Art Resources Team (ART):

The Art of Donating Art

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The ultimate challenge facing a collector may be what to do with the collection during life as well as after the collector's death. It is prudent to create a strategy so as to not put undue financial or emotional pressure on the collector's family.

Art is an important component of the collector's trust, tax, and estate planning and it may require strategic considerations just as other investments. A collector may donate art during his/her lifetime or at death and receive beneficial tax treatment as part of the planning. The clear distinction is whether the collector will be able to enjoy the art during life. In either case, the collector may specify to which charitable beneficiary the art will be given.

The collector's investment of time and resources often results in a personal connection to the art. This can complicate the process of determining a proper charitable beneficiary and how it will work to uphold the collector's wishes and intentions. Customized governing documents can memorialize the collector's intention for the art, address the financial considerations of maintaining the collection and mitigate the emotional uncertainty around the future disposition of the art.

Determining A Charitable Beneficiary

It is important to align the collector's vision with the vision of the charitable beneficiary.

Public Art Museum

While a collector may gift art to any charitable beneficiary, museums are good candidates because they may want the art; the gift may result in a greater income tax benefit for the collector; and a museum may be a more effective and impactful steward of the gift than family members. However, some collectors may mistakenly believe that their donated art will become a permanent piece in the museum of their choice. They assume that once accepted, their art will be displayed and highlighted, or that their art will become part of the museum's permanent collection and not deaccessioned. These assumptions may prove false.

Due to decreased funding, limited storage space and highly selective art committees, major museums have limited their acceptance of works of art. Most major museums will not accept a work of art unless it fills a gap in its permanent collection or otherwise advances a current institutional goal. When the proposed gift is of an entire collection--as opposed to a discrete piece--the likelihood of rejection is even higher. To address this challenge, collectors should inquire and understand the needs and goals of prospective organizations to make it more likely that the gift will be accepted. For most people, it may be best not to focus on the largest and most famous museums. Less notable museums often have more space and additional flexibility. As with other asset classes, the art market is cyclical and particular artists and genres may fall in and out of favor. The collector should understand the long-term plan for the art and create a realistic strategy. Most donors hope to see the art displayed on a long-term basis and do not want a museum to sell the art they have donated or to place it in storage. It is extremely important for the client to make the gift pursuant to a written agreement that builds in flexibility and provides clear enforceable terms.

Private Art Museum

Collectors may also consider creating a private art museum where they may preserve the integrity and legacy of the entire collection, exhibit their art and also receive tax advantages. However, a collector needs to take a number of factors into consideration. First, establishing and maintaining a private museum entails relatively high costs. Clients must also understand the legal and tax obligations that come with establishing and running a private museum. Most private museums choose to operate as tax-exempt 501(c)(3) organizations. Applying for tax-exempt status applies to federal, state, and local tax exemptions after the organization is legally incorporated. The process is costly, complex and time consuming; therefore the client should consult with his/her legal and tax advisors. In addition, collectors who have families with little interest in the art and its legacy should consider donating the art to an existing museum that satisfies the collector's requirements of space, location and structure. An existing museum would be able to manage the art without relying on family members.

Financial Considerations for Donating Art

During Life

It is important to understand how the art is classified for federal income tax purposes as well as how the art will be used by the charitable recipient.

Generally, a work of art will be classified as a capital asset for the donor unless: (1) the donor created it, (2) the donor received it as a gift from the creator; or (3) the donor is a dealer who held it as inventory for sale to customers in the ordinary course of business. If the work of art is not a capital asset or its sale would generate short-term capital gain because the donor held it for one year or less, then it is treated as federal ordinary income property.

The manner in which the charitable recipient will use the artwork can affect whether the donor's income tax deduction may be equal to the fair market value (FMV) of the art or limited to the lesser of FMV and cost basis. Collectors in such circumstances should be familiar with the requirements for appraisals and IRS policies and procedures for valuing artwork for charitable purposes. IRS regulations state that a gift of property other than cash or marketable securities whose value exceeds $5,000 requires that the donor obtain a qualified appraisal dated no earlier than 60 days before the gift and no later than the date on which the donor's federal income tax return is due (including extensions), and that an appraisal summary (or a copy of the appraisal, if the appraised value is more than $500,000) be attached to the income tax return.[1] If the appraised value is $50,000 or more, the collector can request a Statement of Value from the IRS. A Statement of Value reflects the IRS's determination of a work of art's value. The collector can use the Statement of

Notes:

[1] For artwork valued at $20,000 or more, a copy of the signed appraisal must be attached to the income tax return, and a photograph of the work must be provided upon request.

Value in completing their tax return. A Revenue Procedure (Rev Proc 96-15) details the procedure for making such a request. A user fee is required, and the request must be submitted to the IRS after the art has been donated but before the income tax return is filed.

The IRS specifies the following with respect to the income tax charitable deduction:[2]

• If ordinary income property (or tangible personal property that will be used in a manner related) to public charity then deduct the lesser of fair market value (FMV) or cost basis of the property up to 50% of adjusted gross income (AGI)

• If ordinary income property (or tangible personal property that will be used in a manner related) to private foundation then deduct the lesser of FMV or cost basis of property up to 30% of AGI

• If long-term capital gain property (or tangible personal property that will be used in a manner related) to public charity then deduct FMV of the property up to 30% of AGI

• If long-term capital gain property (or tangible personal property that will be used in a manner related) to private foundation then deduct the lesser of FMV or cost basis of the property up to 20% of AGI

• If tangible personal property that will not be used in a manner related to charity's purpose to a public charity then deduct the lesser of FMV or cost basis of the property up to 50% of AGI.

• If tangible personal property that will not be used in a manner related to charity's purpose to a private foundation then deduct the lesser FMV or cost basis of the property up to 20% AGI

Generally, any unused federal income tax charitable deduction may be carried forward until for up to 5 years after year in which the gift was made.

A collector may be entitled to an income tax charitable deduction for gifts of art made during his/her lifetime. For the deduction to be based on the FMV of the artwork (rather than the lesser of basis and FMV), the gift must be made to a public charity and be used by the charity in a manner that is related to its exempt purpose.[3] For example, the gift of a painting to an art museum--if the museum incorporates the painting into its collection—would likely permit the donor to base his/her income tax charitable deduction on the FMV of the painting. However, if the museum accepts the painting with the understanding that it will sell it to raise funds to cover its operating expenses, such use of the painting would not be related to the museum's charitable purpose and the donor's deduction would be based on the lesser of the cost basis of the art and the art's FMV.

After Death

By donating art to a charitable beneficiary at death, the deceased's estate receives an unlimited estate tax charitable deduction equal to the fair market value of the art. A downside to gifting to a charitable beneficiary at death is that the collector forgoes the potential income tax charitable deduction during life.

Notes:

[2] Unrelated use rules only apply to tangible personal property.

[3] The donor's federal income tax deduction may be subject to recapture if the charity disposes of related-use property within three years of the donation.

Disclosures

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