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# Artwork and Your Legacy: Stewarding Your Collection

Art collections are curated with passion and care. They often represent an important part of a family's legacy, making their stewardship fraught with emotional and financial considerations. This article explores options for passing on a collection.

Deciding the future of your artwork is a personal, complex decision. The paintings, sculpture, fine antiques, and other treasured objects you have collected over a lifetime often represent an important part of your family's legacy.

Many art collectors choose to pass on artwork upon their death. Perhaps you envision your artwork hanging on the walls of a museum or benefiting a charity. Maybe you want to instill a love of art in your family and hope your heirs will become stewards of your collection.

We review five techniques and explore key considerations for you to discuss with your family and advisors. You may ultimately choose to use more than one option. The goal is to help enable you to pass on your collections in a manner that preserves your wishes and legacy.

## 1. Gifting to Heirs

Before moving forward with a gift to heirs, it is important to have an honest and thoughtful conversation with them. Sometimes those who have enjoyed and appreciated your art collection may feel uncomfortable with the responsibilities of keeping and caring for it. Some family members may want your collection but may be unaware of the accompanying insurance or security responsibilities.

Talk with your heirs about pieces that are most meaningful to them. If one member of the family is more of an art lover than others, it may be appropriate to bequeath the collection to one person and give different assets to other family members. In contrast, you may want to bequest equal amounts of cash and add the artwork as a special additional gift to an art-loving heir.

Consider whether you prefer to allow many heirs to have a piece or two from your collection, or if you prefer to keep the entire collection intact. Conveying the entire collection as one unit to be owned by several people is possible but can be administratively complex.

If you choose to make specific bequests to individuals in your family, we suggest you clearly express in your will which items should go to whom. If you are trying to achieve a balanced distribution of your estate, you may wish to acquire an appraisal of the works to be given away at your death to help keep the values of those items relatively equal.

## Weighing the Tax Consequences

Your choices about gifting art to heirs can be affected by the tax consequences of the gift. Key differences exist depending on whether the art is gifted at your death or during your lifetime. Bequeathing

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*It may be a sale is the best option for your legacy considerations. This is because sale proceeds from your artwork can provide for your family or charitable interests. Additionally, potential beneficiaries of artwork may not want the collection or have the ability to care for it.*

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art to heirs at your death will create a step-up in basis on the artwork, which we think is especially beneficial in circumstances where art has highly appreciated in value.<sup>1</sup>

Giving your artwork as gifts during life is a way to realize the impact of the art on a person you care about. The value of the artwork may count toward your \$11.18 million lifetime estate and gift tax exclusion<sup>2</sup> or your current \$15,000 per person annual gift tax exclusion.<sup>3</sup> The value of the artwork will be out of your estate and will not be taxed as part of your estate. However, the basis of the artwork will carry over. If you are transferring highly appreciated artwork, we suggest you discuss the potential significantly higher tax liability for your loved ones should they choose to sell the artwork.

## 2. Selling Your Artwork

You may decide that the best course of action is to sell your collection to another collector. The proceeds from a sale can become a portion of the wealth you pass on to your heirs, helping to provide additional financial security for your family. Additionally, a sale and gift of the funds could be an appropriate way to make a charitable donation to a cause close to your heart.

### Be Aware of Taxes

Before deciding to sell, be aware of the tax consequences of a sale of artwork. You should work closely with your tax advisors as IRS rules related to the sale of artwork are complex. Art held

for collectible purposes is part of the special class for collectible capital gains tax. Artwork held for more than a year is considered a collectible asset,<sup>4</sup> and sale of any artwork owned by a collector is taxed at a flat 28%.<sup>5</sup> Additionally, the Patient Protection and Affordable Care Act layers a 3.8% Medicare contribution tax on top of unearned income,<sup>6</sup> above threshold amounts. Any appreciation of the artwork between the time the artwork was purchased (or the basis transferred to you if you acquired the artwork by gift) to the point of sale will be taxed at this rate.

We believe another option is to simply allow the art to pass through your estate, with direction that it shall be liquidated upon your death, with the proceeds going to your heirs. The artwork would be included in your estate, which will be taxed at the 40% federal rate for the assets over \$11.18 million and will be subject to state estate taxes as applicable.<sup>7</sup> This option is the simplest, in our view, and may be the most appropriate choice for your needs.

## 3. Creating a Private Foundation

Creating a private foundation to hold the art could be the ultimate expression of a dedicated art collector's vision. It essentially allows collectors to create their own museums. Famous institutions such as the Barnes Foundation, the Frick Collection, and the Isabella Stewart Gardner Museum

<sup>1</sup> Basis could step down in the event that the piece loses value between date of purchase and date of death (I.R.C. §1014).

<sup>2</sup> Revenue Procedure (Rev. Proc.) 2018-18.

<sup>3</sup> Rev. Proc. 2017-58, November 15, 2017.

<sup>4</sup> I.R.C. §408(m)(2).

<sup>5</sup> I.R.C. §1(h)(1)(F).

<sup>6</sup> Federal Register (Fed. Reg.) Vol. 78, No. 231, p. 72393 (December 2, 2013).

<sup>7</sup> Rev. Proc. 2018-18.

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began as private collections compiled by passionate individuals.

However, creating a private foundation for your collection shifts all of the responsibilities of a museum to the foundation. It requires considerable maintenance as well as ongoing financial and administrative support. For example, the foundation may need to:

- acquire and maintain a dedicated space to hold the collection;
- hire employees;
- maintain property insurance and security; and
- allow access to the public, considering such features as parking and road access.

The artwork you donate to your foundation will be part of the foundation's collection and will no longer be available for your personal use. You will also need to actively engage in succession planning so that your collection will continue to be properly funded and administered after you are gone.

There are tax benefits associated with setting up a private foundation. You will receive an immediate deduction for funding the foundation and can take deductions for future donations. The future donations are not limited to artwork; you can also take deductions for donating cash and stocks. You will avoid estate and gift taxes on the artwork transferred to the foundation, as well as capital gains on the appreciation of assets transferred to the foundation. Finally, under most circumstances, the foundation may deduct the costs of conserving, caring for, and insuring art as a business expense.

#### 4. Donating to a Museum

One way to express your legacy is to donate your artwork to a museum where it can be viewed by others.

Donating to a museum can be a wonderful way to share your collection:

- Museums are intended to exist in perpetuity, and it will become their responsibility to house and care for your artwork once it becomes theirs.
- As part of a museum's collection, a work of art could be temporarily loaned to another art institution, allowing even more people to appreciate it.
- A museum may use your artwork in its catalogues or other materials even before you formally complete all steps of making the donation.

Beginning a conversation early will allow you time to develop a true partnership with the museum and learn its policies.

- Gifting to a museum does not guarantee your artwork will be showcased. It could wind up in storage. Or it might be sold by the museum.
- If a museum has an overabundance of work by a particular artist, it may not wish to accept what you are donating.
- You may discover that certain types of artwork are better candidates than others for the type of donation you envision.
- Museums may have more of a curatorial need for some parts of your collection than for others. In that case, only a portion of your collection may be appropriate for donation.

#### Promised Gifts

When you and the museum come to a mutual agreement about a potential donation, you may be asked to make a promised gift. A promised gift is a legally binding, irrevocable agreement whereby a donor pledges to make a

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## Choosing the Right Deduction

When you make your donation, you will be eligible to take an income tax charitable donation deduction, which will help lower your income tax liability. If a donation is used in a way that relates to the organization's charitable mission, as would be the case for a donation of art to a museum, a preferable deduction limitation is available. You could choose from either of two charitable contribution deductions:<sup>8</sup> limited to fair market value, which is the appraised sale price at the date of the gift, or cost basis, which is the original value, usually the last purchase price of the artwork. We recommend you speak with your advisors to determine what is best for you and your estate.

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gift of a work of art to the museum at a future time, which may be any time prior to or at the donor's death. In the absence of a promised gift agreement, you can express your intention to donate to a specific museum in your estate planning documents.

Your tax planning should begin prior to the time of a promised gift. In your promised gift agreement, your legal advisor should include a provision to prevent the organization's sale of your work for at least three years from the date of your gift. A sale that violates this provision would jeopardize any subsequent ability to take a tax deduction.<sup>9</sup> No deduction will be available until the gift is actually made.

## 5. Benefiting Charitable Groups

There are other charitable institutions besides museums that may benefit from your collection. Consider all the charities you have supported throughout your life and the causes that are dear to you. You may wish for your collection to have a charitable impact beyond the art community. If you prefer to make a donation to a charity unrelated to artwork, consider whether it is better to donate the work to the organization or to sell the work and donate the proceeds.

If artwork is not used in a way that relates to the organization's charitable mission, the donation will not satisfy the related use rule.<sup>10</sup> Your ultimate charitable deduction would then be limited to the item's cost basis, up to 50% of your adjusted gross income.<sup>11</sup> This may not be a substantial concern, especially if a piece of art has not appreciated dramatically since acquisition. This deduction can be carried forward up to five years.<sup>12</sup>

You may find it more appealing to sell the artwork and simply donate the proceeds to the charity. In that case, you will be able to donate the full fair market value and take that amount as a charitable deduction, up to 60% of your adjusted gross income.<sup>13</sup> (However, you may incur income tax on the sale.)

Choices surrounding artwork are complicated because art is an asset unlike any other. High in both economic and emotional value, your collection deserves thought and attention as part of your overall estate plan. Achieving a level of comfort with the fundamental strategies for planning with your artwork can provide you the peace of mind to begin to make decisions. Or it can create a foundation of knowledge upon which you can grow to explore more sophisticated options. The future of your collection starts here, with your vision for your legacy.

**For more information, please contact your Hawthorn advisor.**

<sup>8</sup> These charitable deduction discussions assume you have owned your artwork for more than one year so that the donation would be considered a donation of a collectible item that is considered a capital asset. They also assume you are not the artist who created the artwork. I.R.C. §1(h)(5)(A) and Treasury Regulation (Treas. Reg) §1.170A-1(c).

<sup>9</sup> I.R.C. §170(e)(7).

<sup>10</sup> Treas. Reg. § 1.170A-4(b)(3).

<sup>11</sup> I.R.C. §170(b)(1)(C)(iii). Adjusted gross income excludes net operating loss carrybacks.

<sup>12</sup> I.R.C. §170(d)(1)(A).

<sup>13</sup> I.R.C. §170(d)(1)(A).

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