduction despite it being a tax shelter with the clear goal of obtaining a deduction. But the court allowed a fair market value of only 20 % of catalog list price which was less than the taxpayer originally paid! In Skripak, the court applied blockage arguing that the simultaneous marketing of all the books at one time would have a depressing effect on the market. This might have been inappropriate since the "Valuation Guide for IRS Agents" states that a blockage discount "applies only to estate tax valuations and not to charitable contribution valuations, since the taxpayer (contributor) actually controls the market by how many items are contributed." In the Hunter case below, the court got it right by not allowing the application of blockage to a charitable contribution valuation.

Hunter v. Commissioner 51 T.C.M. (CCH) 1533 (1986) (prints). The taxpayer bought a bulk of lithographs from a middleman who had purchased them as excess stock from a gallery. The

middleman sold them for about one quarter of their retail gallery price to the taxpayer. The taxpayer donated them and claimed a deduction of the full gallery list price. The court dismissed the IRS contention that a blockage discount should be applied. The court, however, concluded that the deduction was limited to what the taxpayer paid for the prints since the relevant retail market level for such a bulk purchase was the middleman-to-donor level and not the gallery-to-retail customer level. “The most probative (i.e. furnishing evidence of proof) evidence of the fair market value of the prints is the amount petitioners paid for them.”

Lio v. Commissioner 85 T.C. 56 (1985). This case is similar to *Hunter v. Commissioner* in that the court limits the deduction to the amount recently paid by the taxpayers for the prints as part of a tax shelter. However, in *Lio* the court rules that the “ultimate consumer” is one who does not hold the item for subsequent resale, at least in the item’s current form. The court also defines “appropriate market” as the most active marketplace for the particular item involved regardless of whether the market is considered primary or secondary.

Goldman v. Commissioner 46 T.C. 136 (1966), aff’d 388 F.2d 476 (6th Cir. 1967) (books). Taxpayer donated outdated medical journals but claimed an amount of deduction equal to the average retail sales price for current issues. The court disallowed the deduction stating that the only market available to an owner of such books was a second-hand book dealer. As such, the fair market value of the books is equal to what the second-hand book dealer would pay.

Tax Court Cases: Fair Market Value

Ashkar v. Commissioner 61 T.C.M. (CCH) 1657 (1991) (ancient biblical fragments). Neither the taxpayer's nor the IRS experts were appraisers. They were academic scholars. The court rejected both appraisals and instead made use of an offer to buy which was close to the average of the prices offered by the two experts.

Murphy v. Commissioner 61 T.C.M. (CCH) 2935 (1991) (sandstone rock sculpture of John Wayne). The court decided that the taxpayer's valuation of \$500K was erroneous because a faulty appraisal failed to discuss the poor condition of the sculpture (brow, chin, cheek missing) and failed to verify the accuracy of comparable prices.

Perdue v. Commissioner 62 T.C.M. (CCH) 845 (1991) (gold artifacts from a sunken Spanish ship.) The Tax Court concluded that a premium could be added when valuing the artifacts in recognition of the excitement and the glamour associated with the fact that the items were recovered from a sunken Spanish ship — the equivalent of a "glamour market" appeal.

Doherty v. Commissioner 63 T.C.M. (CCH) 2112 (1992) (Charles Russell painting). Two eminently-qualified experts could not conclude genuineness. One valued it as genuine at \$200K. One as a fake at \$100. The court did not rule on the issue of authenticity, but assigned a value of \$30K stating that a dispute over authenticity causes a depressing effect on value.

Lightman v. Commissioner 50 T.C.M. (CCH) 266 (1985) (art) and **Rhoades v. Commissioner** 55 T.C.M. (CCH) 1159 (1988) (opals). In both these cases, the court recognized that an advantageous purchase by the taxpayer (perhaps as a result of a price concession made by the seller) could result in a price paid that was not indicative of fair market value but, rather, could have been much less than fair market value. Accordingly, the court used auction prices to establish the fair market value of the donated property which value was higher than the taxpayer's purchase price.

Mast v. Commissioner 56 T.C.M. (CCH) 1.522 (1989) (glass stereoscopic negatives). The court sided with the taxpayer’s valuation of \$1.25M since the taxpayer's appraiser made use of market

comparisons with reported sales, sales catalog sales prices, showroom and gallery pricing, opinions from leading galleries, as well as auction house estimates. The court rejected the IRS's appraiser (\$450K) who based a value conclusion on five collections which the court decided were not comparable.

Williford v. Commissioner 64 T.C.M. (CCH) 422 (1992) (art). Past comparable sales and documented private sales are the best evidence of fair market value. But secrecy and the lack of the private transactions that take place outside the auction house create challenges for the appraiser. Regardless, in Williford the court concludes that the appraiser has an obligation to identify the subject property's most common market and, if necessary, to obtain the necessary private sales data by retaining the services of experts, dealers and consultants who are familiar with the property type.

Tax Court Case: Buyers Premium

Scull v. Commissioner 67 T.C.M. (CCH) 2953 (1994); see also Scull v. Scull, 462 N.Y.S.2d 890 (N.Y. App. Div. 1983), appeal dismissed, (works of Pop art). The court held that the proper measure of fair market value is what could be received on, not what is retained from, a hypothetical sale. Accordingly, the hammer price plus the buyer's premium should be includable in the decedent's estate for federal estate tax purposes. But this ruling has little practical application in most estates because the buyer's premium is often deductible by the estate as an administration expense (if sale was required to pay taxes or decedent's debts or other expenses of administration — but not otherwise such as in selling just to divide property equitably among heirs.) Appraisals should state whether or not comparable sales include the buyer's premium and the amount of the premium.

Scull relied (whether correctly or not is in dispute) on **Publicker v. Commissioner** 206 F.2d 250 (3rd Cir. 1953) (gift tax appraisal of jewelry) in which the court ruled that the fair market value of the jewelry the “price at which such property would change hands between a willing buyer and willing seller includes the excise tax paid by the purchaser of the property.”

Tax Court Cases: Blockage Discount

Smith v. Commissioner 57 T.C. 650 11972, aff'd 510 F.2d 479 (2nd Cir. 1975, cert. denied, 423 U.S. 827 (1975) (numerous art works by the deceased in the decedent's estate). The estate for noted sculpture David Smith argued that the value for 425 of the deceased's sculptures should be discounted by 75% due to the negative impact on value which would be caused by offering such a large number of items to the market at one time. The estate also requested an additional one-third discount as an allowance for the commission that would be needed to pay the dealer who would affect such a sale. The court acknowledged that a blockage effect existed but permitted only a 50% discount instead of the requested 75%. The court disallowed the petitioner's one-third sales commission discount observing that fair market value reflects what is to be received and not what is to be retained from a hypothetical sale. The Tax Court gave official approval to the acceptance of making use of the concept of blockage when valuing art for estate tax purposes. The court recognized the depressing effect on value the simultaneous availability of an extremely large number of items of the same general category would cause. But the court provides no guidance on how to determine the discount.

Unlike the Smith case, in **O'Keeffe v. Commissioner** 63 T.C.M. (CCH) 2699 (1992) the Tax Court sets forth a rational, mechanical way to compute the discount. In O'Keeffe, the Tax Court recognized that it would be unreasonable and unadvisable for the estate to dump a large number of similar items on the market on the valuation date. To do so would invite a depression in values from which recovery could take years. Instead, a more advisable approach would be to stagger

the sale of properties over a long period of time (perhaps years) in order to maximize sales prices. Important tax court conclusions include:

- It is not necessary that it be assumed that all artwork be dumped on the market at a single point in time.
- Artwork, if varying in quality and condition, should be segmented into that which can be sold in a relatively short period of time and that which would require an extended period of time to liquidate.
- A present worth analysis of the anticipated future stream of income would be an appropriate valuation technique.
- The deduction of carrying costs and anticipated future expenses is relevant and should be considered.
- Bequeathed works may not be excluded from the taxable gross estate.

Tax Court Case: After Death Discount

Scull v. Commissioner 67 T.C.M. (CCH) 2953 (1994). What if the decedent's property being sold appreciates in value between the date of death and the eventual sale of the property? In Scull, the executors sold works of art owned by the estate through public auction over ten months following the date of death. During that ten month period, it was shown by the estate that the works of art had appreciated in value. Consequently, the works of art sold at public auction for significantly more than they would have had they instead been sold on the date of death (the normal effective date of valuation for estate tax purposes.) The Tax Court agreed and allowed a 5% discount to the sales results in order to compensate for "after death appreciation."

U.S. Dist. Court Case: Fractional Interest Discount

Stone v. Commissioner No. 3:06-cv-00259 (25 May 2007) (19 Impressionist paintings). The Estate owned one-half interest in the paintings. For the first time, a discount to value was allowed for an undivided interest in personal property. The Court stipulated that the Estate was entitled to claim a 5% discount based on its ownership of a fractional (one-half) interest in the paintings.

Tax Court Case: Deduction Allowed for Donation of Contraband

Sammons v. Commissioner 838 F2d. 330 (9th Cir. 1988) (Native American contraband artifacts). Mr. Sammons donated a collection of American Indian artifacts to the Museum of North American Cultures. The IRS Commissioner contended on two counts that the Sammons should be disallowed a deduction for the 35 eagle artifacts which incorporated feathers, claws, or other parts of birds protected under the Bald Eagle Protection Act (16 U.S.C. §§ 668-668d), the Migratory Bird Treaty Act (16 U.S.C. §§ 703-711), and the Endangered Species Act (16 U.S.C. §§ 1531-1543).

The Commissioner argued that relevant federal statutes prohibited the Sammons from obtaining title to the artifacts. Specifically "that where a statute expressly forbids or penalizes a person from entering into a certain kind of contract, the contract itself is void." (Citing S. Williston, A Treatise on the Law of Contracts, 1972).

It does appear that the Sammons may have violated federal law when they purchased the artifacts. But the Tax Court ruled that reliance on Williston is misplaced. If a statute prohibits an agreement or sale, the result is "that the courts will not lend their aid to any attempted enforcement of the agreement of the parties." The Sammons case does not involve an ownership

dispute between parties. The Sammons may have made an illegal contract, but no one is seeking, or defending, enforcement of the contract of purchase or the subsequent gift. Therefore, the Sammons had a sufficient ownership interest in the artifacts to contribute them to the museum. The government might have instituted a proceeding seeking forfeiture of the artifacts under the Eagle Protection Act or the Endangered Species Act, but it did not do so.

The Commissioner argued that even if the Sammons had title to the artifacts, allowing a deduction for contribution of these items to the museum will frustrate public policy. Federal law makes it illegal to acquire or possess the eagle artifacts. To allow the Sammons a deduction for donating the artifacts to the museum would encourage a violation of federal law by subsidizing, through tax benefits flowing from the donation, illegal transactions.

Note that The Eagle Protection Act makes it a federal crime to "...take, possess, sell, purchase, barter, offer to sell, purchase or barter, transport, export or import, at any time or in any manner, any bald eagle commonly known as the American eagle, or any golden eagle, dead or alive, or any part, nest, or egg thereof..." (16 U.S.C. §688(a)).

Similarly, the Migratory Bird Treaty Act provides that "...it shall be unlawful at any time, by any means or in any manner, to pursue, hunt, take, capture, kill, attempt to take, capture, or kill, possess, offer for sale, sell, offer to barter, barter, offer to purchase, purchase, deliver for shipment, ship, exported, or imported, delivered for transportation, transport or cause to be carried, or receive for shipment, transportation, carriage, or export, any migratory bird, any part, nest, or egg of any such bird, or any product, whether or not manufactured, which consists, or is composed in whole or in part, of any such bird or any part, nest, or egg thereof..." (16 U.S.C. §703).

The tax court cited *Commissioner v. Sullivan* "Income tax deductions are a matter of grace and Congress can...disallow them as it chooses." and *Commissioner v. Tellier* "[W]here Congress has been wholly silent, [the Court has upheld a disallowance]...[o]nly where the allowance of [the] deduction would frustrate sharply defined national or state policies proscribing particular types of conduct...Further, the policies frustrated must be national or state policies evidenced by some governmental declaration of them...[and] the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction."

The tax court recognized the high priority Congress has assigned to the policy of protecting endangered species, such as those in the Sammons donation. However, based on the following, the court concluded that public policy did not prevent the Sammons from claiming a deduction for donating the eagle artifacts to the museum:

- There was no showing that the donation would severely or immediately frustrate national or state policy.
- While the allowance might encourage others to donate endangered species artifacts, no evidence was shown proving that allowing for the deduction would encourage the killing or acquisition of protected species.
- This deduction was not viewed as a threat to the national policy of protecting endangered bird species.
- There was no suggestion made that the donation would encourage unscrupulous sellers of Indian art to hunt, capture, and kill protected eagle species in an effort to manufacture "ancient" artifacts that could be sold to collectors, unsuspecting or not, for spurious donations to charitable organizations.

Tax Court Cases: Is USPAP Compliance Determinant?

Does whether or not the appraiser prepares a USPAP-compliant report the determining factor as to whether or not the resulting appraisal report will be accepted by the Tax Court? The jury is still split. Two cases shed light on the question. *Whitehouse v. Commissioner* and *Kohler v. Commissioner*.

Whitehouse Hotel v. Commissioner 131 T.C. No. 10 (a business appraisal) specifically mentions USPAP compliance by the business appraiser as not being determinant. Rather, reliability is determinant. The IRS' appraiser submitted an appraisal that did not fully comply with USPAP. The taxpayer argued that the appraiser's report was per se unreliable since it was not in conformance with USPAP. The IRS further argued that the report should, therefore, not be received into evidence.

But the court held “...that expert testimony be based on “reliable principles and methods”, and we will not supplant our responsibility to assess an expert appraiser’s reliability by accepting USPAP as the defining standard of reliability; failure to adhere to USPAP may affect the weight we accord to an expert appraiser’s testimony; that failure does not, however, necessarily preclude our receiving the expert’s testimony into evidence; [appraiser A’s] testimony is the product of the application of reliable principles and methods of valuation to sufficient facts and data [and is hereby accepted as evidence]...” The Tax Court rejected that argument and admitted the appraisal into evidence. It offered the following explanation for its holding:

“USPAP is widely-recognized and accepted as containing standards applicable to the appraisal profession. Adherence to those standards is evidence that the appraiser is applying methods that are generally accepted within the appraisal profession. Therefore, at a minimum, compliance with USPAP is an indication that the appraiser’s valuation report is reliable. However, a noncompliant valuation report is not per se unreliable. Full compliance with professional standards is not the sole measure of an expert’s reliability. Petitioner [i.e., taxpayer] essentially asks the Court to supplant its responsibility to assess an expert’s reliability with a rigid standard of reliability. Sole reliance on USPAP is a far more inflexible definition of reliability than the definition (depending on “reliable principles and methods”) incorporated into Rule 702 of the Federal Rules of Evidence. Therefore, we decline to adopt USPAP as the sole standard for reliability of an expert appraiser.”

Kohler v. Commissioner (T.C. Memo 2006-152) (a business appraisal), on the other hand, mentions lack of USPAP compliance by the business appraiser as one of the factors causing the court to give no weight to the appraiser's conclusions.

Dr. Hakala's Background and Certifications: Although Dr. Hakala has a doctorate from the University of Minnesota and is a chartered financial analyst, he is not a member of the American Society of Appraisers (ASA) nor the Appraisal Foundation. Dr. Hakala's report also was not submitted in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). Dr. Hakala did not provide the customary USPAP certification, which assures readers that the appraiser has no bias regarding the parties, no other persons besides those listed provided professional assistance, and that the conclusions in the report were developed in conformity with USPAP.

Analysis: We have several significant concerns about the reliability of Dr. Hakala's report. These concerns lead us to place no weight on Dr. Hakala's report as evidence of the value of the Kohler stock the estate held. We have previously discussed the lack of customary certification of Dr. Hakala's report and that his report was not prepared in

accordance with all USPAP standards. We also have already noted that Dr. Hakala admitted that his original report submitted to the Court before trial overvalued the estate's Kohler stock by \$11 million, or more than 7 percent of the value he finally decided was correct. This is not a minor mistake. When we doubt the judgment of an expert witness on one point, we become reluctant to accept the expert's conclusions on other points. Brewer Quality Homes, Inc. v. Commissioner, T.C. Memo. 2003-200, affd. 122 Fed. Appx. 88 (5th Cir. 2004).

By the way, also in Kohler, the court agreed to shift the burden of proof from Petitioner (taxpayer) to the Respondent (IRS) stating "*At trial, we granted the estate's motion to shift the burden of proof to respondent, because we found that the estate introduced credible evidence including the testimony of several factual witnesses, substantiated items, maintained records, and cooperated with respondent's reasonable requests.*"

So, it appears that in Whitehouse, reliability and methodology rather than compliance with USPAP is of paramount importance in determining whether or not to accept the appraiser's conclusions. But in Kohler, failure to comply with USPAP was a definite factor in Tax Court's decision to give no weight to the appraiser's conclusions.

Who Owns an Appraisal?

Estate of Robert G. Hall No. 81-155 [P. Ct., Piscataquis, ME, Aug. 8, 1983]. To whom does an appraisal belong? In Hall the court found that the client of the appraiser, not the appraiser's heirs, owns the appraisal.

Hall, an appraiser, died and his estate contained many appraisal reports which, during Hall's lifetime, were regarded as confidential material between his clients and himself. Appraisals made for his clients were not disclosed to third parties. The question seems to be whether, upon his death, these appraisals may be disclosed to third parties, which in this case would be the estate beneficiaries.

The court found that Hall, as an independent contractor and appraiser, was entitled during his lifetime to possess and retain copies of any appraisals done by him together with any attendant working papers pertaining to such appraisals for his future use and reference in his business, but the heirs of Hall are not entitled to the same right.

The court found that copies of the appraisals in question were not the property of Hall, although Hall had a right to possess copies thereof during his lifetime, and therefore are not the property of the estate. The appraisals are the property of the clients who paid for them and for whom they were done.

The court ordered that the copies of the appraisals done by Hall should be property disposed of by the personal representative in a manner designed to protect their confidential nature.

The court did not consider the question of transfer of ownership of appraisal report copies should Hall, for example, have been selling his appraisal business to a successor. Hall suggests that, but is not conclusive, that the transfer of appraisal records to a successor would be acceptable if the successor is prepared to honor the confidentiality of the records.

Laws Affecting Possession of or Trade in Contraband Property

Appraisers should be aware of the existence of laws governing the possession and/or trafficking in certain types of property we refer to as “contraband.” For purposes of this discussion we will define contraband property as that property for which it is illegal to transfer ownership through commerce (as opposed to gifting or bequeathing an item.) In some cases it might even be illegal to possess the property, or to transport it across state lines, but it is almost always illegal to “commercialize” the property, i.e., to sell, purchase, barter, etc. Contraband property generally falls into two categories — cultural property, and flora and fauna.

Cultural property involves property said to be owned in violation of the Native American Graves Protection and Repatriation Act (NAGPRA) and of other laws governing archaeological objects found on federal land.

For our purposes, restrictions on the ownership and/or trade of flora and fauna usually falls into the category of owning items which are products or parts of endangered species such as certain ivory, eagle feathers, tortoise shells, rhinoceros horns, etc.

Protected Cultural Property

An example of contraband property is certain Native American artifacts. Several laws have been passed over the years to protect historic sites and resources. Laws include the Antiquities Act of 1906 (more formally known as “An Act for the Preservation of American Antiquities), and the Federal Land Policy and Management Act. These acts empower Federal agencies to protect, preserve, and manage archaeological and historic sites, land and resources that were situated on Federal lands.

The Archaeological Resources Protection Act of 1979 prohibits damage or defacement in addition to unpermitted excavation or removal of archeological artifacts or materials from protected sites. Also prohibited are selling, purchasing, and other trafficking activities whether within the United States or internationally. The Act also prohibits interstate or international sale, purchase, or transport of any archeological resource excavated or removed in violation of a State or local law, ordinance, or regulation.

The most comprehensive and recent such act focusing strictly on Native American artifacts is the Federal government’s Native American Graves Protection and Repatriation Act (NAGPRA) (www.nagpra.org) which was passed in 1990. NAGPRA prohibits the excavation of Native American graves on tribal and federal lands. It also calls for the return of ancestral remains, burial objects, and other "cultural items." The Act requires museums that receive Federal funds to complete inventories and summaries of Native American cultural items in their collections, publish notices in the Federal Register, and repatriate Native American human remains, funerary objects, sacred objects, and objects of cultural patrimony to lineal descendants and culturally affiliated Indian tribes and Native Hawaiian organizations. The law also forbids the buying and selling of these particular objects on the market—which is where the law applies to individual collectors.

The law does not, however, prohibit the owning of the items – just the commercializing of them. So if you inherited a affected item, it is not illegal to keep possession of it, but it is illegal to sell or otherwise commercialize the item.

What types of property are covered by NAGRPA? Included are human remains, funerary objects, sacred objects and objects of cultural patrimony found on Federal and Tribal lands..

- **Funerary objects** are items placed with a human body or made to contain human remains at the time of burial.
- **Sacred objects** are specific ceremonial objects necessary for current practice of traditional Native American religions.
- **Cultural patrimony** includes items that were once owned by the entire tribe (rather than by an individual), and thus was considered inalienable at the time it left the tribe's possession.

Protected Flora and Fauna

Other examples of contraband property are items made from parts of protected species of flora or fauna such as American bald eagle feathers. The Bald and Golden Eagle Protection Act makes it a Federal crime to:

"...take, possess, sell, purchase, barter, offer to sell, purchase or barter, transport, export or import, at any time or in any manner, any bald eagle commonly known as the American eagle, or any golden eagle, dead or alive, or any part, nest, or egg thereof..."
(16 U.S.C. §688(a)).

Additional acts established to protect other types of endangered species of flora and fauna have similar restrictions and include:

- Marine Mammal Protection Act of 1972. With few exceptions, it is illegal to take or import marine mammals or marine mammal products or for any person, with respect to any marine mammal taken in violation of the law, to possess that mammal or any product from that mammal, or for any person to transport, purchase, sell, export, or offer to purchase, sell, or export any marine mammal or marine mammal product.
- Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). CITES is an international agreement between governments. Its aim is to ensure that international trade in specimens of wild animals and plants does not threaten their survival. Annually, international wildlife trade is estimated to be worth billions of dollars and to include hundreds of millions of plant and animal specimens. The trade is diverse, ranging from live animals and plants to a vast array of wildlife products derived from them, including food products, exotic leather goods, wooden musical instruments, timber, tourist curios and medicines. Levels of exploitation of some animal and plant species are high and the trade in them, together with other factors, such as habitat loss, is capable of heavily depleting their populations and even bringing some species close to extinction.
- Endangered Species Act. The ESA protects species of flora and fauna that have been placed on the Federal list of endangered and threatened wildlife and plants. The Act protects threatened species and their habitats by prohibiting the "take" of listed animals and the interstate or international trade in listed plants and animals, including their parts and products (except under Federal permit. Such permits generally are available for conservation and scientific purposes.)

Migratory Bird Treaty Act. The Migratory Bird Treaty Act decreed that all migratory birds and their parts were fully protected. The statute makes it unlawful to pursue, hunt, take, capture, kill or sell birds listed as "migratory birds". The statute does not discriminate between live or dead birds and also grants full protection to any bird parts including feathers, eggs and nests. Over 800 species are currently on the list.