



Estate and Gift Planning: The Art of Giving Art

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Are You a Collector or Investor?

Most purchasers of art fall under the “collector” category. Collectors are those who appreciate art and accumulate it for personal and shared gratification. While expenses for acquiring and maintaining art are not deductible for collectors, often tax incentives can be gained when selling or giving collections away.

To be classified as an investor, an individual must show that he or she collects primarily for investment purposes. Investor status is based on each person’s unique facts and circumstances. The IRS typically will take into consideration the purpose for which the art was acquired, the length of time each piece was held, the investor’s other business interests and the use of the proceeds from the sale of each work. Implicit in this criteria is the belief that investors sell, or they are willing to sell, the art for a profit. The IRS has denied investor status on numerous occasions because taxpayers could not document that they ever sold a piece from their collection.

Tax Facts on Selling Art

Despite reductions over the years in the federal capital gains rate, the rate on gain from the sale of long-term collectible property has held steady at 28%. ^A

^A IRC Section 1(h)(5).

EXAMPLE:

- ▶ John Collector invested \$10,000 in a stock in 1995 now worth \$100,000. He sells the stock and owes capital gains taxes of \$13,500.^B
- ▶ John Collector invested \$10,000 in a piece of art in 1995, which is now worth \$100,000. He sells the artwork and owes capital gains taxes of \$25,200. If John is in a higher tax bracket he might owe \$28,620 (28% + 3.8% Medicare surtax=31.8%)

By giving his art to the Harn (provided the Harn says it can use the art), John avoids paying capital gains tax and deducts the full fair market value of the art.

Gifting Art

As a collector, you have four estate planning choices regarding your works of art, each with distinct advantages and disadvantages.

- ▶ Give them to your family or other individual(s) during your lifetime.
- ▶ Leave them to your family or other individual(s) in your will or trust.
- ▶ Give them to a charity during your lifetime.
- ▶ Leave them to a charity in your will or trust.

Lifetime Gifts to Family or Individual(s)

When collectors give a piece of art to a family member or other individual during their life, there are IRS issues to consider, such as provenance (chronology of ownership) and copyright (collections, in addition to single pieces, can be registered). Both should be addressed to show that after your gift, the artwork has officially exchanged hands. For instance, you as the collector must change your insurance to reflect the artwork is no longer in your possession, as the IRS may ask about this during an audit to prove the gift was completed. Also, you'll need to report gift tax for high-value transfers. To lock in the value of your artwork amid market fluctuations, consider getting a qualified appraisal at the time of your gift, as it can be used for your gift tax return.^C

- ▶ In the example of John Collector, his child Samantha would accept his art with John's original value estimate of \$10,000. When Samantha eventually sells the art she will owe at least 28% of any gain over the original \$10,000 investment.

Bequests to Family or Individual(s)

More commonly, collectors leave artwork or entire collections in their wills to family members or individuals as part of their estate's personal property. Sometimes, and for various reasons, those who receive the artwork chose to sell it. If the art is sold before the estate tax return is filed, then the IRS is likely to accept the auction value(s) for estate tax purposes. Otherwise, a price estimate of the artwork will be required, along with a discussion about the value of the artwork with the IRS during an estate tax audit.^D

- ▶ In the example of John Collector, his friend Sam would inherit his art at the fair market value of \$100,000 on John's date of death. If Sam eventually sells the art for more than this new value estimate, he will owe at least 28% taxes on the profit above \$100,000.

^B Assumption: The taxpayer is in a 15% capital gains tax bracket.

^C Treasury Regulations Section 301.6501(c)-1(f)(3), Treas. Regs. Section 301.6501(c)-1(f)(1).

^D Treas. Regs. Section 20.2031-6(b).

Lifetime Gifts to Charity

If you chose to give your art to a charity that will use it for their non-profit/tax-exempt purpose, you can receive a tax deduction up to the full fair market value of the piece. This is assuming that other paperwork, such as an appraisal, acknowledgment letter and Form 8283 are obtained. But beware: If you give art for a charity auction — even if the auction benefits an art museum — your tax deduction may be reduced to your original purchase price, rather than the current market value. The tipping point between these two scenarios is based on how the charity will use your artwork and whether that use is related to the charity’s main purpose. If the charity disposes of your art within three years of your donation — even if the initial gift qualifies for a fair market value deduction — your tax deduction will be reduced to what the IRS calls “lower of value or basis.” This can be avoided if the charity provides a letter stating that they used the donated art, but the use became impractical or infeasible, so they had to dispose of it.^E If your art does not qualify as a related use of the charity, you’ll still need the appraisal, acknowledgment letter and Form 8283 for your tax return.

- ▶ Example: If John Collector gives a painting valued at \$100,000 to the Harn Museum, he would receive an income tax deduction of \$100,000 if the Harn has a “related use” for the art. John would also avoid the capital gains tax that could be as much as \$28,620 if he were to have sold it.

Bequest to Charity

Giving art to a charity in your will or estate plan is not subject to income tax limitations, nor is the value estimate of your art a significant issue. However, your gift may come with other considerations. Unless your donation is planned in advance, the charity may not be able to accept the art, especially if you want to place conditions on the sale or display of the collection, or if your gift isn’t accompanied by a cash bequest for the maintenance of the art. Those with significant collections should reach an agreement on these arrangements in advance, and not leave them to the executor/trustee.

- ▶ Example: John Collector’s bequest to the Harn Museum may result in an individual tax deduction of the art’s fair market value. If the art is part of his estate, and his estate is subject to taxes, giving the art could save as much as \$40,000 in estate taxes.^F



^E IRC Section 170(e)(7)(D).

^F On January 1, 2013, the American Taxpayer Relief Act of 2012 was passed. It permanently establishes an exemption of \$5 million (as 2011 basis with inflation adjustment) per person for U.S. citizens and residents, with a maximum tax rate of 40% for the year 2013 and beyond.



Converting Art into Income for the Donor

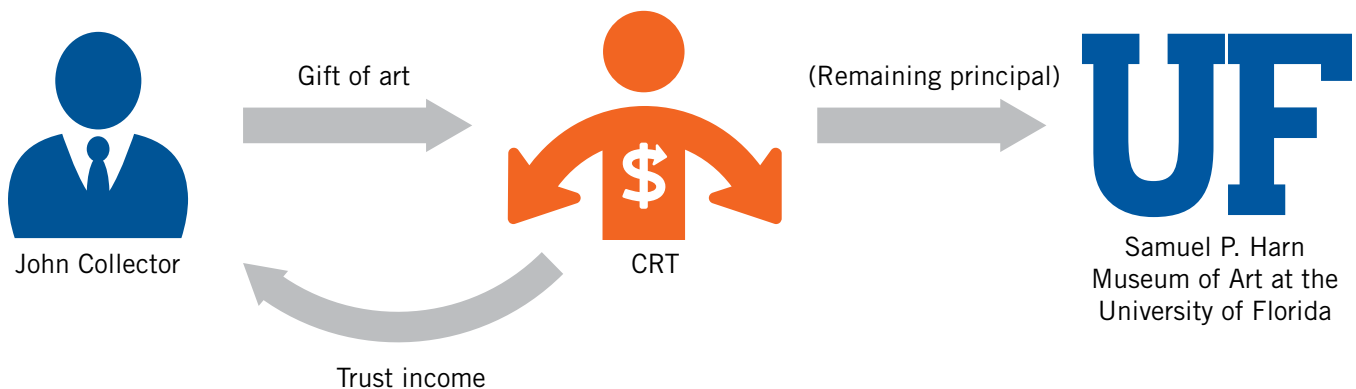
A growing number of collectors want to sell their art to make money, but are reluctant because of the tax trigger. If you want to sell your art, consider transferring it first to a charitable remainder trust (CRT) so you can bypass the immediate taxes associated with selling the art. Once the trust sells the art, the trustee will pay the beneficiary (which may be you or someone you select) income for a period of years or for a lifetime.

Contributions of art to CRTs are subject to a special IRS rule that postpones the income tax deduction until your interests (and/or that of your family members) in the property have expired. For example, if you give a painting to a unitrust with the Harn Museum listed as the remainder beneficiary, you would receive an income from the trust for life. No income tax deduction is allowed until the unitrust sells the painting, at which point you are no longer considered to have an interest in the painting, but rather in the sale proceeds. There is some doubt as to whether CRTs, not being public charities, can have uses related or unrelated to their non-profit/exempt purposes. Nonetheless, the regulations make it clear that because the painting was sold (an unrelated use, even if sold to the Harn) the deduction is limited to the remaining interest times the cost basis of the painting.

Giving art to a CRT is an attractive option even if the tax deduction has to be calculated using cost basis. This is because the sale of the art can provide tax-free income for the trust, and a lifelong income for the donor.

- ▶ Example: John Collector gives his art to a CRT, which generates a partial income tax deduction of his original cost basis once the art is sold by the trust. John would also bypass the capital gains tax, which could be as much as \$28,620. John's trust pays him 5% of the principal annually until his death, and the remainder transfers to the Harn Museum to support its mission.

Charitable Remainder Trust in Action





Checklist: 5 Key Issues Collectors Should Consider When Donating Art

The qualified appraisal requirement

If you expect your gift to be valued over \$5,000, the IRS says you must obtain a qualified appraisal. The IRS also provides procedures for taxpayers to request a review of art valuations for income, estate and gift returns. You may request an IRS Statement of Value for an advance review of art valuation claims prior to filing out your return. This statement can then be used in completing your tax return. The procedure usually applies to artwork appraised at \$50,000 or more. The appraisal submitted must meet substantiation requirements. A user fee of \$2,500 is charged for each request.

The willingness of the charitable organization to accept the gift

A museum could refuse a gift because the art may not fit with its permanent collection plans.

An endowment to support the artwork

Museums today may only be able to accept artwork that is accompanied by an outright gift of cash or other assets to create an endowment for maintaining the piece.

Related use vs. non-related use

It is imperative for you, as the collector, to consider how the donated art will be used by the nonprofit organization (such as the Harn Museum). If the artwork's use is related to the museum's nonprofit purpose, then the collector is allowed to deduct the fair market value based on the qualified appraisal. However if the artwork will be used in a way that is not related to the museum's nonprofit purpose, you would be limited to deducting the acquisition cost (i.e., cost basis). If the museum sells the work of art within 3 years of receiving it, it must file Form 8282, and your tax deduction could be reduced retroactively.⁶

The five-year carry forward

For artwork with a related use, you are limited to deducting 30% of your adjusted gross income of the fair market value. For non-related use, you may deduct up to 50% of your adjusted gross income just on your "basis" in the art. In either case, you are allowed an individual carry forward for unused deductions for an additional five years.

⁶ IRC Section 170(e)(7)(A) and 170(e)(7)(B)(ii).



Tax Rules Can Be Confusing. Let Us Help You Plan.

UF's Office of Gift Planning can confidentially answer your questions and work closely with your legal, tax and other advisers to develop an integrated plan that meets your goals. Contact us anytime or visit <http://giftplanning.uff.ufl.edu>.

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The Harn Museum of Art collects in the areas of:

African Art

Asian Art

Modern Art of the Americas

International Contemporary Art

Photography

