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DISCOUNTS FOR FRACTIONAL OWNERSHIP OF REAL PROPERTY ARE ACCEPTED, SO WHY HAVEN'T THE IRS AND COURTS ACCEPTED DISCOUNTS FOR FRACTIONAL OWNERSHIP OF ARTWORK?

ABSTRACT

In 2014, the Fifth Circuit held that Mr. Elkins's estate was entitled to apply a fractional ownership discount to determine the taxable value of the undivided interest in artwork. The estate received a \$14 million refund plus interest. The Internal Revenue Code directs taxpayers to value the items in a gross estate at their fair market value. Fractional ownership adds another problem in the valuation of an estate's interest property. In general, courts have accepted fractional ownership discounts for real property. In contrast, courts have been reluctant to apply a fractional ownership discount for artwork. This Note will argue that fractional ownership discounts should be applicable in artwork.

INTRODUCTION

During the first half of 2018, Christie's and Sotheby's (i.e. art brokerage firms) reported record breaking sales in the art market.¹ Global art sales have grown, and there is no indication that the market for artwork is slowing down.² One of the more recent approaches to owning artwork is to own a fractional interest of a single work.³ With the artwork market and fractional ownership on the rise, it has become more common for the average person to afford ownership of artwork.⁴ Taxpayers are using the concept of fractional ownership to decrease the amount of taxes paid on their personal tax returns and estate returns.⁵ The notion being that an undivided interest in property, let alone artwork, is not a sound investment.

1. See Fang Block, *Sotheby's Sales up 22% in First Half of 2018, Driven by the Asian Market*, BARRON'S (Aug. 6, 2018), <https://www.barrons.com/articles/sothebys-sales-up-22-in-first-half-of-2018-driven-by-the-asian-market-1533589762>; Abby Schultz, *Reflecting Strength of Art Market, Christie's Sales Jump 26% in the First Half of 2018*, BARRON'S (July 24, 2018), <https://www.barrons.com/articles/reflecting-strength-of-art-market-christies-sales-jump-26-in-first-half-of-2018-1532461772>.

2. See Brenna Hughes Neghaiwi, *High-End Art Sales Boom in 2017, but It's Only a Partial Market Rebound*, REUTERS (Mar. 13, 2018), <https://www.reuters.com/article/us-art-market/high-end-art-sales-boom-in-2017-but-its-only-a-partial-market-rebound-idUSKCN1GP2IQ>.

3. See Oscar Holland, *How Art 'Shares' Could Make You a Warhol Collector for Just \$20*, CNN (Aug. 21, 2018), <https://www.cnn.com/style/article/shares-art-collecting/index.html>.

4. See *id.*

5. See Paul Sullivan, *A Potential Game Changer for Estate Taxes on Art*, N.Y. TIMES (Oct. 3, 2014), <https://www.nytimes.com/2014/10/04/your-money/estate-planning/a-potential-game-changer-for-estate-taxes-on-art.html>.

Thus, “[s]uch interests should trade at significant discounts,” but evidence to support such a discount is not necessarily easy to obtain.⁶

For tax purposes, there must be a valuation of the artwork before any tax can be assessed on it.⁷ A valuation of artwork automatically occurs when a taxpayer dies because the decedent’s date of death valuation, including the value all assets, is necessary to determine estate tax.⁸ Fractional ownership of artwork further complicates the valuation of an interest in the artwork, and taxpayers are using fractional ownership to decrease their individual tax liability by claiming that fractional ownership of artwork decreases the artwork’s value.⁹ Therefore, taxpayers who possess fractional ownership in artwork have claimed valuation discounts for their fractional interests to pay less tax on their fractional ownership of artwork.¹⁰ The valuation process requires that an owner must have evidence to support such an evaluation and evidence may be provided by factual support or an expert opinion.¹¹

A fractional ownership discount is applicable in various types of property, and courts attempting to apply it have looked to the hypothetical buyer and hypothetical seller standard.¹² Although it is possible to have a fractional ownership discount, courts have not officially ruled that a fractional ownership discount is applicable to all types of property.¹³ Discounts for fractional ownership of real property have become an accepted part of real property valuation for tax purposes by the courts.¹⁴ Whereas, prior to the *Estate of Elkins* decision, “there had never been any explicit recognition by a court that fine arts assets . . . were to be entitled to discounts in determining the fair market value of the asset.”¹⁵ Given the Internal Revenue Code’s limited guidance on valuing fractional ownership of property, fractional ownership of artwork should be given the same

6. See Dennis A. Webb & Gerald E. Lunn Jr., *Would You Buy an Undivided Interest?*, 2 VALUATION STRATEGIES 24, 24 (1998).

7. See Alan Breus, *Valuing Art for Tax Purposes*, J. ACCOUNTANCY (July 1, 2010), <https://www.journalofaccountancy.com/issues/2010/jul/20092096.html>.

8. 26 C.F.R. § 20.2031-1(a) (2019).

9. See Craig J. Langstraat et al., *Fractional-Ownership Discounts for Art Reduce Taxable Estate*, 42 EST. PLAN. 37, 37 (Thomson Reuters ed., 2015).

10. See *Estate of Elkins v. Comm’r*, 767 F.3d 443, 447 (5th Cir. 2014); *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *1 (N.D. Cal. May 25, 2007); *Estate of Scull v. Comm’r*, 67 T.C.M. (CCH) 2953, at *27 (1994).

11. See Langstraat et al., *supra* note 9, at 38.

12. 26 C.F.R. § 20.2031-1(b) (2019).

13. JOHN A. BOGDANSKI, FEDERAL TAX VALUATION ¶ 5.01[1] (2019).

14. Anna C. Fowler, *Valuation of Undivided Interest in Realty: When Do the Parts Sum to Less Than the Whole?*, 13 J. REAL EST. TAX’N 123, 167 (Thomson Reuters ed., 1986) (“The majority of the court cases dealing with the valuation of undivided interests have granted discounts.”).

15. Moses Luski, *Estate of Elkins v. Commissioner of Internal Revenue: Cautionary Tale and Gem*, SHUMAKER, LOOP & KENDRICK, LLP (Shumaker, Loop & Kendrick L.L.P., Toledo, Ohio), Spring 2015, at 1, 2.

treatment as real property.¹⁶ Courts have rejected the argument that a discount for valuation of fractional ownership of artwork is not applicable because the willing buyer and willing seller standard allows for fractional ownership discounts based upon the undivided interests.¹⁷

This Note argues that the Internal Revenue Service (IRS) and the courts need to accept fractional ownership of artwork discounts claimed by taxpayers. It is well accepted by the IRS and the courts that a discount is applicable to the fractional ownership of real property.¹⁸ In contrast, requested discounts by taxpayers for fractional ownership of artwork are granted sparingly, and the rationale remains unclear.¹⁹ Comparable to real property, a valuation expert for artwork can calculate the discount based upon the fractional ownership of the artwork and provide an analysis of a discount based on a sale of the undivided interest or a successful partition action.²⁰ As for the correct valuation method, it is up to the discretion of the taxpayer because courts have not stated the proper methodology.²¹ Part I of this Note examines the general valuation of ownership in property and its potential applicability to fractional ownership; Part II addresses the valuation of fractional ownership of real property; Part III explains the valuation of fractional ownership of artwork; Part IV argues that similar to real property, artwork deserves the recognition of fractional ownership discounts; and Part V discusses the correct valuation—the sale of the undivided interest—of such a discount.

I. VALUATION OF OWNERSHIP OF PROPERTY—IT CAN BE DONE FOR FRACTIONAL OWNERSHIP

To evaluate fair market value one needs to look to the price that the property would change hands between a buyer and a seller.²² Comparable property sales can be a helpful reference to understand the fair market value of the property at issue.²³ However, when it comes to fractional interests in property, valuation gets more difficult as “[a] sale of such an interest occurs infrequently. Thus, the market is often a presumed or imaginary one.”²⁴

16. 26 C.F.R. § 20.2031-1(b).

17. See *Estate of Elkins v. Comm’r*, 767 F.3d 443, 449 (5th Cir. 2014).

18. Fowler, *supra* note 14.

19. See, e.g., *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *7 (N.D. Cal. May 25, 2007) (ruling that a nominal fractional ownership discount of 5% was allowed, even though the evidence was not convincing); *Estate of Scull v. Comm’r*, 67 T.C.M. (CCH) 2953, at *23 (1994) (ruling that a 5% discount was applicable but that was not the amount the estate requested).

20. See Langstraat et al., *supra* note 9, at 39–42.

21. See *Estate of Elkins*, 767 F.3d at 453 (accepting the fractional ownership discount of the estate, but the court would not express a preference for the proper valuation method).

22. 26 C.F.R. § 20.2031-1(b) (2019).

23. John G. Steinkamp, *Fair Market Value, Blockage, and the Valuation of Art*, 71 DENV. U.L. REV. 335, 344 (1994).

24. Fowler, *supra* note 14, at 124.

The Internal Revenue Code defines fair market value as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”²⁵ Furthermore, the price is not determined by a forced sale, but rather the price is subject to a market where the item is most commonly sold to the public.²⁶ Beyond a hypothetical willing buyer and a hypothetical willing seller, the Internal Revenue Code provides no further guidance, which creates the opportunity for different interpretations of what the willing buyer and seller standard means.²⁷

Fractional ownership of property is nothing new in tax valuation, as taxpayers already use fractional ownership to obtain a valuation discount for other types of property.²⁸ For many years, parties have claimed fractional interests in real property.²⁹ When real property is subject to another party’s ownership, “undivided interests should be valued at a discount below their pro rata share of the fair market value of the overall property.”³⁰

Courts have approved discounts for tax purposes where there was evidence of a proper appraisal to support such valuation discount.³¹ Valuing fractional ownership of property is a question of whether or not there is a market for fractional ownership of the property.³² The courts have recognized the argument that a taxpayer’s fractional ownership of certain types of property should be discounted because owning a piece of the property can lead to problems in selling it on an open market.³³

II. VALUATION OF FRACTIONAL OWNERSHIP IN REAL PROPERTY

Since it is well accepted by courts that a discount of fractional ownership is permitted for real property,³⁴ “[t]he majority of the court cases

25. 26 C.F.R. § 20.2031-1(b).

26. *Id.*

27. Fowler, *supra* note 14, at 123.

28. *Id.* at 124.

29. Steven C. Colburn & Ted D. Englebrecht, *Valuing Fractional Undivided Interests for Estate Tax Purposes*, 30 REAL EST. TAX’N 87, 87 (2003).

30. JOHN A. BOGDANSKI, FEDERAL TAX VALUATION ¶ 5.01[2][b] (2019).

31. Carsten Hoffmann, *The Quest for Higher Ground Concerning Undivided Interest Discounts Continues*, VALUATION STRATEGIES, Sept./Oct. 2002, at 6 (noting there is an “importance of a well-qualified and a thorough valuation that combines real world data with a well-reasoned analysis”).

32. Fowler, *supra* note 14, at 123.

33. *Id.*

34. See *Estate of Baird v. Comm’r*, 82 T.C.M. (CCH) 666, at *10 (2001), *rev’d on other grounds*, 416 F.3d 442, 455 (5th Cir. 2005); *Pillsbury v. Comm’r*, 64 T.C.M. (CCH) 284, at *6 (1992); *Propstra v. United States*, 680 F.2d 1248, 1251 (9th Cir. 1982).

dealing with the valuation of undivided interests have granted discounts.”³⁵ Courts have granted discounts because these types of fractional interests in real property are hard to sell since few people are interested in purchasing these types of properties given the limited control by any co-owner.³⁶ Therefore, courts have held that fractional interests in real property can lead to a discount in valuation.³⁷

For fractional ownership discount issues of partial interests in real property, the IRS has consistently taken the view that partitioning the property results in a proper valuation discount for tax purposes.³⁸ In *TAM 9336003*, a wife bequeathed her husband one half interest in their ranch, and bestowed the second half to other relatives and beneficiaries.³⁹ When the husband died, his estate calculated a fractional discount because of his partial interest in the real property.⁴⁰ The IRS concluded that since he owned a fractional piece of the land, his partial ownership may not have been easy to sell.⁴¹ The IRS cited to cases where “partitioning is an alternative that results in greater economic benefits to the owner of an undivided interest.”⁴² Within the opinion, the IRS noted this discount should be the amount of a partition and not the fair market value discount based upon the marketability of the property.⁴³ This aspect is relevant to fractional ownership in artwork because courts have been willing to accept fractional ownership of real property; however, the courts have not been as accepting of fractional ownership in personal property.⁴⁴ It is unclear why courts are reluctant to accept discount valuations for fractional ownership in personal property.⁴⁵

In cases of fractional ownership of real property, the IRS has persistently put forth the argument that the cost to partition is the correct valuation for fractional ownership of real property, yet the courts reject the belief that a discount for partition is applicable. It is contended that since this is a forced sale, the property might receive less than the fair market value of the property.⁴⁶ There are instances where partition is applicable, but it is unusual for fractional ownership of real property.

35. Fowler, *supra* note 14, at 167.

36. *Id.* It can be difficult for the co-owners to agree what happens to the property which makes the property worth less to a potential buyer. *See id.*

37. Colburn & Englebrecht, *supra* note 29, at 93.

38. *Id.* at 88.

39. I.R.S. Tech. Adv. Mem. 93-36-003 (Sept. 10, 1993).

40. *Id.*

41. *See* Colburn & Englebrecht, *supra* note 29, at 88.

42. I.R.S. Tech. Adv. Mem. 93-36-003 (Sept. 10, 1993).

43. *Id.*

44. *See* Lance Hall, *Undivided Interest Discounts for Tangible Personal Property*, 11 VALUATION STRATEGIES 34, 34 (2008).

45. *Id.*

46. *Id.* at 37.

The Ninth Circuit in *Estate of Propstra*,⁴⁷ a seminal case in fractional ownership, allowed a discount on community property because the property was unmarketable due to the decedent's undivided interest.⁴⁸ The Ninth Circuit established a precedent to allow such a discount, and this idea has been supported by later cases. The court looked to the requirement that the "holder of an undivided interest in property would have to secure the consent of the owner or owners of the remaining interests before being able to sell as a unit. This factor alone could affect valuation regardless of whether real or personal property is involved"⁴⁹ and the buyer's ownership of his or her portion would be worth less. Therefore, this court and later courts have taken that relevant aspect into account for the property valuation for tax purposes.⁵⁰

Some courts, however, have accepted the IRS's approach that cost to partition is the correct type of valuation, as the Tax Court did in *Ludwick*.⁵¹ The petitioners in *Ludwick*, a husband and wife, purchased a plot of land to build their Hawaiian vacation home and then the property was transferred to a trust.⁵² Both claimed a deduction on their tax returns for their transfer to the trust of their undivided interest in the property.⁵³ The petitioners sought to claim a discount based on the property's perceived difficulty to sell to a third party.⁵⁴ The court rejected the evaluations put forth by the petitioners and held for a partition discount to determine the value of the real property.⁵⁵ Additionally, the court focused on the length of time to complete the partition and the numerous factors that would lead to a discount because of the litigation that would ensue from the partition.⁵⁶ Despite the fact that the petitioners' trust agreement provided that no partition was to take place.⁵⁷ This decision demonstrates there are courts that still accept the IRS's argument that partition is meant to be the imperative factor with regards to a partial ownership in real property.⁵⁸ While *Ludwick* accepted the IRS's view that cost to partition was the right application for valuing

47. *Propstra v. United States*, 680 F.2d 1248, 1253 (9th Cir. 1982).

48. *Colburn & Englebrecht*, *supra* note 29, at 89.

49. *Propstra*, 680 F.2d at 1252 n.6.

50. *Fowler*, *supra* note 14, at 158.

51. *Ludwick v. Comm'r*, 99 T.C.M. (CCH) 1424, at *5 (2010).

52. *Id.* at *1.

53. *Id.*

54. *Id.* at *4.

55. The court held that the partition provided a better evaluation as a 10% discount and rejected the idea that the property was not marketable. *Id.* at *5.

56. See Steven J. Decker, *Valuation Issues in Fractional Real Estate Interests and Partition Cost Analysis*, AM. SOC'Y OF APPRAISERS, http://www.appraisers.org/docs/default-source/discipline_rp/decker-valuation-issues-in-fractional-real-estate-interests-and-partition-cost-analysis.pdf?sfvrsn=0 (last visited Oct. 7, 2018).

57. Howard M. Zaritsky, *Using Tenancy in Common Interests in Valuation Discount Planning*, 37 EST. PLAN. 48, 47 (2010).

58. *Ludwick*, 99 T.C.M. (CCH) 1424, at *5.

fractional ownership of real estate, other tax courts have rejected the IRS's position that "discounts applicable to undivided fractional interests in real property should be based on the estimated costs of partitioning the property."⁵⁹

Different tax courts have looked beyond the cost to partition, and have given more weight to other factors, such as the lack of marketability of real property. For example, in *LeFrak*, the court allowed a 20% discount for partial interest in real estate and a 10% discount for a lack of marketability.⁶⁰ The court applied a two-step process in its application of the discount in the fractional ownership of real estate and looked to a minority and marketability discount.⁶¹ The minority discount came from the lack of control in the asset, and the marketability discount was estimated from the market in which the asset might sell.⁶² After considering both types of discounts, the court applied a discount for partial ownership in real estate. *LeFrak* is noteworthy as "the first Tax Court decision concerning undivided interests subsequent to the cost-to-partition *TAM 9336002*," and the court did not accept the cost to partition approach because of the cost, uncertainty, and delays in a partition proceeding that "must be considered in determining the discount."⁶³

The acceptance of an undivided interest discount from *LeFrak* is echoed in *Estate of Stevens*, where the court went further by asserting, "[w]e do not limit the discount to the costs of partitioning because such a discount does not account for the factors of control and marketability in the circumstances of this case."⁶⁴ Therefore, a cost to partition can be applicable, but it may not be necessary to determine a discount of fractional ownership of real property. *Estate of Stevens* represented "the power of using analytical methods and sales of comparable properties to make a case for discounts for fractional undivided interests in real property."⁶⁵

Furthermore, in *Estate of Baird*, "the Tax Court emphasized that undivided interest discounts should be backed by a well-qualified expert and a thorough valuation that combined real world data with a well-reasoned analysis."⁶⁶ The taxpayers in this case, John and Sarah Baird, died with a fractional interest in tracts of timberland, and the court determined a discount for their undivided interest in the timberland.⁶⁷ Their estates put

59. Colburn & Englebrecht, *supra* note 29, at 93.

60. *LeFrak v. Comm'r*, 66 T.C.M. (CCH) 1297, at *17–18 (1993).

61. *See Webb & Lunn Jr.*, *supra* note 6, at 2.

62. *See id.* at 1.

63. Lance Hall, *Undivided Interest Valuations*, in 10 VALUATION STRATEGIES 33, 34 (2007).

64. *Estate of Stevens v. Comm'r*, 79 T.C.M. (CCH) 1519, at *10 (2000).

65. Colburn & Englebrecht, *supra* note 29, at 91.

66. Hoffmann, *supra* note 31, at 1.

67. *See Estate of Baird v. Comm'r*, 82 T.C.M. (CCH) 666, at *9 (2001) (addressing the issue of the timberland's value itself and not the value of the trust of timberland); Colburn & Englebrecht, *supra* note 29, at 91.

forth various witnesses who successfully tried to emphasize the valuation discounts for the fair market value.⁶⁸ The court considered the valuation from one of the estates' experts due to his knowledge and sales experience of fractional interests in timberland. This expert testified there should be a discount for this type of ownership.⁶⁹

On the other hand, the IRS held the view that a cost of partition could be done easily; therefore, a large discount was not applicable.⁷⁰ However, the court sustained that there was a discount for the fractional interest in the tracts of timberland based upon the estates' expert's testimony.⁷¹ This case and others exemplify the push towards the rejection of valuation for tax purposes based on partition alone. In *Estate of Baird* and similar real estate property cases, the courts have continued to reject the IRS's position for cost to partition and, instead, focused on the valuation evidence put forth by the appraisers for the taxpayer.⁷²

Based on the cases above, the majority of courts have been accepting a discount for fractional ownership of real property, yet the IRS argues that the cost to partition is the best valuation method.⁷³ "More damaging to the IRS position is that Tax Court decisions subsequent to the IRS [cost to partition] pronouncement have rejected the sole reliance on the cost to partition and instead have focused on the delay and uncertainty inherent in the partition process."⁷⁴ For taxpayers that are challenging the cost to partition application, they need to highlight the "impracticability of partitioning the subject property" or the limited marketability of the partial ownership of the real estate itself.⁷⁵ Given the courts rejection of the partition approach, sale valuation methodologies provide a more accurate valuation of the undivided interest.⁷⁶

III. MORE THAN AN IRS MESS UP—*ESTATE OF ELKINS* HAS PRECEDENTIAL VALUE

Estate of Elkins was the first decision where the Tax Court and the Fifth Circuit accepted the discount valuation put forth by the taxpayer with regards to fractional ownership of artwork, yet many attorneys are cautious since this decision might be viewed as an IRS misstep unlikely to be

68. Colburn & Englebrecht, *supra* note 29, at 91.

69. *See id.* at 92.

70. *See id.* at 93.

71. *See id.*; *Estate of Baird v. Comm'r*, 82 T.C.M. (CCH) 666, at *10, *rev'd on other grounds*, 416 F.3d 442, 455 (5th Cir. 2005).

72. *See* Colburn & Englebrecht, *supra* note 29, at 93.

73. Lance Hall, *Should the IRS Surrender Cost-to-Partition Discounts for Undivided Interests?*, VALUATION STRATEGIES, Jan./Feb. 1998, at 1.

74. *Id.* at 6.

75. Fowler, *supra* note 14, at 167.

76. Hall, *supra* note 73, at 6.

repeated.⁷⁷ Some have argued that because of the poor strategies and tactical choices made by the IRS, a “gem” decision was created for the taxpayers.⁷⁸ However, *Estate of Elkins* is much more than a “gem” decision because it opened the door for taxpayers to evaluate their fractional ownership in artwork as taxpayers have generally done with real estate—by determining a discount based upon either partition or a valuation based upon the sale of the fractional ownership.

Nevertheless, the IRS likely will not make the same mistake again by providing no evidence to support a zero valuation discount because the Fifth Circuit rejected the argument that no discount was applicable.⁷⁹ While taxpayers will be concerned with what discount they may or may not receive, *Estate of Elkins* stands for the proposition that fractional ownership discounts can exceed the negligible amount courts have held for in the past, as the Tax Court and the Fifth Circuit accepted a larger discount.⁸⁰ The IRS’s mishandling of the case resulted in precedent by the Fifth Circuit which allows taxpayers to be creative in structuring ownership of artwork to obtain a fractional ownership discount.⁸¹

Estate of Elkins enables taxpayers to obtain a valuation discount with the proper structuring and planning. While understandable that critics of *Estate of Elkins* highlight the IRS’s lack of evidence as the key takeaway of the case, the Tax Court focused on other cases where courts have accepted that personal property, specifically artwork, can receive a valuation discount for fractional ownership.⁸² The analysis of real property is relevant for the valuation of artwork because a valuation discount is not as widely recognized by courts.⁸³ Given the similar nature of both types of property, both are unique in nature and one of a kind, it is not clear why fractional ownership of artwork is not given the same type of tax treatment.

IV. VALUATION OF FRACTIONAL OWNERSHIP IN ARTWORK

It is difficult to evaluate the fair market value of artwork due to its unique nature because two pieces of artwork are never the same.⁸⁴ Artwork, like real property, has its own distinct features. Although it is possible to have fractional ownership of artwork, valuation problems surface because “of the illiquid nature of undivided interest in art . . . and restrictions on

77. Luski, *supra* note 15, at 4.

78. *Id.*

79. Quincy Cotton et al., *Fractional Interests in Art and Other Valuation Challenges*, ROBERTS & HOLLAND L.L.P. EST. & GIFT TAX PLAN. NEWSL. (Roberts & Holland L.L.P., New York, N.Y.), Nov. 2014, at 1–2.

80. *Id.*

81. Luski, *supra* note 15, at 4.

82. See *Estate of Elkins v. Comm’r*, 140 T.C. 86, 118–22 (2013).

83. See Langstraat et al., *supra* note 9, at 37–38.

84. See Anne-Marie E. Rhodes, *Big Picture, Fine Print: The Intersection of Art and Tax*, 26 COLUM. J.L. & ARTS 179, 196 (2003).

marketability and control that a potential buyer would face can reduce the value of a fractional interest below the pro rata value of the underlying art work.”⁸⁵ Fractional ownership of artwork is becoming more common by people taking joint ownership through buying “shares” of the artwork⁸⁶ or through contractual agreements that specify each co-owner’s rights to the artwork.⁸⁷

The first significant case on the fractional ownership discounts of artwork is *Estate of Scull*.⁸⁸ The decedent, Robert Scull, upon his death, owned a 65% of undivided interest in an art collection he shared with his separated spouse.⁸⁹ The Tax Court divided the estate’s artwork into different categories to determine the discount based on his fractional ownership of the entire art collection.⁹⁰ The estate and the IRS disagreed on the valuation of the artwork, and both parties provided witnesses to assert that their valuation was correct.⁹¹ The Tax Court assessed the entire value of the artwork collection through the evidence introduced by the estate and the IRS.⁹² As for Mr. Scull’s fractional ownership of the artwork itself, the Tax Court determined that a buyer was unlikely expect more than a 5% discount for the fractional ownership of the collection.⁹³ The court determined a 5% discount by looking to the willing buyer and seller standard and noted that the willing buyer would contemplate the separated spouse’s interest.⁹⁴ The court awarded a discount for “the uncertainty of the decedent’s ownership claim” because of the unpredictability in the divorce proceedings.⁹⁵ Therefore, a hypothetical purchaser would take that uncertainty of ownership into account.

In *Stone*, the decedent’s estate claimed a discount in partial ownership of artwork in the decedent’s nineteen piece collection.⁹⁶ The court accepted

85. Langstraat et al., *supra* note 9, at 43.

86. *See* Holland, *supra* note 3.

87. Cotton et al., *supra* note 79, at 1.

88. *See* Estate of Scull v. Comm’r, 67 T.C.M. (CCH) 2953, at *27 (1994).

89. *Id.* at *8; Langstraat et al., *supra* note 9, at 38–39 (noting that when Scull died “divorce proceedings had not yet concluded, and neither party took possession of the art pieces”).

90. *Estate of Scull*, 67 T.C.M. (CCH) 2953, at *18. The court divided the collection in four categories: (1) works of art sold at auction in November 1986; (2) works of art offered and sold at auction; (3) works of art included in the 1985 appraisal but not offered at auction; and (4) works of art not included in the 1985 appraisal and not offered at auction. *Id.*

91. *Id.* at *10.

92. *Id.* at *23.

93. *Id.*

94. *Id.*

95. Stephen C. Gara & Craig J. Langstraat, *Property Valuation for Transfer Taxes: Art, Science or Arbitrary Decision?*, 12 AKRON TAX. J. 125, 146–47 (1996); *Estate of Scull*, 67 T.C.M. (CCH) 2953, at *23.

96. *See* Stone v. United States, No. C06-0259, 2007 WL 1544786, at *1 (N.D. Cal. May 25, 2007), *modified*, No. C06-0259, 2007 WL 2318974, at *3 (N.D. Cal. Aug. 10, 2007) *aff’d*, Stone *ex rel.* Stone Trust Agreement v. United States, No. 07-17068, 2009 WL 766497, at *2 (9th Cir. 2009).

the IRS's valuation of the nineteen pieces and rejected the estate's valuation.⁹⁷ Moreover, the court analyzed whether there can be a discount on the cost of partition or the fair market value of the fractional ownership.⁹⁸ For the actual discount valuation, the court ordered both parties to "meet and confer to attempt to settle this case now that the Court has resolved certain highly disputed issues."⁹⁹ However, the parties could not settle and had to appear before the court again.¹⁰⁰ The court held the estate had not proven that a discount greater than 5% for fractional ownership was applicable; thus, the court held for a 5% valuation discount.¹⁰¹

The *Stone* court decided it was possible to have a discount of fractional ownership of property only if the taxpayer offered credible evidence.¹⁰² The court "rejected the assertions by the IRS that a discount is not applicable to personal property."¹⁰³ The court considered cases where other courts would have allowed personal property to receive fractional discounts had the parties put forth enough evidentiary support.¹⁰⁴ As the court observed in *Stone*, the court in *Pillsbury* held that fractional discounts cannot be upheld based upon the "bare assertion that a discount is appropriate . . . *with no evidence to support it.*"¹⁰⁵ Similarly, in *Propstra*, the court held that a "holder of an undivided interest in property would have to secure the consent of the owner or owners of the remaining interest before being able to sell as a unit. This factor alone could affect valuation regardless of whether real *or personal property* is involved."¹⁰⁶ These cases exemplify the possibility to have a discount of fractional ownership of personal property. In other words, *Stone* represents that a discount of fractional ownership of artwork is possible and attainable.¹⁰⁷

In *Estate of Elkins*, the taxpayer prevailed by offering enough evidence to support its valuation and to apply the discount.¹⁰⁸ Additionally, Mr. Elkins and his wife owned sixty-four pieces of artwork over the course of their marriage and devised a plan to pass on their artwork.¹⁰⁹ Mr. Elkins and

97. *Stone*, 2007 WL 1544786, at *3.

98. *Id.* at *5–6.

99. *Id.* at *8.

100. *Stone v. United States*, No. C06-0250, 2007 WL 2318974, at *1 (N.D. Cal. Aug. 10, 2007).

101. *Id.* at *2–3.

102. *Stone*, 2007 WL 1544786, at *6.

103. Hall, *supra* note 44, at 36.

104. See *Pillsbury v. Comm'r*, 64 T.C.M. (CCH) 284, at *6 (1992); *Propstra v. United States*, 680 F.2d 1248, 1251 (9th Cir. 1982).

105. *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *6 (N.D. Cal. May 25, 2007) (quoting *Pillsbury v. Comm'r*, 64 T.C.M. (CCH) 284, at *6 (1992)).

106. *Id.* (citing *Propstra v. United States*, 680 F.2d 1248, 1252 n.6 (9th Cir. 1982)).

107. *Stone*, 2007 WL 2318974, at *1.

108. *Estate of Elkins v. Comm'r*, 767 F.3d 443, 451 (5th Cir. 2014).

109. Langstraat et al., *supra* note 9, at 41.

his wife wrote agreements where Mr. Elkins retained 50% in three pieces of artwork through a trust and he owned 73.055% in the remaining art.¹¹⁰ When the estate of Mr. Elkins claimed a 44.75% fractional ownership interest discount, the IRS challenged the discount as inapplicable.¹¹¹

The estate of Mr. Elkins “supplied the testimony of three expert witnesses: [a]n art appraiser[,] [a]n expert in valuation services[,] [and a] lawyer experienced in partition actions.”¹¹² The experts provided ample evidence that there should be a discount for the valuation of the fractional ownership of the artwork.¹¹³ One expert argued for a discount based upon either the sale of the interest in the artwork or the potential cost to partition the artwork itself.¹¹⁴ After his valuation, the expert for the estate relied on the lesser cost of the sale of an undivided interest.¹¹⁵ The IRS argued that the fractional ownership interest discount was not applicable to artwork because there was no market for fractional ownership of artwork and the partition discount was not applicable.¹¹⁶ The court deemed the evidence offered by the estate’s experts sufficient, but the court only applied a 10% discount for the fractional ownership of the artwork.¹¹⁷ However, the court did not explain how it calculated this percentage.¹¹⁸

On appeal, the Fifth Circuit held for the estate’s full fractional ownership discount because the court found the valuation by the estate’s experts unchallenged and by default more accurate.¹¹⁹ The court reasoned that the IRS offered no information to rebut the evidence put forth by the estate’s experts.¹²⁰ Additionally, the experts for the estate weighed all the relevant factors affecting what a hypothetical buyer would pay for the fractional ownership interest in the artwork.¹²¹ In the comparison to *Estate*

110. *Estate of Elkins v. Comm’r*, 140 T.C. 86, 88–89 (2013). A trust was set up with Mr. Elkins’s wife that was to expire in 10 years and to be passed onto their children where each child was to receive 16.667% ownership. Mr. Elkins’s wife predeceased him and he received her 50% interest. Their children each received 8.98167% of the artwork that was not owned by the decedent. *Id.*

111. *Id.* at 91.

112. Langstraat et al., *supra* note 9, at 42. The appraiser divided the collection into three categories: (1) the five most desirable pieces; (2) nineteen good pieces for which alternatives were readily accessible; and (3) forty works not worth the risk associated with the sale restrictions. *Id.* Each expert witness used the same three categories of the artwork for their own evaluation. *Id.*

113. *Estate of Elkins*, 140 T.C. at 9.

114. *Id.* at 100–101.

115. Langstraat et al., *supra* note 9, at 42. Under the sale of the undivided interest, the discount would range from 51.7%–71.7% for one category of artwork, 71.1% of second category, and 79.7% in the third category. *Id.* Under the cost to partition, the discount would range from 60%–85%, 60%–90%, and 100%, respectively. *Id.*

116. *Estate of Elkins*, 140 T.C. at 110; Langstraat et al., *supra* note 9, at 43.

117. *Estate of Elkins*, 140 T.C. at 135.

118. *See id.*

119. *Estate of Elkins v. Comm’r*, 767 F.3d 443, 453 (5th Cir. 2014).

120. *Id.* at 451.

121. Thomson Reuters, *Estate was Entitled to Apply Fractional-Ownership Discount to Artwork*, 93 PRAC. TAX STRATEGIES 225, 226 (2014) (“These factors included each child’s

of *Scull* and *Stone* mentioned by the Tax Court, minimal fractional discounts were awarded in those cases “because of a lack of proof [by the taxpayer] that any greater discount was warranted.”¹²² In contrast, Mr. Elkins’s estate provided ample evidence, unrebutted by the IRS, to support a sale of the undivided interest and a possible cost of partition.¹²³

Estate of Elkins differs from *Estate of Scull* and *Stone* because the taxpayer provided plenty of evidence to support their requested discount.¹²⁴ In *Estate of Elkins*, the estate provided a sufficient amount of evidence, including experts’ evidence to support a claim for a discount based upon the fractional ownership of the artwork.¹²⁵ There, the IRS experts asserted there was no market for fractional ownership of artwork.¹²⁶ On appeal, the Fifth Circuit went further than the Tax Court and rejected the IRS’s argument that no market for fractional ownership existed, noting that “given the total absence of substantive evidence from the Commissioner . . . the Tax Court should have accepted and applied the uncontradicted quantum[s] [sic] of the partial-ownership discounts” provided by the estate.¹²⁷ In contrast, the *Estate of Scull* and *Stone* courts did not even compare the IRS’s evidence to the taxpayer’s evidence. In both cases, the taxpayer did not meet the burden to support their claim of having a discount of fractional ownership of artwork.¹²⁸ These cases are important since the court did accept a nominal 5% discount based upon the fractional ownership of artwork. However, *Estate of Elkins* goes further and stands for the proposition that if taxpayers “collect specific evidence regarding both the reasonableness and the magnitude of a discount,” then the taxpayer stands a greater chance to obtain a higher reduction in the valuation.¹²⁹

As a result of *Estate of Elkins*, in the future the IRS will need to offer evidence to support the contention that the discount is not applicable to the case at hand.¹³⁰ The case affirmed fractional ownership of artwork could provide for some level of discount, but the taxpayer must provide ample evidence to support his or her valuation.¹³¹ Since this decision, practitioners have suggested best practices for a favorable outcome comparable to that of

financial astuteness and net worth, their hypothetical desire to acquire the decedent’s fractional interest if a hypothetical buyer should acquire them first . . .”).

122. *Estate of Elkins*, 767 F.3d at 450–51 (quoting *Estate of Elkins v. Comm’r*, 140 T.C. 86, 119 (2013)).

123. *Id.* at 451.

124. Langstraat et al., *supra* note 9, at 42–43.

125. See *Estate of Elkins v. Comm’r*, 140 T.C. 86, 93 (2013).

126. *Id.* at 111.

127. *Estate of Elkins*, 767 F.3d at 450.

128. See Langstraat et al., *supra* note 9, at 43.

129. See *id.*

130. Robert E. Madden et al., *Fifth Circuit Allows Discount for Fractional Interest in Art Estate of Elkins*, 41 EST. PLAN. 32, 32–33 (2014).

131. Cotton et al., *supra* note 79, at 1.

Estate of Elkins.¹³² While the IRS has learned from its mistake of providing limited evidence to support a no-discount valuation, the court should have gone further to indicate that if the taxpayer puts forth enough evidence, then a discount in fractional ownership in artwork is applicable as seen with real property.¹³³ As a result of these decisions, fractional ownership of artwork should be subject to the same analysis as fractional ownership in real property. There are two possible solutions to address the potential discount of the fractional ownership of artwork: (1) a sale of the undivided interest of the artwork or (2) a successful partition action.

A. PARTITION THE ARTWORK? IT WORKS FOR REAL PROPERTY

Partition is defined as “the segregation of property owned in undivided shares, so as to vest in each co-owner exclusive title to a specific portion in lieu of his undivided interest in the whole.”¹³⁴ For a partition, courts can grant two types of partition: “partition in kind” or a “partition in sale.” Under a partition in kind, “the property is physically divided in equitable portions”¹³⁵ However, it can be challenging to physically divide property in exact and impartial portions.¹³⁶ A partition in sale is where the property is sold and “the cash is distributed to the undivided interest holders on a pro-rata basis.”¹³⁷

Personal property is “[a]ny movable or intangible thing that is subject to ownership and not classified as real property.”¹³⁸ In contrast, real property is defined as “[l]and and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land.”¹³⁹ For both types of property, each owner of the undivided interest “has the right to use and enjoyment of the asset, subject to the same rights accorded to other owners.”¹⁴⁰

The IRS’s position regarding an undivided interest in real property is formulaic to determine whether a discount should be based on the cost to partition.¹⁴¹ When looking to the Internal Revenue Code and its limited guidance for determining value, it is unclear why a partition in sale or partition in kind is not possible for any property.¹⁴² However, for an undivided interest in artwork, the IRS’s position is that no discount should

132. Elizabeth A. Bowers et al., *Forging Elkins: How to Copy This Taxpayer Victory*, 29 PROB. & PROP. 24, 25 (2015).

133. See Colburn & Englebrecht, *supra* note 29, at 93.

134. *Partition*, BLACK’S LAW DICTIONARY (10th ed. 2014).

135. Hall, *supra* note 73, at 2.

136. *Id.*

137. *Id.*

138. *Personal Property*, BLACK’S LAW DICTIONARY (10th ed. 2014).

139. *Real Property*, BLACK’S LAW DICTIONARY (10th ed. 2014).

140. Hall, *supra* note 44.

141. *Id.*

142. Fowler, *supra* note 14, at 123–124.

be allowed.¹⁴³ There is a similarity between an undivided interest in real property and personal property, namely artwork in this context, because “the rights, preferences, privileges, and restraints are largely similar.”¹⁴⁴

Since personal property has such a broad definition and both types of properties are subject to the same rights, the IRS should clarify and substantiate its position that personal property cannot be subject to a fractional ownership discount. Moreover, the Internal Revenue Code does not indicate a difference between personal property and real property.¹⁴⁵ Therefore, a cost to partition may be used to determine a discount of an undivided interest in artwork. In the IRS’s view, there is no market for this type of artwork ownership, yet courts have not accepted this view.¹⁴⁶ Furthermore, given the IRS’s position that cost to partition is the best methodology for valuation of fractional ownership in real property, the IRS provides no reason for its belief that a taxpayer cannot claim a cost to partition discount for fractional ownership in artwork.¹⁴⁷ The cost to partition includes the cost of litigation, court oversight to implement the partition, and the years of litigation that could ensue.¹⁴⁸ Notably, personal property has similar, yet different ownership attributes to real property.¹⁴⁹ For example, personal property may have a stronger emotional or sentimental value, and a partition action is likely to be more “contentious, drawn out, expensive, and unlikely to arrive at a reasonable settlement than when dealing with [real] property.”¹⁵⁰

Although partition is typically implemented with real property, a partition of personal property, while uncommon, is still possible.¹⁵¹ For instance, in *Killiam*, a couple divorced and the property settlement stipulated both parties take turns using the boat they purchased while married.¹⁵² Over time, the arrangement was untenable, and the court ordered a partition because the joint ownership of the “boat caused four years of strife and disagreement. . . .”¹⁵³ Moreover, in certain states, such as Florida, there are statutes that provide for partition of personal property.¹⁵⁴ State statutes, such as Florida’s, have been applied by the courts to partition

143. *Estate of Elkins v. Comm’r*, 767 F.3d 443, 444 (5th Cir. 2014).

144. Hall, *supra* note 44.

145. See 26 C.F.R. § 20.2031-1(b) (2019).

146. *Estate of Elkins v. Comm’r*, 140 T.C. 86, 123 (2013).

147. Langstraat et al., *supra* note 9, at 40.

148. *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *7 (N.D. Cal. May 25, 2007).

149. Hall, *supra* note 44, at 36.

150. *Id.*

151. See 59A, AM. JUR. 2D *Partition* § 9 (2019).

152. *Killam v. Killam*, 444 P.2d 479, 480 (Or. 1968); Robert M. Jarvis & Phyllis Coleman, *Boats and Divorce*, 49 J. MAR. L. & COM. 319, 365 (2018).

153. *Killam*, 444 P.2d at 480.

154. FLA. STAT. § 64.091 (2019) (“The laws applicable to partition and sale for partition or real estate are applicable to the partition and sale for partition of personal property and the proceedings therefore, as far as the nature of the property permits.”).

different types of personal property.¹⁵⁵ While this is not necessarily pertinent for the valuation of the undivided interest for tax purposes, cases like *Killiam* involving partition of personal property show that courts will partition an undivided interest in personal property.¹⁵⁶ Additionally, given that the standard for valuation of property is based upon the hypothetical buyer and seller scenario, there is no reason the analysis for discounts allowed in undivided interest in real property would be different for undivided interest in personal property.¹⁵⁷

A personal property partition might be difficult to achieve because a partition action could take years since a partition of personal property is not as intuitively economic as commonly seen with real property.¹⁵⁸ “Because the rights to occupy and operate are held by all undivided interest holders, the potential for chaos exists between the various undivided interest holders that is detrimental to the value of the underlying property,” the right to partition typically increases the discount of the undivided interest.¹⁵⁹ This effect is especially heightened for personal property. If it is held between family members, as in many of the cases involving artwork, then the cost to partition the undivided interest is high because of the many potential problems in a partition sale.¹⁶⁰

In *Estate of Elkins*, the court accepted the sale of the undivided interest and rejected a cost to partition—despite being provided with both valuation methods.¹⁶¹ Under the cost of partition, the discount was much larger, and the court accepted the valuation based upon the sale of the undivided interest.¹⁶² The valuation made on the partition was heavily discounted because of testimony provided by Elkins’s children expressing their attachment to the property as opposed to the monetary value of the artwork

155. Harry M. Hipler, *Breaking Up is Hard to Do: Developments in Partitioning Real and Personal Property in Martial, Business, and Personal Relationships in Florida Jurisprudence*, 24 U. MIAMI BUS. L. REV. 81, 91 (2016).

156. Even though this decision and others are more applicable to state law in allowing the partition of personal property, the fact is that a partition of personal property is possible, especially since there is no distinction between real property and personal property for valuation purposes, just the fair market value of a sale between a willing buyer and seller. See 26 C.F.R. § 20.2031-1(b) (2019).

157. See *id.*; Hall, *supra* note 44, at 37.

158. Hall, *supra* note 44, at 36.

159. Hall, *supra* note 73, at 2.

160. Years of litigation may likely ensue, as in the case of *Estate of Elkins*, the court was presented with evidence that the Elkins’s children would strongly oppose a partition sale because of their “strong sentimental and emotional ties to each of the 64 works of art.” *Estate of Elkins v. Comm’r*, 140 T.C. 86, 121 (2013).

161. Langstraat et al., *supra* note 9, at 42.

162. *Id.* (explaining that under the sale of the undivided interest, the discount would range from 51.7%-71.7% for one category of artwork, 71.1% of second category, and 79.7% in the third category; under the cost to partition, the discount would range from 60%-85%, 60%-90%, and 100%, respectively); *Estate of Elkins v. Comm’r*, 767 F.3d 443, 453 (5th Cir. 2014).

itself.¹⁶³ On appeal, the court accepted the valuation discount derived from the undivided interest valuation by the estate because the discount was lower than the cost to partition and Elkins's children were less likely to accept a partition of the artwork.¹⁶⁴

However, under *Stone*, the court concluded that “because an undivided interest holder has a right to partition, a hypothetical seller under no compulsion to sell would not accept any less for his or her undivided interest than could be obtained by splitting proceeds in this manner.”¹⁶⁵ The court went on to find that a discount was applicable “to allow for the uncertainties involved in waiting to sell the collection until after a hypothetical partition action is resolved.”¹⁶⁶ As a result of the two discrepancies between the two valuation methods, there was room for interpretation regarding the correct methodology. Other courts “have found that willing sellers would accept substantial discounts for undivided interest in real estate, despite having the right to partition” yet, the *Stone* court “could not accept the same for an undivided interest in 19 paintings.”¹⁶⁷

In cases involving undivided interest of real property, courts still struggle to determine the correct valuation method for the real property.¹⁶⁸ There has been tension between taxpayers and the IRS. The IRS has supported the cost to partition discount valuation, whereas taxpayers have argued that the discount should be determined by the sale of the undivided interest.¹⁶⁹ However, recent cases, such as *Estate of Baird*, emphasize “a current trend in Tax Court decisions that favor estate positions when using solid data and the analyses of expert witnesses.”¹⁷⁰ Expert data from other sales highlight “how it relates to, or is different from, the property at issue” which provides the courts with a more accurate depiction of the valuation discount.¹⁷¹

B. SALE OF THE UNDIVIDED INTEREST WORKS FOR REAL PROPERTY AND CAN ALSO WORK FOR ARTWORK

Taxpayers who petition for a discount are more successful when they provide experts to present valuation methodologies to support a determination of the fractional ownership interest discount.¹⁷² The sale of an undivided interest in property consists of calculating the discount a buyer

163. *Estate of Elkins*, 140 T.C. at 129.

164. *Estate of Elkins*, 767 F.3d at 453.

165. *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *4 (N.D. Cal. May 25, 2007).

166. *Id.* at *7 (citing *Estate of Scull v. Comm’r*, T.C.M. (CCH) 2953, at *23 (1994)).

167. Hall, *supra* note 44, at 37.

168. See Colburn & Englebrecht, *supra* note 29; *Estate of Baird v. Comm’r*, 82 T.C.M. (CCH) 666, at *3 (2001).

169. See Colburn & Englebrecht, *supra* note 29.

170. *Id.*

171. *Id.* at 93.

172. Fowler, *supra* note 14, at 167.

would take into account if he or she was to resell the property.¹⁷³ The taxpayer can put forth evidence of factors the hypothetical buyer would take into account, including but not limited to, the lack of control, marketability of the interest, and the number of property owners.¹⁷⁴

In the undivided fractional ownership of real estate, many courts have rejected the cost to partition as the calculation of the discount of the fractional ownership.¹⁷⁵ “Instead, reliance is placed on the testimony of qualified witnesses who present data for comparable sales (if they can be found) and consider other factors that may help determine the appropriate amount of discount.”¹⁷⁶ Cases, such as *Estate of Baird*, highlight the importance of highly qualified experts and a thorough analysis to determine the valuation.¹⁷⁷

In *Estate of Baird*, the estates provided various valuation specialists to support their contention that a discount is applicable for the fractional ownership of timberland. The estates provided three experts deemed qualified by the court, whereas the IRS presented one expert that the court did not find qualified in fractional ownership interests.¹⁷⁸ In other words, the IRS offered the evidence of an expert, “but the Tax Court ruled that he was incompetent to testify as an expert . . . and his report was not offered into evidence at trial.”¹⁷⁹ As a result of presenting an unqualified expert, the IRS failed to provide credible support for their contention that no discount was applicable.¹⁸⁰ In its decision, the Tax Court had to look to the estates’ experts and concluded that the estates were entitled to a 55% discount for the lack of control, as well as an additional 5% discount for the circumstances regarding the decedents’ family members.¹⁸¹

In contrast, in *Estate of Elkins* the IRS’s experts were allowed to testify, but the court did not accept their valuations.¹⁸² At trial, an IRS expert focused on the fact that there was no retail market for fractional interests in works of art.¹⁸³ In response, the court explained that nothing in the hypothetical buyer and seller scenario in the Internal Revenue Code indicated a need for a market at all for this type of ownership to calculate the discount for fractional ownership.¹⁸⁴ “The fact that there exists a retail market for works of art with multiple owners does not necessarily mean that

173. Colburn & Englebrecht, *supra* note 29, at 93.

174. *Id.*

175. *Id.*

176. *Id.*

177. Hoffmann, *supra* note 31.

178. Colburn & Englebrecht, *supra* note 29, at 92.

179. *Estate of Baird v. Comm’r*, 416 F.3d 442, 446 (5th Cir. 2005).

180. *Estate of Baird v. Comm’r*, 82 T.C.M. (CCH) 666, at *3 (2001).

181. *Estate of Baird*, 416 F.3d at 446.

182. *Estate of Elkins v. Comm’r*, 140 T.C. 86, 125–26 (2013).

183. *Id.* at 123.

184. *Id.* at 131.

all fractional interests in art must be valued as if it is certain that the art will be sold in that market.”¹⁸⁵ The testimony of the IRS’s experts was not determinative for the valuation of the fractional ownership discount; therefore, like in *Estate of Baird*, the Tax Court had to calculate its valuation based upon the estate’s experts.¹⁸⁶

In both *Estate of Baird* and *Estate of Elkins*, the courts accepted the testimony of one of the estates’ experts. In *Estate of Baird*, the court found the expert with “experience of over 20 years and knowledge of sales of fractional interests of timberland” to be the most compelling.¹⁸⁷ The expert considered various factors to determine the amount of discount and accepted that the discount based upon the fractional ownership should be 55% and an additional discount due to the lack of cooperation between the other fractional owners.¹⁸⁸ In *Estate of Elkins*, the estate’s experts explained the factors a willing buyer of the fractional interest in art would consider, and determined the range of discounts depending on the piece of artwork.¹⁸⁹ In both cases, courts were willing to accept the sale of an undivided fractional ownership of property because of the qualified and detailed evidence put forth by the estates’ experts and given the lack of evidence of the IRS.

For the determination of the sale of the undivided interest in property, courts can look to various valuation methods, as seen in *Estate of Barge*.¹⁹⁰ There, the Tax Court looked to the property’s specific income-producing value to determine the undivided interest discount in the particular property at issue and accepted a 26% discount.¹⁹¹ The Tax Court looked to those valuation methodologies beyond partition, specifically value influencing elements, which are “those that would be expected to affect the purchase price arrived between an informed buyer and seller.”¹⁹² For example, a hypothetical buyer would have to take into account the lack of control of the property and percentage of ownership the hypothetical buyer would be entitled.¹⁹³ *Estate of Barge* is significant in that the Tax Court accepted another methodology beyond the cost of partition and insinuated that if the

185. *Id.* at 123.

186. One of the other expert’s testimony was with regards to the agreement of the artwork, and that testimony is not relevant to this issue.

187. Colburn & Englebrecht, *supra* note 29, at 92.

188. *Id.* at 92–93. The expert considered the following factors to determine the discount: fair market value of 100% ownership; percentage available for sale; total number of owners; ‘staying power’ of existing owners; property location; number of tracts; number of acres; ability of the buyer of a fractional interest to influence property management; continuity of the tracts; access topography (including wetland classification); and mineral value, either in or out of production. *Id.*

189. Bowers et al., *supra* note 132, at 27.

190. See *Estate of Barge v. Comm’r*, 73 T.C.M. (CCH) 2615, at *4 (1997).

191. Hall, *supra* note 73, at 4.

192. Webb & Lunn Jr., *supra* note 6, at 3.

193. See *id.* at 9.

taxpayer has enough evidence to support a discount of fractional ownership, then the court will rule in the taxpayer's favor.¹⁹⁴

As the court in *Estate of Elkins* noted, *Stone* and *Estate of Scull* stand for the proposition that a discount is warranted with supporting factual data by the taxpayer.¹⁹⁵ The Elkins estate provided sufficient evidence to support their contention that a discount was applicable because the estate "combined, interrelated and interdependent testimony and reports" of its experts in applying the willing buyer and willing seller standard to determine the fair market value of the estate's undivided interests in the artwork.¹⁹⁶ As a result of decisions like *Estate of Elkins* and *Estate of Baird*, the IRS needs to abandon the cost to partition approach in favor of the sale of the undivided interest approach because it looks to valuation methods that produce the correct valuation of the property at issue.

V. THE CORRECT VALUATION IS THE SALE OF THE UNDIVIDED INTEREST

Estate of Elkins is to fractional ownership of artwork as *Estate of Baird* is to fractional ownership of real property. Before *Estate of Elkins* the Tax Courts and the Fifth Circuit did not accept the position that fractional ownership is entitled to a valuation discount. However, the courts have not gone far enough in their assertion that discounts are applicable to fractional ownership of artwork, specifically, that the discount should be calculated based upon the sale of the undivided interest.

The cost to partition discount is not applicable in the context of artwork because, in certain instances, the discount would be too high since some parties might not be willing to sell the artwork. With personal property like artwork, people have an emotional and sentimental attachment.¹⁹⁷ "The value of these assets are based not on recurring income streams, but rather on the desire of the owner to possess the asset, or hold it as an investment if there is potential for future value appreciation."¹⁹⁸ As a result, the cost to partition discount would be extremely high. For example, the experts in *Estate of Elkins* estimated the cost to partition one category of artwork would be subject to a 100% discount and the cost to carry out the partition can be anywhere from \$25,000 to over \$1.1 million.¹⁹⁹

The significant holding of *Stone* is "the costs of a court-ordered partition must be considered in determining the fair market value of the

194. See *Estate of Barge*, 73 T.C.M. (CCH) 2615, at *4.

195. *Estate of Elkins v. Comm'r*, 140 T.C. 86, 119 (2013).

196. *Estate of Elkins v. Comm'r*, 767 F.3d 443, 448 (5th Cir. 2014).

197. Hall, *supra* note 44, at 36.

198. *Id.*

199. *Estate of Elkins*, 140 T.C. at 99, 104.

[e]state's interest in the collection."²⁰⁰ However, the holding of *Stone* should be modified in that the sale of the undivided interest must be considered to determine the fair market value of the estate's interest. Notably, the *Stone* court was not a Tax Court, and commentators have pointed out if a Tax Court had evaluated the case, then "the outcome would have been more favorable to the taxpayer" as "the Tax Court is much more sophisticated in its understanding of valuation issues"²⁰¹ Courts need to look to sale of the undivided interest method to calculate the discount of fractional ownership because the cost to partition is extremely high.

In *Estate of Scull*, there was no mention of cost to partition. Instead, the "uncertainties involved in acquiring decedent's 65-percent interest" were the only aspect of the decision that refers to valuation discount.²⁰² While *Estate of Scull* bolstered the idea that a discount was applicable, the court provided minimum support for its conclusion that a 5% discount was applicable. The Tax Court in *Estate of Scull* looked to the fact that a hypothetical buyer would have considered this if he or she was purchasing the estate's fractional ownership.

The Tax Court in *Estate of Elkins* held that fractional ownership of artwork can be entitled to a discount, but the court failed to adequately discuss how to calculate the discount either under the cost to partition or the sale of the undivided interest approach. Consequently, there was confusion how taxpayers should present their valuation. In *Estate of Elkins*, the Fifth Circuit accepted the estate's valuation of a discount for the sale of the undivided interest valuation and not the cost to partition,²⁰³ whereas in *Stone*, the court applied a nominal 5% discount because the estate did not support their cost to partition analysis.²⁰⁴

Since *Stone* and *Estate of Elkins* looked to different valuation methodologies, the preferred method is unclear. The valuation is a determinable matter of fact and law by the court, and courts need to be clearer as to what valuation methodology taxpayers should utilize to defend their valuation discounts.²⁰⁵ Furthermore, if a decision by a trial court were to be appealed, then an appellate court "generally defers to a trial court's determinations regarding the credibility of fact and expert witnesses."²⁰⁶

200. See *Stone v. United States*, No. C06-0259, 2007 WL 1544786, at *6 (N.D. Cal. May 25, 2007).

201. Hall, *supra* note 44, at 37. ("The Tax Court has been through the arguments regarding the right of partition and the magnitude of discounts for undivided interests in real estate. It understands that a 44% discount is within a reasonable range in which a willing seller would accept such a discount, despite having the right of partition.")

202. *Estate of Scull v. Comm'r*, 67 T.C.M. (CCH) 2953, at *23 (1994).

203. See *Langstraat et al.*, *supra* note 9, at 43.

204. See *id.* at 41.

205. *Bowers et al.*, *supra* note 132, at 30.

206. *Id.*

There is confusion in valuing discounts for fractional ownership of artwork, and the courts should set a definitive precedent holding that the sale of an undivided interest is the correct valuation method. Furthermore, courts have allowed a discount for the valuation of fractional ownership of real property supported by expert testimony calculating the discount by looking to a sale of the undivided interest.²⁰⁷ Subsequently, the same consideration should be given to fractional ownership of artwork.

CONCLUSION

Fractional ownership of artwork has been used by taxpayers as a unique way to reduce their fair market valuation of their ownership in the artwork for tax purposes. Taxpayers have used fractional ownership in real property to claim discounts, and there has been a recent trend in court decisions “that favor estate positions when using solid data and the analyses of expert witnesses.”²⁰⁸ Earlier decisions, such as *Propstra*, stand for the proposition that valuation based upon fractional ownership applies to real or personal property involved.²⁰⁹ Therefore, the distinction that fractional ownership of real property and personal property, such as artwork, receive different tax treatment in terms of their valuation is misguided.

For real property, the IRS’s view that the cost to partition analysis is necessary for the valuation for fractional ownership has been rejected by many courts, and courts have ruled in favor of testimony of qualified witnesses.²¹⁰ For artwork, the IRS has continuously argued that there should be no discount for the fractional ownership of artwork, but this has been rejected by the decision of *Estate of Elkins*.²¹¹ *Estate of Elkins* represents the acceptance by the Tax Court and the Fifth Circuit that a taxpayer can provide sufficient evidence to support a discount, thus shifting the burden to the IRS to support their own valuation.²¹²

Moreover, the courts need to go further and hold that the proper valuation for fractional ownership of artwork is based upon the sale of the undivided interest method rather than the cost to partition. Courts have declined the IRS’s position of cost to partition in real property. In this area of fractional ownership of artwork, courts need to reject the cost to partition approach due to its impracticality.²¹³ Instead, courts should accept the valuation based upon the sale of the undivided interest, rather than struggle with the same issues dealt with by courts in a real property context.

207. Hoffmann, *supra* note 31.

208. Colburn & Englebrecht, *supra* note 29.

209. *Propstra v. United States*, 680 F.2d 1248, 1252 n.6 (9th Cir. 1999).

210. Colburn & Englebrecht, *supra* note 29, at 93.

211. *Estate of Elkins v. Comm’r*, 767 F.3d 443, 450 (5th Cir. 2014).

212. Langstraat et al., *supra* note 9, at 43.

213. Fowler, *supra* note 14.

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