



NAILING DOWN AN ACCURATE FINE ART APPRAISAL

by Dr. John Daab

You have just purchased a work of fine art from the gallery around the corner. The owner assured you that the price you paid was based on an appraisal provided by the manager of the gallery, who has a degree in Fine Art. You go home feeling comfortable that the price you paid was accurate since it was based on the appraisal provided by the gallery. Is this comfort justified? No, it is not. Recent developments indicate that significant problems exist in the world of fine art appraising. Fine Art Registry® has received numerous complaints from fine art purchasers regarding the appraised value of their purchase. The complainants allege that the value provided by the seller does not come close to the

offering price provided by interested galleries. So far off the mark are some of those appraisals that prints appraised at hundreds or even thousands of dollars turn out to be, in fact, worth no more than the paper they are printed on. The appraisals are inaccurate and worthless. Those providing such appraisals argue that they are based on gallery prices and other unidentified reliable sources. These sources do not include auction hammer prices.

Where does the problem lie for such shoddy appraisals? In order to understand the nature of the problem it is necessary to identify the standard appraisal process.

Authentication First

In determining the value of fine art, the first step is to ensure that the authenticity of the particular piece being appraised has been established or verified by qualified experts. A qualified appraiser in art, whose qualifications satisfy IRS Publication 561 (2007, April), would approach this by making sure that there was sound evidence of authenticity from accepted reliable sources following a managed process grounded in science, provenance, and connoisseurship. Authenticity conclusions are arguably reached when the above three categories of authenticity are in agreement that the piece under consideration is authentic. Science starts the process and may stop it in its tracks if a determination of inauthenticity arises due to inconsistencies between the date of manufacture of materials and the date of production of the art object. For example, analysis may find that the paint pigment found in a painting under examination did not exist at the time of the work's creation. Authenticity moves the process forward and inauthenticity closes down any further action.

Unlike many industries in the United States, such as real estate or automobile, the art industry is not regulated by laws or statutes. However, the rules and practices outlined in the Uniform Standards of Professional Appraisal Practice USPAP give a good outline and are recommended.



Methods of Appraising Fine Art for Monetary Value

The American Society of Appraisers lists four common values which can be

established for fine art objects: Fair Market Value, Actual Cash Value, Replacement Value and Internal Revenue Value.

Fair Market Value

The fair market value is the value of an object based on what others have paid for it in similar situations. Thus the value of a house in a given neighborhood would be determined by an examination of similar

houses recently sold in a given neighborhood. A two bedroom ranch-type house would not possess the same value as a four bedroom Colonial. Fine art values would be determined by examining recent sale prices of works by a given artist and comparing them to the work to be sold. The IRS considers sale price as the value of a given object.

Marketable Cash Value

The marketable cash value of a product is the cash remaining to the seller after the costs of the sale are subtracted from sale price. For example, a residential house sold by a broker for \$118,000 would leave the seller with the monies remaining after the seller paid the broker's fee, taxes, repairs made and so on. In the fair market concept, the value is the total sale not excluding costs. Marketable cash value excludes the costs.

Replacement Value

Replacement value is the value established by an insurance company for a product stolen, lost or damaged. It is understood to mean the amount of money required to replace a product with a product of similar standing in a reasonable timeframe. Also the market in which the sale takes place must be relevant and appropriate. One would not expect to secure a fine art work in an automobile shop. The problem with insurance estimates is that according to the ASA, there are very few underwriters experienced enough to make sound estimates of fine art value. Further, insurance policy language is deliberately ambiguous regarding similar standing or quality so that values driven by such concepts are questionable.

Internal Revenue Service Value

As noted earlier, the IRS uses the selling price of an item to determine monetary value. The IRS prefers to use auction sales of fine art as their platform of appraisal value. Appraisals of fine art monetary value come under scrutiny as donations, estate pass-throughs and normal sales. Their concern focuses on whether the taxes paid under such circumstances are accurate. The IRS assumes that when donating art the work is usually appraised too high; in leaving art to one's

heirs it is assumed that the art will be appraised too low. High value appraisals via donations reduce taxes to be paid on gross income. Low value appraisals on art for estate purposes reduce taxes owed as estate inheritances. The IRS requires that appraisals of fine art be scholarly, follow the requirements of IRS code, be performed by expert appraisers and be based on completed sales not sale prices.

Some Issues of the Appraisal Process

Appraisals are only as good as the time period in which they are presented. What this means is that appraisals do not possess longevity but are subject to the ups and downs of the fine art market. Currently there are reports that we are witnessing a downturn in art market pricing due to an economy moving deeper into a recession. *Artprice* reported recently that the market over the last quarter dropped about 14% in sale prices compared to last year. Appraisal numbers must be judged as relative to a given time period, economic cycle and market forces. Appraisal numbers should not be expected to hit a bulls-eye but should be regarded as an estimate.

Although there are four methods of determining appraisal value, there are problems with how some view the mutual exclusivity of the methods. That is, it is not altogether clear that each method is conceived to be totally distinct from another. In particular, replacement cost is not very much different from market cash value, and as a concept leaves an uneasy feeling about how one replaces a singular work of art by a dead artist. How would the owner of Van Gogh's *Sunflowers* replace his work? Such concept issues detract from accuracy and as such one is almost forced to accept that market cash value should be the approach taken in appraisal examinations and conclusions.

Market forces at a given period determine accurate appraisals. For example, an appraisal of a given work provided a year ago must recognize that current market conditions entail an adjustment of the appraisal downward. More importantly, if the appraisal did not consider tax costs resulting from failing to follow the various processes and steps, the appraisal is inaccurate. If an appraisal has the risk of

hidden added costs to it, its accuracy is questionable. That is, if the owner of the work has been given a fair market value (which includes all costs) of a work believing it to be the marketable cash value (where costs are subtracted), the appraisal is basically inaccurate. The owner assumes from the appraisal that he owes taxes on the market value, but the IRS wants the taxes on the cash in hand plus expenses. This occurs when the work is used to offset taxes. When an appraised value is too high or low at the time of the sale and is used as a tax instrument the IRS will make a determination based mainly on auction house numbers as to taxes due. The determination consists of accurate appraised value, taxes due if the value is inaccurate, interest and penalties. It would not be inaccurate to argue that this determination may decrease the value of the work by 50%.



The Elements of the Accurate Appraisal Process

It is evident that a sound appraisal process wards off IRS harmful consequences and at the same time provides the benefit of knowing the real value of a work of fine art. From the above a sound process consists of the appraiser following the procedures below:

1. An analysis undertaken by a certified appraiser knowledgeable in the field he or she is examining.
2. A delineation of the factors leading to the analysis.
3. Providing and clearing identifying data supporting the analysis.
4. Identifying the consensually approved methods of analysis, and utilizing the most sound method to appraise.
5. Developing conclusions or opinions from the data and information examined.
6. As the appraiser, accepting responsibility for the appraisal. Some appraisers stand by their work to the extent that they will perform forensic guidance before any panel examining the appraisal.
7. Maintaining a distance from the product being appraised and conflicts of interest.



Watching Out for the Worthless Appraisal

There are those in the field of fine art who profit from appraisals that are ill devised, logically meaningless and without substance, rendering the appraisal

itself without value and ripe for financial calamity.

Some examples include:

1. The authenticity of the work has not been identified or verified and/or the work has proven to be a fake.
2. The authenticating agent or agency is not certified or has questionable experience as it relates to the piece being authenticated. Merely because the agent has a title does not automatically pass on expertise.
3. The authenticating agent or agency is the seller of the work being authenticated. This is recognized as conflict of interest.
4. The appraiser charges a fee for the appraisal but disclaims any responsibility for it by noting that he or she is not accountable for error, omissions or accuracy. If an appraisal has errors, has omitted data or is inaccurate, it is without substance and therefore meaningless. It is equivalent to a builder completing a house with the disclaimer that if the house falls down it is not his responsibility.
5. The appraiser did not actually examine the work in question.
6. The appraiser failed to identify the sources leading to his appraisal.

7. The appraiser did not spend any significant time developing the appraisal, or thoroughly investigating the information available about the work in question.

8. The appraiser is not certified or experienced in the work he or she is appraising. A certified appraiser in farm machinery is not necessarily an expert in fine arts.

9. The appraiser is also the seller, owner or buyer of the work or has some other conflict of interest influencing the results of the appraisal.

10. The appraisal fee is determined by the value of the appraisal.

11. The appraiser uses listed prices to determine value.

12. The appraiser fails to provide a written report.

13. The appraiser uses list prices to determine value. List prices are prices wished for by a seller. They are never used to determine value since they are not based on fact but hope.

Conclusion

Fine art appraisals require a thorough investigation to determine value. The value must be supported by sound data accepted consensually as coming from valid sources and the methodology used must not be subjective or arcane. Transparency in detail, open ended sources, confirmed selling prices and a logical processing of information generate valid approaches which protect fine art collectors from apparently worthwhile investments turning out to be worthless. 📌



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