A Role For "Expert Arbitrators" in Resolving Valuation Issues Before the United States Tax Court: A Remedy to Plaguing Problems

Nina J. Crimm*

One cannot know everything. — Horace

Introduction

As early as the first century B.C., Quintus Horatius Flaccus Horace, the Latin poet, remarked on the impossibility of being an expert in all disciplines. So too, centuries later in the twelfth century A.D., Maimonides acknowledged the truth of Horace's observation when he suggested that differences in opinion can be attributed to four fundamental factors, three of which rest upon the existence or absence of personal knowledge or expertise:

> One of them is love of domination and love of strife . . . . The second cause is the subtlety and the obscurity [also translated as profundity] of the object of apprehension in itself and the difficulty of apprehending it. And the third cause is the ignorance of him who apprehends and his inability to grasp things that [are] possible to apprehend. . . . However, in our times there is a fourth cause. . . . It is habit and upbringing [also translated as education].[1]

Today, many centuries later, the comments of Horace and Maimonides seem almost unremarkable. We take for granted that we might be exposed to many ideas, concepts, techniques, and disciplines, but that we cannot master them all. Ours is an age of expertise, of professionalism reflected and underwritten by our institutions. For instance, the structure of our educational systems illustrates our appreciation of the importance of specialization. We have vocational schools which teach special crafts such as carpentry, welding, and plumbing skills. We have graduate and professional

---

* Professor of Law, St. John's University School of Law. A.B., 1972, Washington University; J.D., 1979, Tulane University School of Law; M.B.A., 1979, Tulane University; LL.M. in Taxation, 1982, Georgetown University Law Center.

1. Moses Maimonides, The Guide of the Perplexed 66-67 (Shlomo Pines trans, Univ. of Chicago Press 1963) (1856-66).

Maimonides attributed the definitions of the first three causes to Alexander of Aphrodisias. The fourth is Maimonides' own idea. Joseph A. Buijs, Maimonides: A Collection of Critical Essays 112 (1988).

schools that teach disciplines such as law, medicine, architecture, engineering, business, and the sciences. Within each of those subject areas, a student can obtain a degree or special certification that acknowledges expertise in a particular specialty. For example, an individual might obtain a Master of Laws in Taxation, or might be board certified in pulminary medicine or pediatrics, or might secure a Ph.D. in electrical or mechanical engineering. The wealth of available disciplines and specialty areas taught in our schools serves as a signal of the complexities and breadth of existing information beyond our abilities to master. Likewise, the structure of our judicial systems acknowledges the "subtlety and the obscurity [or profundity]"[2] of the subjects that the judiciary must address. We have established special federal bankruptcy courts, a federal tax court, federal military law courts, state courts of family law, and state criminal law courts. Judges who serve on each of these courts have particular expertise in the named field of law. Thus, among other institutions, our educational and judicial structures recognize that each subject merits its own exegesis by persons having special knowledge.

By further focusing on the judiciary, we find that it has developed useful systems by which experts may be enlisted to advise the trier of fact of subjects outside the expertise of the judge or jury. Partisan or nonpartisan experts, or both, may be called upon to synthesize and extrapolate facts, to approximate the truth, and to express reasoning and opinions which should enlighten the court. As part of the adversarial process, these systems usually take the form of partisan representation whereby each party employs one or more expert witnesses to present educated reasoning and opinions as to the facts and truths of a case. Influences and benefits of these partisan expert systems might be measured by judges' reliance on the experts' persuasive reasoning and opinions. The tolls extracted by these partisan expert systems might be measured by the attendant biases, frustrations, inefficiencies, and financial penalties.

The purpose of this Article is to measure and address some of the problems and influences that accompany the use of partisan expert witnesses in United States Tax Court (Tax Court) litigation involving valuation issues and to propose a possible remedy to the problems. The Article first gives a brief historical overview of the use of partisan and nonpartisan expert witnesses in litigation. Next, the Article addresses difficulties that have long emanated from the use of partisan expert witnesses at trial. The Article then specifically focuses on the Tax Court and the frustrations that the court has encountered with partisan expert witnesses. By relating the results of the author's empirical study concerning the use of partisan expert witnesses in the Tax Court in certain categories of valuation cases from 1985 through

---

2. MAIMONIDES, *supra* note 1, at 66.

1990, the Article explores the facts behind the court's frustrations. Finally, the Article suggests a possible means of overcoming the afflictions brought about by the Tax Court's current system of permitting the use of multiple partisan expert witnesses during litigation of valuation issues.

I. Historical Background

For centuries, the judiciary has utilized expert witnesses. There are English cases dating back to the fourteenth century in which courts summoned skilled persons for advice. These skilled individuals acted as nonpartisan advisers to the presiding judge or jury when questions of fact arose about which the judge or jury lacked particular knowledge.[3] For example, the courts in several instances called surgeons to advise them of the freshness or permanency of wounds when central to the questions before the courts.[4] In other cases, the courts obtained advice of grammarians to assist in the interpretation of commercial instruments and other documents.[5] Sometimes the court empaneled a special jury of experts to decide questions requiring special knowledge. More recently, but as far back as the seventeenth century, parties to controversies summoned skilled persons to testify to their observations and conclusions drawn therefrom. Typical of such cases were those in which the prosecution in a criminal trial called a physician to testify as to his observations during the autopsy of a deceased individual and to draw conclusions on the probable causes of death.[6]

The need to summon one or more experts to participate in judicial proceedings, either as impartial consultants to the trier of fact or as partisan advisers, arises from the reality that a trier of fact cannot be a "jack of all trades." Often, the trier of fact is asked to intelligently decide issues that depend upon specialized knowledge or experience beyond that of the fact finder.

The modern judiciary and bar have responded to evolving demands and shortcomings by promulgating rules and procedures by which the trier of fact can be advised by experts. For example, today Rule 706 of the Federal Rules of Evidence provides for the appointment of court-selected neutral experts and for the far more common, party-selected partisan appointment of experts.

Even in the Tax Court, which is composed of judges who have tax expertise, the parties often hire and utilize expert witnesses to testify and

---

3. For a history of the use of experts by the courts, see Lloyd L. Rosenthal, *The Development of the Use of Expert Testimony*, 2 Law & Contemp. Probs. 403 (1935).

4. *See, e.g.*, Learned Hand, *Historical and Practical Considerations Regarding Expert Testimony*, 15 Harv. L. Rev. 40, 42-43 (1901).

5. *See id.* at 43.

6. *See id.* at 46.

submit reports with respect to factual issues beyond the ken of the judges. Parties to a tax controversy involving the valuation of unique, novel, or difficult-to-value assets routinely utilize one or more expert witnesses to promote asserted values. The Tax Court rules do not impose a restriction on the number of partisan experts that can be utilized for litigation purposes. It is quite common for parties to call upon the services of several experts to value real estate, artwork, partnership interests, and closely held stock.

Although parties frequently utilize expert witnesses, to date there has been no reported case in which a Tax Court judge has chosen to appoint a neutral expert adviser.[7]

II. Problems Arising From Use of Partisan Experts

The literature is replete with discussions of problems attendant to the use of partisan expert witnesses. Theoretically, each expert witness should provide the trier of fact with the *best* considered opinion to diminish the trier's uncertainty on the factual issues at hand. However, in practice, partisan expert witnesses often increase fact-finders' uncertainty because of the conflicting biases experts represent. Partisan expert witnesses are hired to contribute the best observations, reasoning, and opinions to support the hiring party's position. Stated in the extreme, an expert witness can become a party's "hired champion" or "hired gun."

As early as 1876, an English judge expressed discontentment with the partisan expert witness system:

> The mode in which expert evidence is obtained is such as not to give the fair result of scientific opinion to the court. A man may go, and does some times, to half-a-dozen experts . . . . He takes their honest opinions, he finds three in his favor, and three against him; he says to the three in his favor, 'will you be kind enough to give evidence?' and he pays the three against him their fees and leaves them alone; the other side does the same . . . . I am sorry to say the result is that the Court does not get that assistance from the experts which, if they were unbiased and fairly chosen, it would have a right to expect.[8]

---

7. Rule 706 of the Federal Rules of Evidence, which permits court-appointed experts, presumably should apply to the Tax Court. Rule 101 provides that the Federal Rules of Evidence are applicable to all United States courts. Fed. R. Evid. 101. Moreover, 26 U.S.C. § 7441 (1988) establishes the Tax Court as a court of the United States, and 26 U.S.C. § 7453 (1988) provides that proceedings in the Tax Court will be conducted in accordance to the rules of evidence applicable to nonjury trials in the U.S. District Court of the District of Columbia. *Accord* Tax Ct. R. 143.

8. Thorn v. Worthing Skating Rink Co., (M.R.1876, Aug. 4) (Jessel, M.R.), *quoted in* Plimpton v. Spiller, 6 Ch.D. 412 (1877), *in* Charles T. McCormick, Evidence 35 (1954), and *in* Judge Francis Van Dusen, *A United States District Judge's View of the Impartial Medical Expert System*, 32 F.R.D. 498, 499 (1963).

As long ago as 1858, the United States Supreme Court commented on the biases and inefficiencies flowing from adversaries' attempts to counterbalance one another's use of partisan expert witnesses:

> Experience has shown that opposite opinions of persons professing to be experts may be obtained to any amount; and it often occurs that not only many days, but even weeks, are consumed in cross-examinations, to test the skill or knowledge of such witnesses and the correctness of their opinions, wasting the time and wearying the patience of both court and jury, and perplexing, instead of elucidating, the questions involved in the issue.[9]

These fundamental themes have been echoed by the Tax Court on numerous occasions. Not only has the Tax Court expressed its concern that "experts may lose their usefulness and credibility when they merely become advocates for one side,"[10] but the court has repeatedly admonished the parties for using court time to resolve valuation disputes rather than settling or employing other procedures to avoid court proceedings.[11] Judge Theodore Tannenwald, Jr. articulated one particularly forceful expression of these sentiments in *Buffalo Tool and Die Manufacturing Co. v. Commissioner*:[12]

> As the Court repeatedly admonished counsel at trial, the issue is more properly suited for the give and take of the settlement process than adjudication. See *Messing v. Commissioner*, 48 T.C. at 512. The existing record reeks of stubbornness rather than flexibility on the part of both parties based upon 'an overzealous effort . . . to infuse a talismanic precision' into their respective views as to valuation. See *Messing v. Commissioner*, 48 T.C. at 512. We are convinced that the valuation issue is capable of resolution by the parties themselves through an agreement which will reflect a compromise Solomon-like adjustment, thereby saving the expenditure of time, effort, and money by the parties and the Court—a process not likely to produce a better result. Indeed, each of the parties should keep in mind that, in the final analysis, the Court may find the evidence of valuation by one of the parties sufficiently more convincing than that of the other party, so that the final result will produce a significant financial defeat for one or the other, rather than a middle-of-the-road compromise which we sus-

---

9. Winans v. New York & Erie R.R. Co., 62 U.S. 88, 101 (1858).

10. Estate of Halas, Sr. v. Commissioner, 94 T.C. 570, 577 (1990).

11. *See, e.g.*, Estate of Gilford v. Commissioner, 88 T.C. 38, 62 (1987); Symington v. Commissioner, 87 T.C. 892, 904-05 (1986); Buffalo Tool & Die Mfg. Co. v. Commissioner, 74 T.C. 441 (1980); Messing v. Commissioner, 48 T.C. 502, 512 (1967).

12. 74 T.C. 441 (1980).

> pect each of the parties expects the Court to reach. If the parties insist on our valuing any or all of the assets, we will. We do not intend to avoid our responsibilities but instead seek to administer to them more efficiently—a factor which has become increasingly important in light of the constantly expanding workload of the Court.[13]

Thus, the adversarial use of partisan expert witnesses allegedly to aid in the resolution of factual issues beyond the expertise of the trier of fact may indeed serve as a double-edged sword that creates as many or more problems than it solves.

III. Empirical Study

A. Background and Methodology

The words of Judge Tannenwald inspired me to empirically study the use of partisan qualified expert witnesses in various categories of valuation cases before the Tax Court.[14] Specifically, I began the study by reading all (in excess of 220) Tax Court opinions and memorandum opinions that involved a valuation issue and were issued during the period of 1985 through 1990. I then chose to focus on cases concerning issues involving either an Internal Revenue Code (I.R.C.) section 183 question,[15] the valuation of estates, gifts, charitable contributions, or reasonableness of compensation. From those opinions and memorandum opinions, I excluded several cases from the study either because the parties did not utilize expert witnesses for the valuation issue, or because the Tax Court rejected all proffered expert witnesses as unqualified. From the remaining opinions and memorandum opinions, which totalled 184 for the six-year period, I collected information on the frequency of parties' usage of multiple expert witnesses in valuation cases, the frequency that the Tax Court's decision on the

---

13. *Id.* at 451-52.

14. A case involving a valuation issue is a dispute over the proper fair market value of an asset or assets. For example, assets may need valuation for federal tax purposes with respect to cases involving a decedent's estate; a tax shelter with respect to which the IRS challenges the taxpayer's profit-motive and/or deductions claimed; a commodity straddle; a liquidated business; a charitable contribution; reasonable compensation; or I.R.C. § 482 (1988) (under which the Internal Revenue Service has authority to allocate the value of certain assets among businesses owned and controlled by the same persons).

15. The category of cases involving an I.R.C. § 183 question involves a valuation type issue. The statute requires a taxpayer to have a profit motive in order to be allowed credits or deductions claimed from tax shelter arrangements. I.R.C. § 183 (1988). This profit-motive determination is made based upon consideration of the worth of the investment and the amount that the taxpayer paid for the investment. For further discussion, see *infra* Part IV.B.

valuation issue coincided with the valuation posed by one party's expert witness, and the frequency that the Tax Court's decision reflected "a middle-of-the-road compromise" between the valuations posed by the parties' expert witnesses. One purpose in obtaining this information was to consider empirically two of Judge Tannenwald's comments from *Buffalo Tool & Die Manufacturing Co.*:

> (1) the opportunity for significant financial defeat of one party arises frequently when valuation issues are litigated in the Tax Court;
>
> (2) the parties might be well advised to consider resolution of valuation disputes by some means other than trial before a judge of the Tax Court.

B. Findings and Analysis

As one might expect, it was rare to find a valuation case within the selected categories in which both the taxpayer and the Internal Revenue Service (IRS) did not utilize at least one expert witness. In an occasional case, one party employed at least one qualified expert witness for valuation purposes while the other party used none. Surprisingly, in those cases in which one party chose not to utilize any expert witness, the party without the expert was as often the IRS as the taxpayer. In the overwhelming number of cases, the IRS and the taxpayer each called one or more qualified expert witnesses for valuation purposes. Most often one party utilized one expert witness, while the other party utilized multiple expert witnesses. As table 1 below indicates, in a substantial number and percentage of the cases studied, one or both parties employed multiple expert witnesses.

Table 1

(1) Taxable Year	(2) Number of cases in which one or both parties utilized multiple expert witnesses	(3) Total number of cases in study	(4) Percentage of total cases with 1 or both parties using multiple expert witnesses
1985	15	30	50.0%
1986	16	33	48.5%
1987	18	32	56.3%
1988	13	33	39.4%
1989	14	32	43.8%
1990	11	24	45.8%
	87	184	47.3%

When a party utilized multiple expert witnesses, usually two experts were used; however, it was not uncommon to find a party who employed three expert witnesses.[16] Sometimes a party utilized the services of four or five expert witnesses.[17] In no case did the number of experts used by a single party exceed five.

In looking for patterns, taking the six-year period as a whole, one finds the data reveals that taxpayers chose to employ multiple expert witnesses more often than did the IRS. Yet, as tables 2 and 3 below indicate, in comparing the percentage of cases in a given year in which the taxpayer used multiple expert witnesses for valuation purposes to the percentage of cases in which the IRS utilized multiple expert witnesses for the same purpose, there often was significant variation.[18]

Table 2

(1) Taxable year	(2) Total number of cases in study	(3) Number of cases in study in which taxpayer used multiple expert witnesses	(4) Percentage of cases in study in which the taxpayer used multiple expert witnesses
1985	30	9	30.0%
1986	33	14	42.4%
1987	32	5	15.6%
1988	33	7	21.2%
1989	32	11	34.4%
1990	24	11	45.8%
	184	57	31.0%

16. For the entire six-year period, there were twenty cases in which one party used three expert witnesses. In one of those cases, both parties utilized three experts.

17. For the entire six-year period, there were five cases in which one or both parties utilized four and five expert witnesses.

18. Note that the total combined number of cases in table 2, column 3 and column 3 of table 3 exceeds the total number of cases in column 2 of table 1. The reason for the difference is attributable to the fact that in some cases, both parties utilized multiple expert witnesses. This overlap occurred as follows: 1985 = 3 cases; 1986 = 7 cases; 1987 = 1 case; 1988 = 2 cases; 1989 = 3 cases; and 1990 = 4 cases.

Table 3

(1) Taxable year	(2) Total number of cases in study	(3) Number of cases in study in which IRS used multiple expert witnesses	(4) Percentage of cases in study in which IRS used multiple expert witnesses
1985	30	10	33.3%
1986	33	9	27.3%
1987	32	13	40.6%
1988	33	9	27.3%
1989	32	4	12.5%
1990	24	4	16.7%
	184	49	26.6%

This data indicate that the parties utilized multiple expert witnesses in a significant percentage of the valuation cases decided by the Tax Court from 1985 through 1990. There are no means of determining from the data whether the usage of multiple witnesses in valuation cases played a direct role in delaying the court's disposition of cases.[19]

Although there might be an expectation that the larger the amount of taxes in dispute, the more numerous the partisan expert witnesses employed, the data did not demonstrate such a correlation. Additionally, there was no apparent relationship between the type of valuation case—whether estate

---

19. There are no direct data to support the supposition that the use of numerous partisan expert witnesses in litigation before the Tax Court may be a contributing factor to the court's overcrowded docket and to delays in the disposition of cases. However, as intimated by Judge Tannenwald in *Buffalo Tool & Die Mfg. Co.*, one can surmise that the greater the number of expert witnesses called at trial to testify, the likelihood increases for lengthier trial proceedings. Buffalo Tool & Die Mfg. Co. v. Commissioner, 74 T.C. 441, 451-52 (1980). It also follows that the greater the number of partisan expert witnesses, the more numerous the expert reports (as required by Tax Court Rule 143(f)(1), discussed below) and the greater amount of testimony through which the presiding judge must sift in order to make a determination in a case.

Tax Court Rule 143(f)(1) provides that unless otherwise permitted by the court, "any party who calls an expert witness shall cause that witness to prepare a written report for submission to the Court and the opposing party" no later than 30 days before the call of the trial calendar on which the case appears. TAX CT. R. 143(f)(1). Tax Court Rule 143(f)(2) states that the "court ordinarily will not grant a request to permit an expert witness to testify without a written report where the expert witness' testimony is based on third-party contacts, comparable sales, statistical data, or other detailed, technical information." TAX CT. R. 143(f)(2). Finally, the rule indicates that there are circumstances in which the transcript of a deposition of an expert witness may serve as the expert's report. TAX CT. R. 143(f)(3) (referring to TAX CT. R. 76(e)(1), paragraph 1).

valuation, charitable donation valuation, etc.—and the number of expert witnesses employed by the parties.

As part of the study, I collected data on the valuation suggested by each expert witness if stated in the Tax Court's opinion or memorandum opinion. Additionally, I maintained a record of the final valuation the Tax Court determined appropriate in those cases in which the determination was made.[20] A comparison of the Tax Court's determination with the suggested valuations of the expert witnesses reveals, as shown in table 4 below, that for taxable years 1985 through 1990 the Tax Court's determination coincided with a single expert's suggested valuation in a substantial percentage of the cases.

Table 4

(1) Taxable year	(2) Total number of cases in study	(3) Number of cases in which court's determination coincided with one expert witness	(4) Percentage of cases in which court's determination coincided with a single expert witness
1985	30	12	40.0%
1986	33	8	24.2%
1987	32	13	40.6%
1988	33	8	24.2%
1989	32	10	31.3%
1990	24	13	54.2%
	184	64	34.8%

20. In a number of cases, the Tax Court did not determine a specific dollar amount for valuation purposes. This occurred exclusively in I.R.C. § 183-type cases, in which the issue generally is whether a transaction was profit motivated. In that category of cases, the court often found that determining an exact dollar amount was unnecessary if it could determine a generally appropriate fair market value range. *See* table 7 *infra* p. 53.

Of those cases in which the court's determination coincided with a single expert witness's suggested valuation, more often than not, the court's determination matched the suggested valuation of a witness who testified on behalf of the IRS. This is demonstrated in tables 5 and 6 below.

Table 5

(1) Taxable year	(2) Number of cases in which court's determination coincided with a single expert witness	(3) When valuation coincided, number of cases in which court's determination coincided with taxpayer's expert witness	(4) When valuations coincided, percentage of court's valuation determinations which coincided with taxpayer's expert witness
1985	12	5	41.7%
1986	8	1	12.5%
1987	13	3	23.1%
1988	8	3	37.5%
1989	10	5	50.0%
1990	13	4	30.8%
	64	21	32.8%

Table 6

(1) Taxable year	(2) Number of cases in study in which court's determination coincided with a single expert witness	(3) When valuation coincided, number of cases in which court's determination coincided with IRS's expert witness	(4) When valuations coincided, percentage of court's valuation determinations coincided with IRS's expert witness
1985	12	7	58.3%
1986	8	7	87.5%
1987	13	10	76.9%
1988	8	5	62.5%
1989	10	5	50.0%
1990	13	9	69.2%
	64	43	67.2%

Therefore, as did Judge Tannenwald in *Buffalo Tool*,[21] tables 5 and 6

21. 74 T.C. 441, 451-52 (1980); *see supra* notes 11-13 and accompanying text.

indicate that the opportunity for significant financial defeat of one party arose frequently when valuation issues were litigated in the Tax Court. Furthermore, more often than not, the economic blow was to the taxpayer. On occasion the opinion explained the reason for this outcome. For example, sometimes the presiding judge considered the position of the IRS in the case to have been stronger, more convincing, or more reasonable. Other times, the presiding judge viewed the taxpayer's expert witnesses as less credible or less reliable, or their opinions and reports to be unjustified or less useful than those of the IRS's experts. Although mere conjecture, other reasons for the rather high incident of correlation between a valuation suggested by an expert witness for the IRS and the final determination of the Tax Court might be submitted. For instance, for many cases the IRS chooses not to settle before litigation, the IRS has a strong position that is represented by one or more expert witnesses long familiar to the court as credible, accurate in valuation matters generally, and thorough in research efforts. Another reason for the correlation could be attributable to the fact that in most cases, the taxpayer has the burden of proof. Regardless of the reason, the "Solomon-like" pronouncements of the Tax Court in the studied valuation cases most often spelled financial defeat for the taxpayer rather than for the IRS.

For issues in which the presiding judge did not adopt the exact valuation amount suggested by any expert witness, most of the valuation amounts finally determined by the judge were closer to the figure suggested by the IRS's expert witness than by the taxpayer's expert.[22] This observation suggests that the court often did not take a "middle-of-the-road" compromise approach. Yet, again, even if there was not an uncompromised victor in the dispute, the IRS position tended to prevail. Finally, in fewer than ten cases during the six-year period, the presiding judge totally discarded the valuation approaches and suggested amounts of all expert witnesses in a case. The stated explanations for this action included the lack of credibility of all experts, pervasive inaccuracies in reports, and unreliability of all valuation approaches presented by all experts. In these few situations, the presiding judge independently formulated the appropriate valuation approach or amount, or both.

In a number of cases, the Tax Court did not determine a specific dollar amount for valuation purposes. This occurred exclusively in I.R.C. section 183-type cases, in which the issue generally concerned whether a taxpayer's transaction was profit motivated. For example, the court used this approach when taxpayers claimed investment tax credits, depreciation deductions or business expense deductions with respect to their

---

22. *See infra* Appendix A.

investments in such tax shelters as master recordings, movies, or videotapes. In the I.R.C. section 183 category of cases, the court often found that determining an exact dollar amount was unnecessary if it could determine by estimated dollar ranges that the taxpayer had entered the transaction either with a profit motive, or, conversely, without the requisite profit motive. In essence, the court compared the approximate fair market value of the assets in the tax shelter at the time of the taxpayer's investment to the actual price paid by the taxpayer for the investment interest. This comparison enabled the presiding judge to determine whether the transaction had economic substance or whether the taxpayer paid an excessively inflated price for the investment. An excessively high purchase price indicated that the investment lacked economic substance, the taxpayer had no profit motive, and was primarily motivated by tax consequences (e.g., a higher basis, larger depreciation deductions).

An analysis of these I.R.C. section 183-type cases from 1985 through 1990 reveals that most often the court held that the taxpayer did not have the requisite profit motive and found in favor of the IRS. In fact, as shown in tables 7 and 8 below, depending upon the particular taxable year at issue, between sixty-six percent and 100% of the Tax Court's decisions were favorable to the IRS.

Table 7

(1) Taxable year	(2) Total number of § 183-type cases in which no exact value determined by court	(3) Number of § 183-type cases favorable to the taxpayer	(4) Percentage of § 183-type cases without exact value determination and with decision favorable to taxpayer
1985	3	0	0%
1986	0	N/A	N/A
1987	10	2	20.0%
1988	12	1	8.3%
1989	6	1	16.7%
1990	3	1	33.3%
	34	5	14.7%

Table 8

(1) Taxable Year	(2) Total number of §183-type cases in which no exact value determined by court	(3) Number of § 183-type cases favorable to IRS	(4) Percentage of § 183-type cases without exact value determination and with decision favorable to IRS
1985	3	3	100.0%
1986	0	N/A	N/A
1987	10	8	80.0%
1988	12	11	91.7%
1989	6	5	83.3%
1990	3	2	66.7%
	34	29	85.3%

Therefore, the doomsday prediction of Judge Tannenwald in *Buffalo Tool* again proves correct; the opportunity for significant financial defeat of one party arises frequently when valuation issues are litigated in the Tax Court. In I.R.C. section 183-type cases, most often the IRS was the victor, while the taxpayer was the financial loser.[23]

IV. Resolution of Problems Attributable to Use of Partisan Experts

A. Problems Needing Resolution

My empirical study confirms that there is factual basis to the expressed frustrations and concerns of Judge Tannenwald in *Buffalo Tool.*[24] The data clearly indicate that litigation of valuation issues in the Tax Court often resulted in significant financial defeat to the taxpayers. Fees paid to attorneys and expert witnesses throughout the litigation process also must be accounted for in considering the extent of the taxpayers' financial burdens. Because the parties, and especially taxpayers, incur significant financial burdens when litigating tax controversies, they may be well advised to consider resolution of valuation disputes by some means other than a trial before a Tax Court judge. Because the taxpayer has the choice of forum, the taxpayer may wish to consider another

23. *Id.*
24. *Id.*

forum—the appropriate federal district court or the Claims Court.[25] However, there are no assurances that the outcome of litigation in either of those two forums would produce more advantageous results for a taxpayer. Alternative possible approaches exist. Taxpayers might want to consider settlement of the valuation issues, or, as I propose below, they might agree to voluntary binding arbitration in front of an "expert arbitrator." The Tax Court might be influential in steering the parties to accept either of these two alternatives. However, if instead the parties decide to litigate a valuation matter in the Tax Court, there are two avenues of relief for the court. First, the Tax Court might consider modifying its rules so as to limit the number of partisan expert witnesses that may be utilized by each party in valuation cases. Although on first blush this suggestion might be appealing, it would be problematic in its fairness. Second, and perhaps a more attractive alternative, the presiding judge might consider appointing a neutral nonpartisan valuation expert as an adviser.

B. Court-Appointed Experts

Many leading authorities and commentators have recommended the use of neutral court-appointed experts as a means of remedying the problems that arise from the prevailing use of partisan expert witnesses.[26] Several years ago, two commentators proposed the utilization of court-appointed expert witnesses in valuation cases before the Tax Court.[27] Although the Tax Court has the authority to appoint nonpartisan expert witnesses,[28] to date the Tax Court has not utilized its power to appoint a neutral expert witness. Numerous explanations could be ventured, including the lack of established procedural mechanisms; a belief by

---

25. For a recent article on choice of forum in tax controversies, see Nina J. Crimm, *Tax Controversies: Choice of Forum*, 9 B.U. J. TAX LAW 1 (Nov. 1991).

26. *See, e.g.*, CHARLES T. MCCORMICK, EVIDENCE 35-38 (1954); 2 JOHN H. WIGMORE, EVIDENCE § 563; Hand, *supra* note 4, at 56; Roger A. Pies and David J. Fischer, *Why Not Court Appointed Experts?*, 40 TAX NOTES 303 (July 18, 1988); Van Dusen, *supra* note 8, at 498.

27. Pies and Fischer, *supra* note 26.

28. Pursuant to Rule 706(a) of the Federal Rules of Evidence, a United States court may appoint expert witnesses agreed to by the parties or of its own selection. FED. R. EVID. 706(a). The Federal Rules of Evidence are applicable to the Tax Court pursuant to I.R.C. § 7453 (1988) and TAX CT. R. 143(a). *See* Holland v. Commissioner, 835 F.2d 675 (6th Cir. 1987), in which the taxpayer complained that the Tax Court did not follow the requirements of Rule 706 in acquiring a court-appointed handwriting expert. *Id.* The Sixth Circuit found that the Tax Court did not appoint an expert witness, but rather suggested that the Internal Revenue Service call a handwriting expert. *Id.* The appellate court apparently recognized the authority of the Tax Court to appoint an expert witness. *Id.*

presiding judges that they should not be actively involved in recruiting even nonpartisan expert witnesses; and uncertainty over means to assess the expert's costs against the parties.[29]

C. Voluntary Binding Arbitration

1. Tax Court Rule 124.—In 1989, the Tax Court adopted Tax Court Rule 124, which permits parties to file jointly a motion that any factual issue in dispute be resolved through court-supervised voluntary binding arbitration.[30] To date, the rule has not been utilized for the arbitration of tax controversies involving a valuation issue. There are some basic procedures and minimum requirements established by Rule 124 for its use. The rule addresses the obligations and duties of the parties and the court only; it does not speak to the procedures and standards to be utilized by the arbitrator.

In accordance with Rule 124, the parties may move for binding arbitration at any time after the case is deemed at issue under Tax Court Rule 38 and before trial.[31] Upon receipt of the motion, the Chief Judge will assign the case to a judge or special trial judge for disposition of the motion and supervision of the arbitration.[32] The procedure required by the rule requires that both parties or their counsel execute a stipulation that specifies:

(1) A statement of the issues to be resolved by arbitration;
(2) The agreement of the parties to be bound by the findings of the arbitrator;

---

29. As to the assessment of costs for an expert, see FED. R. EVID. 706(b); United States v. Means, 858 F.2d 404 (D.C. Cir. 1988); United States Marshal Serv. v. Means, 724 F.2d 642 (5th Cir. 1983), *aff'd on reh'g*, 741 F.2d 1053 (8th Cir. 1984); United States v. R.J. Reynolds, 416 F. Supp. 313 (D.N.J. 1976); United States *ex. rel.* T.V.A. v. 109 Acres of Land, 404 F. Supp. 1392 (E.D. Tenn. 1975); Pies and Fischer, *supra* note 25, at 307.

30. The Official Note to Tax Court Rule 124, indicates that the court considers voluntary binding arbitration particularly appropriate in valuation cases. TAX CT. R. 124 official note [hereinafter Official Note]. Chief Justice Arthur L. Nims remarked that Tax Court Rule 124 is not "intended absolutely to preclude voluntary *non*-binding arbitration." BNA Daily Tax Report, No. 8, S-41 (January 13, 1992) (emphasis added). This also is reflected in the language of the official note to the rule. If permitted, non-binding arbitration would allow an aggrieved party to seek de novo review by the Tax Court even after arbitration. A significant reason for binding arbitration under Tax Court Rule 124 is to reduce litigation before the Tax Court by use of a procedure "short of trial." Official Note, *supra*. One might wonder whether use of non-binding arbitration will effectively undercut one of the critical purposes of the rule.

31. TAX CT. R. 124(a).

32. *Id.*; *see* Official Note, *supra* note 30.

(3) The identity of the arbitrator or the procedure to be used to select the arbitrator;
(4) The manner of compensation of the arbitrator;
(5) A prohibition against ex parte communication with the arbitrator; and
(6) Any other matters considered appropriate by the parties.[33]

This stipulation must be attached to the parties' motion filed with the court.[34]

If the court considers binding arbitration an appropriate route for disposition of the factual matters in controversy, it will appoint an arbitrator by court order.[35] The order also may contain "appropriate" instructions to the arbitrator and to the parties.[36] The arbitrator will formally signify his acceptance of the position and directions of the court order.[37]

After completion of the arbitration process, the parties are obligated to "promptly" report in writing to the court the findings of the arbitrator.[38] Any written report or summary of the arbitrator must be attached to the parties' report.[39] The court will conclude the matter, assuming no other disputes remain in the case, by entering a decision or directing the parties to file a computation under Tax Court Rule 155.[40]

2. Proposal: "Expert Arbitrator."—Nothing in Rule 124 prohibits the selection of a qualified, trained arbitrator who additionally has special expertise in valuing unique, novel, or difficult-to-value assets. Therefore, I propose that parties choose an "expert arbitrator" or panel of arbitrators with at least one member being an "expert arbitrator" to resolve valuation issues. The "expert arbitrator" selected might have special expertise not only in valuing assets similar to those at issue, but also in such particulars as the region in which the real property at issue is located or the artistic periods of the artist who produced the artwork at issue. If the asset at issue is real property, the parties might select an arbitrator who is also a board certified real estate appraiser.

By utilizing an "expert arbitrator," several goals could be attained. This system could save the expenditure of time, effort, and money by the parties and the Tax Court. Tax Court judges would be relieved of

---

33. Tax Ct. R. 124(b)(2).
34. Tax Ct. R. 124(b)(1).
35. Tax Ct. R. 124(b)(3).
36. *Id.*
37. *See* Official Note, *supra* note 30.
38. Tax Ct. R. 124(b)(4).
39. *Id.*
40. *See* Official Note, *supra* note 30.

the arduous task of resolving valuation disputes that are capable of resolution only by "Solomon-like" pronouncements. Disputes involving solely valuation issues could be disposed of more rapidly. Judges would be free to turn their attention to other tax controversies before the court — hopefully reducing the Tax Court's enormous case backlog. The use of an "expert arbitrator" might preclude the need for parties to hire and pay one or multiple partisan expert witnesses. This could lower the monetary outlays required of the parties. Finally, an "expert arbitrator" conceivably could reduce the financial defeat now commonly experienced by taxpayers. A nonpartisan "expert arbitrator" system that would operate without the presentation of partisan expert witnesses would preclude the "hired champion" bias syndrome, which otherwise might negatively affect taxpayers' positions.

3. Procedural Questions Remain.—Rule 124 broadly defines the obligations of the parties and the Tax Court. Because "the Rule is not intended to be unduly restrictive or to discourage innovative and imaginative approaches to arbitration,"[41] its flexibility leaves many unanswered procedural questions.

a. Selection of the arbitrator

Rule 124 permits the parties to select an arbitrator. It is silent as to the qualifications required or needed, and it does not require the Tax Court to maintain a list of acceptable arbitrators with or without specialized expertise. Perhaps the best procedure would be for the American Bar Association Section on Taxation to submit a list of possible arbitrators to the Tax Court for its approval. The American Arbitration Association might be a source of names of qualified "expert arbitrators." Parties could be encouraged or required to select an arbitrator from the court's preapproved list in order to expedite the selection process. The list could be updated annually to assure inclusion of appropriate candidates. The list should be divided into categories of asset types. Persons having expertise in real estate appraisal would be listed as qualified to act as an "expert arbitrator" in that area. Likewise, individuals with expertise in appraising artwork might be qualified and listed as a possible "expert arbitrator" for the valuation of art. Because Rule 124 does not require the court to appoint the arbitrator selected by the parties, such a list of preapproved arbitrators would increase the likelihood that the candidate chosen will be appointed and that the appointment will occur quickly.

---

41. *Id.*

b. Form and effect of arbitrator's determination

Rule 124 provides that the "parties shall promptly report to the Court the findings made by the arbitrator and shall attach to their report any written report or summary that the arbitrator may have prepared."[42] The Official Note to Tax Court Rule 124 states that the Tax Court will conclude the arbitrated matter by entering a decision or directing the parties to file a Rule 155 computation.[43] Nothing in the rule or in the Official Note requires the arbitrator to prepare a report giving the reasons for the determination. The lack of a written report by the arbitrator could produce problems, and a procedure should be developed to require the arbitrator to issue a written report.[44] The lack of a written report by the arbitrator could be most deleterious if the parties are able to appeal the portion of the Tax Court decision attributable to arbitration. Without such a written report in the record, it would be difficult for the appellate court to review the determination.

According to I.R.C. section 7482, "decisions of the Tax Court" are reviewable exclusively by the federal circuit courts. Yet, the courts have concluded that not all "decisions" can be appealed. For example, the circuit courts have held that the Tax Court's adoption of a decision stipulated by the parties as a result of settlement should not constitute an appealable decision.[45]

Decisions entered by the Tax Court as a result of the parties entering into voluntary binding arbitration can be distinguished from stipulated decisions. In voluntary binding arbitration, the parties stipulate that they "agree to be bound by the findings of the arbitrator in respect of the issue to be resolved."[46] The purpose of this stipulation is to prevent the parties from subsequently requesting a trial de novo by the Tax Court. The parties are submitting to binding arbitration as a substitute for a trial before a Tax Court judge, and the determination of the arbitrator should supplant a factual determination by a judge that otherwise would be required. The judge must incorporate the arbitrator's findings in the final decision. The effect of the rule

---

42. Tax Ct. R. 124(b)(4); *see* Official Note, *supra* note 30.

43. *See* Official Note, *supra* note 30.

44. Tax Court Rule 143(f) requires that in cases heard by a judge of the Tax Court, expert witness reports must be prepared and submitted to the court and to the opposing party for any expert witness to be called to testify. Among other things required in the report are the "witness's opinion and facts or data on which that opinion is based . . . [and] the reasons for the conclusion." Tax Ct. R. 143(f)(1). *See supra* discussion in note 19.

45. *See, e.g.*, Clapp v. Commissioner, 875 F.2d 1396, 1398 (9th Cir. 1989); Tapper v. Commissioner, 766 F.2d 401, 403 (9th Cir. 1985).

46. Tax Ct. R. 124(b)(2)(B).

is not to have the parties stipulate to the decision, and therefore, a decision entered by the judge that incorporates the findings of an arbitrator is not the equivalent of a stipulated decision. Moreover, unless such decisions are appealable, it is unlikely that many parties will be willing to enter into arbitration, especially when the alternative choice would permit appeal of the presiding judge's decision. Consequently, the judge's decision entered with respect to the arbitrated matter should be appealable.

c. Other procedural subjects

Ideally, the Tax Court should address other procedural issues that might arise. For example, Rule 124 does not address any timing requirements, such as the amount of time that the parties have for producing evidence to the arbitrator, and the arbitrator has for making a determination. The rule does not address whether an "expert arbitrator" may gather facts independently or whether the "expert arbitrator" would be constrained to weigh only evidence as presented by the parties. The rule also does not address whether a panel of arbitrators can be appointed, and if so, whether such a panel could include at least one "expert arbitrator". It also does not suggest rules by which such a panel of arbitrators would operate.

V. Conclusion

As the empirical study confirms, the current system of utilizing partisan expert witnesses during the trial of valuation issues can be deleterious to the Tax Court and to the parties. This system often results in the parties' employing multiple expert witnesses which results in large (and perhaps undue) expenditures of Tax Court and parties' time, effort, and monies. One possible remedy to these problems is the use of either one "expert arbitrator" or a panel of arbitrators with an "expert arbitrator," whose determination would be binding on the parties at the trial level. While this remedy might raise new problems, it would go a long way toward resolving financial and time burdens that have plagued the parties and the Tax Court. Moreover, aside from the tangible benefits that could result from the use of an "expert arbitrator" or panel of arbitrators having an "expert arbitrator," an intangible benefit might result. Taxpayers who agree to utilize an "expert arbitrator" might experience some of the same sentiments expressed by Paul, who, in the New Testament, stated to King Agrippa after being accused of offenses that he claimed to have not committed:

> I consider myself fortunate, King Agrippa, that it is before you that I am to make my defence today upon all the charges

brought against me . . ., particularly as you are expert in all . . . [these] matters . . . . And therefore, I beg you to give me a patient hearing.[47]

---

47. *Acts* 2:3.

Appendix A

On Issue By Issue Basis, Court's Determination As Compared With Experts' Suggested Valuations When Conflicting*

(1) Taxable Year	(2) Author's Assigned Issue Number**	(3) Valuation Suggested by Taxpayer's Experts	(4) Valuation Suggested by IRS's Expert	(5) Court's Determination
1985	1	$ 94,000	$ 53,500	$ 55,278
	2	$3,093/share	$14,604/share	$3,480/share
	3	$ 8,300,000	$ 2,490,000	$ 8,193,000
	4	$ 9,509	$ 2,377	$ 2,641
	5	$ 1,900	$ 577	$ 380
	6	$ 161,915	$ 16,941	$ 18,934
	7	$ 49,700	$ 18,408	$ 10,971
	8	$ 15,200	$ 2,212	$ 5,678
	9	$ 10,415	$ 3,158	$ 4,500
	10	$ 75,000	$ 1,080	$ 65,000
	11	$3.68-$5.02/share	$45.13-$49.25/share	$25.65-$26.35/share
	12	$ 4,380	$ 600	$ 1,000
	13	$ 8,294	$ 750	$ 4,000
	14	$ 2,200	$ 5,000	$ 4,000
	15	$ 474,000	$ 671,500	$ 632,000
	16	$ 3,363,363	$ 6,300,000	$ 3,933,181
1986	17	$ 78,000	$ 79,000	$ 80,000
	18	$ 550,000	$ 1,265,000	$ 726,122
	19	$58.80/share	$454.99/share	$389.37/share
	20	$ 6,704,040	$ 1,100,000	$ 4,970,000
	21	$ 150,000	$ 111,657	$ 92,370
	22	$415,000-$579,000	$85,000-$172,000	$220,625-$431,500
	23	$750/acre	$1050/acre	$975/acre
	24	$ 15,603	$ 900	$ 10,059
	25	$ 540,185	$ 100,000	$ 140,000
	26	$ 50,000	$ 35,000	$ 40,000
	27	$ 135,360	$ 50,000	$ 62,000
	28	$ 750,000	$ 275,000	$ 600,000
	29	$ 217,320	$ 450,000	$ 445,507
	30	$ 220,000	$ 37,000	$ 60,000
	31	$ 264,000	$ 1,278,132	$ 509,250
	32	$ 4,402,545	$39,500,000	$31,200,000

* When more than one expert witness for a party suggested a valuation, the author has chosen to report the suggested valuation closest to the court's determination.

** If a case involved multiple valuation issues, for purposes of this summary only, the author assigned a separate valuation issues number.

	33	$ 261,746	$ 457,890	$ 322,371
	34	$ 236,752	$ 0	$ 90,956
	35	$11,900,000	$12,000,000	$12,170,000
1987	36	$7.35/share	$24.00/share	$7.58/share
	37	$ 6,120,000	$21,000,000	$ 7,304,664
	38	$ 929,000	$ 1,225,000	$ 657,195
	39	$ 525,000	$ 700,000	$ 570,887
	40	$ 60,000	$ 20,000	$ 35,000
	41	$ 80,000	$ 25,000	$ 40,000
	42	$40.35/share	$81.48/share	$72.42/share
1988	43	$ 30,000	$ 5,000	$ 15,000
	44	$ 175,000	$ 72,500	$ 110,000
	45	$ 239,125	$ 150,000	$ 168,700
	46	$ 750,000	$ 350,000	$ 514,650
	47	$ 500,000	$ 60,600	$ 130,000
	48	$ 338,000	$ 492,000	$ 484,000
	49	$ 70,000	$ 86,000	$ 80,500
	50	$ 48,250	$ 63,500	$ 60,500
	51	$ 320,000	$ 1,873,500	$ 1,000,000
	52	$ 237,600	$ 400,000	$ 244,304
	53	$10.00/share	$24.75/share	$12.97/share
	54	$ 463,000	$ 30,000	$ 28,702
	55	$ 50,000	$ 279,679	$ 270,179
	56	$ 2,500,000	$ 479,732	$ 3,000,000
	57	$ 27,850	$ 2,135	$ 11,751
1989	58	$ 145,000	$ 35,000	$ 95,000
	59	$ 37,000	$ 14,500	$ 10,433
	60	$ 35,000	$ 12,000	$ 10,783
	61	$ 35,000	$ 10,500	$ 10,610
	62	$312.00/share	$556.00/share	$475.06/share
	63	$ 9,500	$ 6,000	$ 6,750
	64	$ 200,000	$ 110,000	$ 175,000
	65	$3,800/item	$1,239/item	$1,981/item
	66	$ 750,000	$ 260,000	$ 538,000
	67	$ 682,000	$ 1,600,379	$ 1,404,213
	68	$ 42,000	$ 61,400	$ 50,000
	69	$ 51,800	$ 83,000	$ 66,600
	70	$ 42,200	$ 42,300	$ 39,800
	71	$ 25,000	$ 53,300	$ 45,000
	72	$ 25,000	$ 52,100	$ 45,000
	73	$ 55,000	$ 82,000	$ 78,000
	74	$ 332,700	$ 823,000	$ 465,000
	75	$ 488,250	$ 35,400	$ 32,008
	76	$ 1,207,500	$ 450,000	$ 1,250,000
	77	$ 158,682	$ 0	$ 65,860
	78	$22.43/share	$45.94/share	$37.86/share
	79	$22.43/share	$41.77/share	$25.24/share
	80	$ 1,730,000	$ 1,310,000	$ 1,338,855
	81	$ 1,080,000	$ 735,000	$ 740,677
	82	$ 2,390,000	$ 1,260,000	$ 1,397,897
	83	$11,000,000	$ 8,000,000	$ 9,010,991
	84	$ 1,130,000	$ 994,000	$ 980,025
	85	$ 475,000	$ 147,500	$ 175,000

1990	86	$ 2,000	$ 1,133	$ 1,350
	87	$ 110,000	$ 50,150	$ 103,000
	88	$ 366,583	$ 460,000	$ 153,422
	89	$ 450,000	$ 41,500	$ 100,000
	90	$ 4,362,000	$ 7,400,000	$ 6,381,050
	91	$800/share	$1,636/share	$1,394/share
	92	$43.16/share	$109.00/share	$127.12/share
	93	$ 213,900	$ 340,000	$ 341,000
	94	$423/share	$1,069/share	$825/share