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Valuing Your Artwork

At its core, the art market is subjective and unpredictable, underscoring the importance of establishing the value of your artwork at many points in the life cycle of artwork ownership.

Authentication and appraisal are the two critical assessments for establishing the value of artwork.

Authentication is the process of determining whether the artwork really was created by the artist to whom it is attributed. Authenticators are often academics or other experts who are familiar with one particular artist's body of work or have a specific focus on one period of art history. If an authenticator believes a work of art is a forgery or a copy of an artist's trademark style, he will refuse to offer an authentication. Refusal of authentication can render a work of art unsalable.

An appraisal is performed by an expert and is an approximation of the fair market value of a piece of artwork. In many cases, appraisals are necessary for income, gift, and estate tax purposes. An artwork appraisal is necessary when an individual is seeking an income tax charitable deduction over \$5,000 or has an estate with artwork valued in excess of \$3,000.¹ Though not required for noncharitable gifts, appraisals are highly recommended

since the donor is required to disclose the fair market value of the transferred property.² Further, many strategies for noncharitable gifting beyond direct gifting require an appraisal.³

Authenticating Your Art

Authentication is generally a necessary first step toward a reliable appraisal. A lack of authentication would dramatically reduce the appraised value.

Finding an appropriate professional to authenticate your collection, however, may not be as straight forward as it would seem. Authentication has become increasingly fraught as high-profile art fraud gains international attention.⁴ Much recent art fraud is either perpetuated or authenticated by family and friends of the late artist, casting doubt upon the judgment of those who are many times considered the ultimate authorities on an artist's body of work.

Additionally, in response to the increasing risk of litigation, many individuals in this field have decided

¹ Reg. 1.170A-13(c); Reg. 20.2031-6(b).

² Reg. 301.6501(c)-1(e).

³ Complex strategies for gifting, though not covered here, include creating a limited liability company (LLC), family limited partnership (FLP), grantor retained income trust (GRIT), or sale to intentionally defective grantor trust (IDGT).

⁴ Colin Moynihan, "Knoedler Art Fraud Trial, Expert Testimony on Fakes Weighs Heavily," *The New York Times* (February 1, 2016), <http://www.nytimes.com/2016/02/02/arts/in-knoedler-art-fraud-trial-expert-testimony-on-fakes-weighs-heavily.html>.

To reduce litigation risk, authenticators may present rigorous contracts to protect themselves from liability.

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to stop making authentications.⁵ Authentication boards, which are the common source of authentication for contemporary works, are also disbanding due to the litigious environment.⁶ Authentication boards frequently come from outgrowths of foundations established to advance the artistic ideals of one particular artist. Collectors with work believed to be by a certain artist can submit the work in question for review to the board. As part of the agreement, the collector agrees to be bound by the board's decision. Many lawsuits against authenticators eventually fail, but they are extremely expensive to defend.

Some authenticators may present rigorous contracts to protect themselves from liability. The general belief in the industry is that these clauses do not prevent authenticators from acting in good faith, as the business hinges upon reputation. More broadly, when a whole industry of authenticators decides the risk of lawsuit is too high, all artworks not already authenticated are stigmatized.

Legislative steps aimed at removing the chill from this market are just

beginning to surface. For example, the New York Senate introduced a bill in January 2017 to deter frivolous litigation against authenticators.⁷

Establishing Provenance

As a guarantee of authenticity, buyers and auction houses will expect sound provenance and other guarantees to authenticity as soon as discussions of a sale begin. Reports of forgeries have increased in recent years,⁸ and prospective buyers are becoming more discerning.⁹

Establishing a record of ownership dating all the way back to the artist is the best way to prove that an artwork is authentic. A bill of sale is the best way to prove that ownership has passed. Other types of documentation can build a strong provenance as well. Appearance of the artwork in auction catalogs, photos of owners with the artwork, newspaper articles documenting physical location of the artwork, and other formal, written materials can establish provenance.

Options for When There Is No Provenance

In the absence of established provenance, art experts seek to

⁵ Stacy Perman, "This Is Bad News for People Who Spend Millions on Art," *Fortune* (September 24, 2015), <http://fortune.com/2015/09/24/art-fakes-lawsuits/>.

⁶ See The Andy Warhol Foundation for the Visual Arts, *Authentication Procedure*, http://warholfoundation.org/legacy/authentication_procedure.html (last visited August 26, 2016); Jean-Michel Basquiat, *Notification from Authentication Committee* (January 7, 2012), <http://basquiat.com/events.htm?pg=news>; Randy Kennedy, "Is This a Real Jackson Pollock?," *The New York Times* (May 29, 2005), <http://www.nytimes.com/2005/05/29/arts/design/is-this-a-real-jackson-pollock.html>.

⁷ New York State Senate, Senate Bill 1974, 2017-18 legislative session.

⁸ Belinda Luscombe, "A Fake Rothko and the Rise of Modern Fraud," *Time Magazine* (March 7, 2016): 80.

⁹ Robert Frank, "Art Buyers Becoming More 'Careful': Sotheby's CEO," CNBC Inside Wealth (October 27, 2015), <http://www.cnbc.com/2015/10/27/art-buyers-becoming-more-careful-sothebys-ceo.html>.

Estate settlement will be significantly easier for the executor if the owner has compiled a full inventory and appraisal during life, authenticated only suspect works, and created a paper trail to establish provenance for future owners.

authenticate works of art by examining formal elements. Usually those who have published research on a certain artist, curated a collection of his or her work, or who have extensively studied and taught this artist's work will be considered experts of an appropriate level. While this high level of connoisseurship and expertise in the artistic style certainly renders an expert's opinion valuable, authentication based on expertise is ultimately subjective.

Scientific Techniques

Certain techniques are frequently used not to authenticate but to disprove an authentication. Scientific means that refute an authenticator's decision are viewed as all but irrefutable. Pigment dating can be the source of a challenge when material postdates the years an artist was active.¹⁰ Thorough analysis also looks at the date of the wood in the frame and the fiber of the canvas.¹¹ Computers can now analyze brush strokes to sift out fakes¹² and analyze the presence of crack lines that appear over time in a painting.¹³

Science can assist in an authentication in quite unexpected

ways: a new Leonardo da Vinci painting was authenticated following a macrophotography that demonstrated a page in a book had been removed from the exact place where the small portrait in question would have been.¹⁴

Appraisals Can Ease Estate Settlement

Estate settlement will be significantly easier for the executor if the owner has compiled a full inventory and appraisal during his or her lifetime, authenticated only suspect works, and created a paper trail to establish provenance for future owners.

Coordination of an appraisal for a full collection must happen relatively quickly after the passing of the owner.¹⁵ Estates with major art collections may experience a liquidity problem when taxes come due if the mechanics of an appraisal and sale have not been planned for. For an individual leaving behind this type of estate, it will be very helpful to undertake a full appraisal, or at least complete a full inventory of works during the collector's lifetime. Certain pieces can be earmarked for quick sale upon death if they are fairly

¹⁰ Susan Dackerman, *Painted Prints: The Revelation of Color in Northern Renaissance and Baroque Engravings, Etchings, and Woodcuts* (University Park, PA: Penn State University Press, 2002).

¹¹ Suzanne Bell, *How to Identify a Forgery: A Guide to Spotting Fake Art, Counterfeit Currencies, and More* (New York: Skyhorse Publishing, 2013).

¹² Fabrizio Lamberti, Andrea Sanna, and Gianluca Pavarati, "Computer-Assisted Analysis of Painting Brushstrokes: Digital Image Processing for Unsupervised Extraction of Visible Features from Van Gogh's Works," *Journal of Image Video Processing* (2014), <http://jivp.eurasipjournals.com/content/2014/1/53>.

¹³ Siwei Lyu, Daniel Rockmore, and Hany Farid, "A Digital Technique for Art Authentication," *Proceedings of the National Academy of Science of USA* (2004), <http://www.pnas.org/content/101/49/17006.full>.

¹⁴ Tom O'Neill, "Lady with a Secret," *National Geographic* (February 2012), <http://ngm.nationalgeographic.com/2012/02/lost-da-vinci/o-neill-text>.

¹⁵ Internal Revenue Code (IRC) Section 6075 (a).

An art collector may need to engage several different professionals for different art services.

certain to sell well and provide the estate with some liquidity.

An appraisal also can help a collector leave artwork of relatively equal value to heirs, if that is the collector's intent. Discord among family members could arise after the collector's death if heirs receive pieces that, through oversight, differ greatly in value.

Appraisal fees to determine date-of-death values or for purposes of making distributions are deductible on the estate tax return¹⁶ and can be claimed on an income tax return when there is an appraisal for a charitable gift.¹⁷ Expressly stating in estate planning documents that the appraisal costs will be deductible will help provide guidance to estate administrators.

Having a recent appraisal or inventory on hand is most helpful for someone settling an estate. In lieu of those, owners should carefully retain all documentation regarding the purchase dates and prices of artwork items. At the very least, conveying to the executor or heirs the location of the art receipts or other information surrounding the purchase will make the subsequent sale simpler.

Provenance is the surest proof of authentication. A collector should

share as much information as possible during his or her lifetime to make subsequent provenance searches easy and help maintain or improve the value of the art.

IRS May Dispute Appraisals

Appraisals can be high stakes even when authentication is not at issue. The Internal Revenue Service (IRS) may dispute valuations for estate, gift, or charitable deduction purposes.

Appraisals are mandatory for many artworks, yet the process of determining a value is so subjective the IRS has created an Art Advisory Panel to audit appraisals and provide recommendations to the Art Appraisal Services (AAS) unit of the Office of Appeals for the IRS. If a single work of art or cultural property is valued at \$50,000 or more and the tax return on which such property is reported is selected for audit, the local IRS office must refer the case to AAS for possible referral to the panel.¹⁸ The panel's recommendations are advisory, but 88.9% of their recommendations are fully adopted by AAS.¹⁹ Reconsideration of value is only available if a taxpayer provides new information or probative evidence.²⁰

¹⁶ Internal Revenue Bulletin: 2014-22 T.D. 9664 (May 27, 2014), https://www.irs.gov/irb/2014-22_IRB/ar05.html.

¹⁷ Appraisal fees can be claimed, subject to the 2% of adjusted gross income limit, as a miscellaneous itemized deduction on Schedule A (Form 1040). See *Publication 526 Main Content*, IRS, https://www.irs.gov/publications/p526/ar02.html#en_US_2015_publink1000229700.

¹⁸ Art Advisory Panel of the Commissioner of Internal Revenue, Annual Summary Report for Fiscal 2015.

¹⁹ Data averaged from Annual Summary Reports, Years 2012 through 2015. Calculations performed by author.

²⁰ Art Advisory Panel of the Commissioner of Internal Revenue, Annual Summary Report for Fiscal 2015.

Art owners should not be surprised that many art valuations are audited, and of those audited 58% are recommended for adjustment.²¹

During the audit, the panel does not know whether the piece has been submitted for a charitable deduction (incentivizing a taxpayer to submit a higher appraisal) or for estate and gift tax purposes (incentivizing a taxpayer to submit a lower appraisal).²²

Despite this blind process, the panel consistently adjusts charitable contribution items down and adjusts estate and gift items up, in essence, consistently creating a less favorable tax consequence.²³

Art collections most often represent

both financial and emotional assets. When planning for their future, it is important to work with professionals you trust to address both technical and emotional complexity. This may require coordination of art market advisors, technical estate planning advisors, and those with expertise on family dynamics. If casualty or title insurance is required, different professionals with those specialties may also be added to the mix.

Each person brings a different skill set to your ultimate art team.

Understanding each role can help you maximize the benefits you receive and help you feel at ease with the ultimate direction of your art collection goals and estate planning needs.

For more information, please contact your Hawthorn advisor.

²¹ Data averaged from Annual Summary Reports, Years 2012 through 2015. Calculations performed by author.

²² Art Advisory Panel of the Commissioner of Internal Revenue, Annual Summary Report for Fiscal 2015.

²³ Data averaged from Annual Summary Reports, years 2012 through 2015. Calculations performed by author. The Annual Summary Report for fiscal 2015 does not release the type of tax that was adjusted, only values for items increased or decreased.

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