

## Media Mentions

### Art Succession Planning



#### ***Estate Planning for Art***

By Malcolm Katt

May 2, 2007 -- You may not think of your collection of art, antiques and collectibles in financial terms, but you should.

Michael Mendelsohn, founder and president of Briddge Art Strategies Ltd., estimates that art and collectibles represent 10% to 15% of the \$41 trillion in wealth that is expected to change hands over the next 50 years as baby boomers leave their estates to their beneficiaries.

For some families, collections represent a significant portion of their net worth. Mendelsohn, whose company works with collectors and their advisers (law firms, trust departments and accounting firms) to determine strategies to manage their collections, adds, "We find that a lot of people who don't even think they collect things actually have \$1 million to \$1.5 million worth of collectibles."

When it comes to estate and charitable planning, your collection is a financial asset that requires careful consideration.

If you don't think proactively, your treasured collection may have to be sold to pay estate taxes.

This sale is usually at an auction house, where the collection might not bring its true value.

For instance, a major collector of folk art was recently tracked down by an artist's agent and learned that the value of his works was 30 times greater than that suggested by a reputable auction house.

"A financial-based strategy will make it possible for you and your heirs to realize the full potential of your collection, from both a philanthropic and a financial perspective," says Mendelsohn, as described in his book *Life is Short, Art is Long: Maximizing Estate Planning Strategies for Collectors of Art, Antiques, and Collectibles*.

#### The Wrong Way

Most collectors are not aware of the estate and charitable planning options open to them. Too often they use what is referred to as "empty hook" or "moving van" planning: Shortly before or after death, their children back up a moving van to the house and remove the collection without reporting the transfers as gifts or inheritances.

Estate-tax examiners expect to see a certain level of personal property reported on an estate-tax return commensurate with a collector's level of wealth, and this so-called planning can easily backfire.

Auditors routinely request copies of any insurance policies on art and other collectibles owned by a descendant to verify holdings. Remember, there is no statute of limitations for estate-tax fraud, or on a taxable gift for which no return was ever filed.

Even collectors who leave collections to museums and report the transfers may not be attending to necessary details. The museum may not want the works or, if accepted, will keep them stored and not put them on display as the collectors had wanted. Some museums, as a condition for accepting a gift, may want a cash donation to help defray the cost of storage and



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#### *Estate Planning for Art cont'd*

maintenance for donated items.

##### The Right Way

Instead, create a strategic plan for your collection, preferably with an adviser who has experience in succession and philanthropic planning.

This could cover such areas as strategic selling, donating to a museum, putting the collection in a trust or limited partnership, setting up a private foundation -- all ways to minimize capital gains and estate taxes. Which opportunities are most appropriate will depend on your goals, values and stage of life.

Also, consider the following:

**Determine value.** One of the most troublesome aspects for the disposition of art and collectibles is how items are to be valued. The general rule for federal estate tax, gift and income taxes is that items are valued at their fair market value. The tax authorities will sometimes accept the buyer's cost, or a recent sale, as evidence of fair market value.

In most cases, the fair market value will need to be determined by a qualified appraisal; find appraisers at the American Society of Appraisers and International Society of Appraisers, or through the Art Dealers Association of America. If you are making a gift of art work or a collection worth more than \$5,000 to charity and want an income tax charitable deduction, the item must be appraised by a qualified appraiser.

For an item valued at \$50,000 or more, you can avoid problems later on by asking the IRS to give you a statement of value for tax purposes. You submit your own appraisal and the IRS' experts will tell you, within six months to a year, whether they agree or not and why. This process costs \$2,500, a fee worth spending for such an expensive item.

**Gifts to charity.** Charitable gifts and bequests of your collectibles can be a tax-efficient way of keeping your collection intact. But there are traps to avoid, such as rejection of gifts and ceilings on lifetime gifts.

Make sure that the intended recipient wants the item or collection and will use it according to your wishes. Discuss the matter with someone in authority at the charity and work out any terms and restrictions.

The ceiling on an income tax charitable deduction for a gift of appreciated art or collectibles to a charity depends on whether the charity's use of your gift is deemed "related" or "unrelated" to the charity's exempt purposes.

If related (e.g., a painting donated to a university is used for art history curriculum), you can deduct the property's fair market value, up to 30% of your adjusted gross income. If unrelated (e.g., the donated painting is sold by the school), you can only deduct your cost basis, subject to a 50%-of-AGI ceiling.

Instead of making an outright charitable gift of your art to charity, you can use alternative transfer planning, such as bargain sales, a sale of appreciated property to a charity at a price lower than its present fair market value. A charitable deduction is allowed for the difference between the sale price and the property's fair market value.



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### *Estate Planning for Art cont'd*

Or, look to a charitable remainder trust, an irrevocable trust that holds paintings, sculpture and antiques (and, perhaps, other property). You and your spouse enjoy income from the trust for life or a term of years and the charity gets the property when you die. When you fund the trust during your lifetime, you are entitled to an income tax charitable deduction equal to the present value of the charity's remainder interest.

#### Safeguard Your Collection

Gifts to family and friends. There are also noncharitable techniques for art and collectibles that allow you to remove items from your estate on a tax-advantaged basis. You can pass ownership, directly or indirectly, to your heirs and accomplish important goals: The property ends up with those you intend, you reduce your estate that could otherwise be exposed to federal and state estate tax, and you do this all without any gift tax costs.

Examples: Annual exclusion gifts. You can make a direct gift of \$12,000 (\$24,000 for a married couple)

per beneficiary each year, free of federal gift tax. This enables you to remove property from your estate without any transfer tax cost. This is a simple and effective means of removing the value of works of modest value (under the exclusion limit) from your taxable estate. Any future appreciation on the works belongs to the recipient.

Art limited liability company (LLC). You can place your collection in an LLC and then, using the annual gift tax exclusion, make gifts of interests in the LLC to family members. Over time, they will gain a significant ownership interest in the LLC, which holds the collection, and you will have reduced your taxable estate at no tax cost.

It is always advisable to work closely with an appraiser and a knowledgeable attorney, however, who can help ensure that the transfers meet all tax requirements.

