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Subject: FW: The FMV Valuation Alert - Estate of Newberger
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From: Lance S. Hall, ASA [REDACTED]
Sent: Wednesday, December 30, 2015 06:41 PM Eastern Standard Time
To: Paul Morris
Subject: The FMV Valuation Alert - Estate of Newberger

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Did the Great Recession Impact Art Prices?

(Estate of Newberger^[1])

By Lance S. Hall, ASA*

Bernice Newberger died on July 28, 2009, a month after the Great Recession was declared to be over. As part of her estate, she had three paintings – "Tête de Femme (Jacqueline) by Pablo Picasso (the Picasso), Untitled by Robert Motherwell (the Motherwell), and Elément Bleu XV by Jean Dubuffet (the Dubuffet)." One of the paintings was sold after the date of death for an amount considerably in excess of the 706 filing amount. This case addresses two fundamental questions:

- (1) Did the Great Recession impact the fair market value of the paintings?
- (2) Can an estate's valuation experts ignore the post-date-of-death sale prices?

Background

The Picasso, Tête de Femme (Jacqueline), painting "depicts Pablo Picasso's second wife, Jacqueline, whom he portrayed in over 400 paintings." The Picasso was created in 1963 and is an oil on canvas work, 35.5 by 23 inches. It was acquired by Ms. Newberger in 1981 for \$195,000. The Estate's valuation expert determined the fair market value of the Picasso, as of the date of death, to be \$5 million. On February 2, 2010, only six months after the date of death, Christie's London sold the painting at auction for \$12,927,874 (an \$11,484,000 "hammer price," plus commission paid by the buyer). In its notice of deficiency, the IRS valued the Picasso at \$13,000,000 as of the date of death. At trial, the IRS's expert valued it at \$10 million.

The Motherwell painting, a 66- by 50-inch oil on canvas work created in 1966, was acquired by Ms. Newberger in 1969 for \$8,000. Using the 2010 sale of Motherwell's *In Black and White No. 5* (a work similar in size, composition, and date of creation) for \$1,426,500 as a comparable, the Estate's valuation expert determined the date of death value of the Motherwell at \$450,000. The IRS valued the Motherwell at \$1,500,00 and, at trial, the Estate raised the fair market value of the painting to \$800,000.

The Dubuffet painting is a rather large piece (79.25 by 44 inches, with a "4-inch deep transfer on polyester"). The Dubuffet was acquired by Ms. Newberger in 1982 for \$40,000. In November of 2007, a "similar sized work from the same series," sold for \$825,000. The Estate's expert determined the fair market value of the Dubuffet to be \$500,000. For purposes of the notice of deficiency, the IRS valued the Dubuffet at \$750,000, as of the date of death. At trial, the IRS's expert had raised the value of it to \$900,000.

The Court's Considerations and Opinions

In assessing the veracity of the various experts' value determinations, the *Newberger* Court examined the economic conditions as of the date of death and noted,

The market for fine artwork declined precipitously during the autumn of 2008. In October of that year 44% (i.e., double the October 2007 rate) of the artwork up for auction failed to reach its minimum or guaranteed price and was returned to the auctioneer or owner. In 2009 Sotheby's and Christie's, the top artwork auction houses, experienced auction revenue decreases of 53% and 46%, respectively. Lower sale prices and a lack of available, high-quality artwork contributed to the decline in auction revenue. The artwork market rebounded in 2010, with auction revenue from that year nearly doubling the 2009 total and almost matching the 2007 high point.

Picasso Painting

The determination of the Picasso painting's fair market value was complex. Between December of 2009 and February of 2010, Sotheby's had offered to sell the painting and agreed to "pay the estate \$3 million if the Picasso did not sell at auction." A short time later, Sotheby's raised that price to \$3.5 million. The Estate rejected Sotheby's offer and entered into an agreement to sell the Picasso through Christie's for a minimum price of \$4.8 million, plus 60 percent of the "hammer price" above that amount. On February 2, 2010, the Picasso sold for \$12,927,874. The Estate's expert valued the painting at \$5 million and, at trial, the IRS's expert valued the painting at \$10 million, \$3 million lower than in its notice of deficiency.

The Estate argued that the sale was a "fluke" and should be ignored. Furthermore, "the sale is not relevant because it could not have been reasonably anticipated on the date of death."

Despite the six months between the date of death and the sale of the Picasso, during which time the art market was in recovery, the *Newberger* Court stated, "no evidence is more probative of the Picasso's fair market value than its direct sales price. The estate's experts' failure to consider the sale of the Picasso renders their valuation wholly unreliable. ... We agree with [the IRS's] expert."

Motherwell Painting

In examining the sale of Motherwell's *In Black and White No.5* painting some 16 months after the date of death, the Court noted that, at the date of sale, "the artwork market had largely rebounded from the downturn." The Court criticized the IRS's expert's \$1.5 million

appraisal for the art as "inexplicable" since the \$1.5 million exceeded the actual selling price, which did not reflect the art market downturn. The Court further stated, "[The IRS's expert] did not make a market adjustment as she made relating to the Picasso...." Because the Estate's experts had made adjustments from the sales price and the IRS's expert had not, the Court agreed with the Estate's \$800,000 fair market value.

Dubuffet Painting

In the determination of the fair market value of the Dubuffet painting, both experts noted that a sale from the same series, a painting very similar to the Estate's painting, sold for \$825,000 in November of 2007, prior to the art market downturn. The Court rejected the IRS's expert's value, saying that the "[IRS's expert's] contention that the Dubuffet's value was higher during the market downturn than ... before the market downturn is, in short, nonsensical." The Court accepted the Estate's expert's \$500,000 determination for the Dubuffet.

Summary

While it is often tempting for experts to ignore a post-valuation-date sale because the sale was "not reasonably anticipated on the date of death," the sale is not irrelevant. The *Newberger* Court was very clear; an expert cannot ignore a sale that took place after the valuation date. When faced with a post-valuation-date sale, the valuation expert must make adjustments for differences in time, economic environment, and asset performance (in the case of an operating company).

Because the IRS's expert considered the sale of the Picasso (which took place some six months after the date of death) and made appropriate adjustments due to the differences in economic conditions, the Court favored the IRS's expert's value. However, because the IRS's expert then ignored changes in economic conditions when valuing the Motherwell and Dubuffet paintings, the Court rejected the IRS's expert and accepted the Estate's value.

It is possible that the Estate's expert's disregard of the actual sales price of the Picasso cost the Estate dearly. Perhaps, had the Estate's experts considered the actual sales price and made more appropriate adjustments for the art market recovery, the concluded value would have been lower than that determined by the IRS's expert. The Court then could have split the difference between the two experts or, alternatively, accepted the Estate's expert's value because the adjustments were more reasonable than those made by the IRS's expert.

[1] T.C. Memo. 2015-246 (December 22, 2015)

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