The Accidental Collector

Key Tips for Owning Art and Antiques

Hemenway & Barnes thanks you for joining our October 25, 2012 roundtable discussion on "The Accidental Collector: Key Tips for Owning Art and Antiques."

Art and collectibles have special significance to many of us. We feel a sense of stewardship over these items, whether carefully passed down through generations, discovered in the corner of an attic, or zealously pursued as a key addition to our collection. As stewards, we want to ensure that our fine art, antiques and other collectibles are protected – now and in the future – and that the people and institutions intended to enjoy and care for these special objects in the future can do so.

Hemenway & Barnes is uniquely positioned to work with you on the real questions you have about your art and collectibles. We can guide you through the planning process by helping you:

- Create a plan for your collection that is consistent with your goals and values
- Inventory your collection and work with a qualified appraiser to determine its value
- Assemble provenance documentation
- Develop a tax-wise plan for ongoing management of your collection and for transferring it to family or charity
- Minimize estate and gift taxes and reduce audit risk
- Resolve copyright and licensing issues

Our Experts

1. Nancy Dempze (Hemenway & Barnes) opens the discussion by addressing the importance and process of appraisals and inventory.
2. Karen Keane (Skinner) addresses the question of what's hot and what's not. She builds on the topic of appraisals by presenting examples of items that have sold at Skinner in the last two years, comparing the estimated and actual sales prices.
3. Gioia Perugini (Hemenway & Barnes) develops the issue of establishing value with a discussion of stewardship. Her key topics include: insurance, loss prevention (best practices for storage and display), shipping and authentication.
4. Joan Garrity Flynn (Hemenway & Barnes) moves on to the topic of legacies. She emphasizes the importance of planning in advance for both private and institutional collections, and introduces different mechanisms that can be used to own and/or transfer the art: LLC, Trust, Foundation, and lending to museums.
5. Charles Fayerweather (Hemenway & Barnes) closes the discussion by addressing the special tax and donation considerations for art and collectibles. He covers specific issues of income tax, estate and gift tax, as well as the steps involved in charitable donations, from negotiations with a charity to written gift agreements and endowments for ongoing care and storage.

Hemenway & Barnes LLP

What Do I Own?

Inventory Your Art and Collectibles:

The first step in planning for your art or collectibles is developing an inventory. You cannot plan well without knowing what you own and where it is located. An inventory can be used to:

- Streamline the appraisal and planning process and provide for more accurate estimates of value.
- Help you decide whether potential additions to your collection make sense.
- Document your collection for insurance purposes in the event of theft or damage.
- Assist you and your advisors in deciding what should be given or bequeathed to family and/or charitable organizations.
- Provide a list for your family to facilitate the division of your property after your death.
- Document original purchase price or the income tax cost basis of a gifted or inherited item.
- Document your ownership of the work, its provenance, its authenticity, and the history of its exhibitions.

If you have the time and skills you can prepare the inventory yourself using a simple spreadsheet or one of the software programs designed for documenting collections such as: Collectify; Art, Antiques Organizer Deluxe; Artbase/Collector; Artsystems/Collections; or Gallery Systems. If you have a large or valuable collection you will want to have professional help. If you are unsure of the current values of items, it will be more efficient to have an experienced appraiser review the collection and separate the valuable items from the less valuable before you begin the inventory process.

The inventory will include background information on your collection including information regarding the artist, history of ownership and exhibition, past appraisals and deeds of conveyance or bills of sale, and any other information that is helpful in understanding the work.

You will need a digital and/or paper file for each item that includes the following:

- A good quality digital photo of the item.
- Object type and media (wood sculpture, Greek coin, watercolor landscape, etc.).
- For objects produced in multiples, the number of the piece, total number produced, and whether the plate or cast was destroyed.
- Description of item's condition.
- Identifying information such as the size, date created, artist or maker, artist's signature and any maker's mark.
- Purchase records including bill of sale or deed of gift, date acquired, cost or value at that time, and name of seller or donor.

- Information regarding any exhibitions of the piece.
- Information regarding any references to the piece in publications or newscasts.
- Current location of the piece.
- Written gift agreements or other documentation regarding works that have been promised to an organization.

You should keep the original paper files in a secure place. You should also secure your computerized inventory by having good backup storage and sending a copy to your advisors and a trusted friend or family member. You will need to update the inventory periodically to reflect new acquisitions and gifts or sales. Make sure that your advisors and friend or family member receive updated copies as well.

What is It Worth?

The Importance of a Good Appraisal:

It is difficult to value art and collectibles given the unique aspects of each piece and the constantly shifting trends in the market. As noted below, the stakes are high for accurately valuing art and collectibles. It is extremely important to retain highly qualified appraisers who are unbiased.

For tax purposes, including charitable donations, gifts and transfers at death, the value of a work of art, antique or collectible is its "fair market value." Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The tax regulations require the fair market value of artwork and collectibles to be determined by the sale price in the market in which the article is most commonly sold. The relevant market will vary depending upon the quality of the piece, the reputation of the artist or maker and the piece's condition.

If you have not had your collection appraised in a few years you should consider doing so. You cannot do good tax planning without knowing what your art and collectibles are worth. Many clients have collected more items than they realize or their works have increased dramatically in value. It is not unusual to see appraisals with values that are several times higher than what the client had estimated.

You will also need a contemporaneous appraisal to support the values of art or collectibles in connection with charitable donations, gifts and estates. An appraisal by a qualified expert will be money well spent. A well-prepared income, gift tax or estate tax return that includes a high quality appraisal is less likely to invite an audit. Also, as noted below, there are stiff penalties for grossly under or over reporting the value of an item on an income, estate or gift tax return.

Request for Statement of Value:

There is a special Revenue Procedure that allows taxpayers to request a Statement of Value for art or other objects worth $50,000 or more. The Statement of Value is useful when a taxpayer wants to be sure that he or she can rely on a certain value for purposes of a charitable deduction, gift tax return or estate tax return. The Statement of Value can be requested for paintings, sculpture, watercolors, prints, drawings, ceramics, antique furniture, decorative arts, textiles, carpets, silver, rare manuscripts, historical memorabilia and other similar objects. The request for a Statement of Value must be submitted with a user fee to the IRS along with an appraisal that was prepared no earlier than 60 days prior to the valuation date. The Revenue Procedure includes detailed requirements for the appraisal and supporting documentation.

IRS Art Advisory Panel:

If a tax return that includes works of art is selected for audit, the IRS agent may refer any works of art valued in excess of $20,000 to the IRS Art Advisory Panel. The Art Advisory Panel comprises art specialists, including dealers and other art experts, and meets twice a year. The Art Advisory Panel reviews the values of art listed on income, estate and gift tax returns that have been selected for audit. The Panel does not know whether they are valuing the work for purposes of an estate, gift or income tax return.

Valuation and Substantiation Rules for Donations of Art and Collectibles:

There are strict rules governing the charitable deduction for donations of art and collectibles. A deduction in excess of $5,000 requires a qualified appraisal of the object. The appraisal must be made not more than 60 days before the donation and an appraisal summary (Section B of Form 8283) must be filed with the income tax return reporting the deduction. For donations of art or collectibles worth $20,000 or more, a copy of the appraisal and a photograph must be submitted with the income tax return. For any donation of art or collectibles, the donor should make sure that he or she has received a written acknowledgment letter from the donee organization prior to filing the income tax return.

If the value of a charitable donation of art or collectibles is overstated on the income tax return by 200% or more, a 20% penalty for underpayment of tax will apply. If the value claimed on the income tax return is 400% or more of the correct value, the penalty equals 40% of the underpayment amount. The penalty does not apply if the amount of additional tax due is less than $5,000.

Valuation for Estate and Gift Tax Returns:

Nearly every estate is required to have an appraisal of the tangible personal property, including furnishings, rugs, jewelry, art, and collectibles, owned by the decedent. The IRS requires that an appraisal by an expert appraiser, signed under oath, is filed with the estate tax return for any estate where the tangible personal property is worth more than $3,000. The regulations require the person filing the estate tax return to take steps to ensure that the appraiser is reputable and of recognized competency to appraise the particular class of property involved. When an estate tax return lists paintings with artistic value, the return must state the size, subject and artist’s name.

Valuation understatements are a serious concern for estate and gift tax returns. If the value of any property claimed on the return is 50% or less of the amount determined to be correct, there is a 20% penalty for underpayment of tax. If the value claimed is 25% or less of the amount finally determined, the penalty increases to 40%. In each case the penalty does not apply if the increased tax is $5,000 or less.

How Do I Take Care of It?

Collectors—whether accidental or not—have many thing to consider to keep their valuables safe. After determining the value of a piece of art or your entire collection, the next step is determining how best to safeguard that work. Chubb, the international insurance company, describes it as "The Fine Art of Protection."

Insurance:

Insurance is the first and most obvious of steps toward safeguarding a piece of fine art or an antique. Many general purpose insurers will offer fine art coverage, although for specialized or high value collections, an insurer that specializes in fine art is more desirable.

- A homeowner's policy will offer some level of protection for the contents in your home, but typically those policies have dollar limits for how much coverage they would provide to fine art, jewelry or other special collections.
- A fine art floater policy will likely offer a greater variety of protection for art and collectibles, depending on if you insure items individually or as a collection, where you store those items and how secure the location is, or whether those items will travel to another location.
- Many insurers will require a qualified appraisal, or at least a reasonable estimate of the work's value, along with any documentation provided at the time of sale or acquisition, to establish a baseline for a work's value. This is important if a claim ever has to be made if the work is lost, stolen or broken. Such an appraisal should be updated regularly, as the value of a work can change over time, and impact both the coverage provided and the cost for such coverage.
- Many insurers will also advise a collector on how best to store, display and/or properly secure a work of art.
- Many insurers will also refer you to an independent and specialized appraiser, or even a conservation specialist, if there are condition issues with a work of art.

Provenance:

Provenance is important for collectors of fine art and antiques. The trail of ownership for these works is not often totally clear. It is not like a home or piece of land that has a clearly recorded legal title in the registry of deeds. It matters for sale, insurance and other documentation reasons. Before they will resell a work, many auction houses require not just proof of purchase but proof of provenance. Even if a work of art was purchased from a reputable dealer, if the chain of ownership before that is unclear at any point, you may end up with no claim to the work if the "true owner" steps forward. Although ownership claims are subject to a statute of limitations as well as timeliness in reporting the theft or inappropriate handling of a work, a collector is still put at greater risk without a clear title to the work.

How do I Keep the Kids from Fighting Over My Art and Collectibles?

Importance of planning in advance:

Your art and collectibles often hold significant emotional and personal value which can be overlooked in estate planning. What should you do to plan for these items as effectively as you plan for your financial assets, real estate and business interests?

- Identify and recognize the potential for conflict among your children. The distribution of your tangible personal property should not divide your family. If possible, have discussions with your children to let them know your wishes and learn their feelings with respect to certain items.
- Inventory your collectibles and have a realistic estimate of their value. If there are items you received by gift or inheritance which you have owned for many years, consider obtaining a current appraisal, as this information may help guide your planning process.
- Your choice of fiduciary is extremely important, as division and distribution of tangibles can be one of the most challenging tasks an executor has to deal with. It may be appropriate to designate an independent executor for this purpose.
- Give thoughtful consideration to the recipients of your tangible personal property and manner in which you want to transfer these assets. Should all property be distributed to individual or charitable beneficiaries or should certain items be sold? If items are to be sold, who receives the sale proceeds? If a beneficiary does not survive you, do the beneficiary's children receive his or her share?
- If the nature of your tangible personal property is such that it will be difficult for the beneficiaries to receive items with the same aggregate value, consider providing for cash gifts to equalize the value of property received.
- Determine whether you want the beneficiaries to individually bear the costs of packing, insuring and transporting the items of tangible personal property passing to them or whether your estate will cover these charges.
- If your estate will be subject to estate taxes, there are additional considerations. Are there sufficient liquid assets to pay the estimated taxes? You should review the tax clause in your will and consider whether you want the estate to pay all taxes associated with the tangible personal property or have the beneficiaries bear a pro rata share of the estate taxes attributable to the tangible personal property received. Care should be taken with the wording of the tangible personal property clause in your will/trust, as it has the potential to invite an

estate tax audit if items of significant value are specifically listed and qualified appraisals of those items are not attached to the estate tax returns.

Different vehicles that can be used to transfer and/or own art and collectibles:

Art and collectibles can be transferred in a variety of ways depending on your goals with respect to the property:

- **Your will.** The most common vehicle for transferring your tangible personal property is your will. Thoughtful consideration should be given to the tangible personal property clause in your will and use of a memorandum. Frequently, tangible personal property is devised to children in equal shares, without direction as to how that is to be accomplished. Your will and/or memorandum can specify how division will occur, whether in the executor's or another individual's sole discretion, by agreement among the beneficiaries, or by lottery.
- **Trusts.** Trusts can be established during life or upon death to hold art for a variety of purposes, including tax savings, asset protection, estate planning and charitable gifts. The terms of the trust should address the beneficiaries' use of the property, and care should be given to the choice of trustees.
- **Limited Liability Company.** If your family is interested in maintaining your artwork as a collection, or if you want to keep a collection together within your family rather than giving specific items to individual members, it may make sense to transfer it to an LLC. Family members would own LLC interests rather than the art itself. In addition to providing a management vehicle for your art, LLCs can also afford estate and gift tax savings when the LLC interests are transferred.
- **Charitable arrangements.** If you are charitably inclined with your art or collectibles, the most commonly used charitable planning opportunities include:
    - **Bargain sales to qualified charitable organizations.** Bargain sales provide cash to the seller along with an income tax charitable deduction.
    - **Private or operating charitable foundations.** Gifts of art to foundations during life are subject to income tax deduction limits whereas there is no estate tax limitation for testamentary gifts to foundations at death. If you have a large collection that you would like to keep together and enable your family to retain control over the collection, a private operating foundation may be suitable.
    - **Charitable remainder trusts.** If you own highly appreciated items, want to make a charitable deduction and still provide for yourself and your family, a charitable remainder trust might be appropriate if a sale of the items is desired.
    - **Loans to charities.** While a loan of property to a charity is not a transfer of the property producing an income tax deduction, it is a method to share your art for which you may be recognized. If you die during the term of the loan, the art will be included in your estate and has the

potential to generate sizeable estate taxes, so this arrangement should be reviewed very carefully.

- **Fractional interest gifts.** While recent tax law changes have made contributions of fractional interests in a work of art less desirable, this technique may still be useful in certain situations.

What are Special Tax Considerations for Art and Collectibles?

There are a number of tax rules that apply to art, including antiques and other collectibles, that don't apply to most other investments.

If you buy art:

1. Keep all documentation relative to the purchase, to establish tax basis as well as provenance.
2. Be aware that you will owe Massachusetts use tax if you bring the art into Massachusetts and did not pay sales tax of at least 6.25% when you purchased the art.

If you sell art:

1. Anything you sell, art or otherwise, is subject to capital gains taxes on the difference between the sales price and what you paid plus other costs of improvements and sales (your tax basis).
2. Art is subject to special capital gains tax rates: 28% federal (vs. 15% for most other assets) and 12% Massachusetts (vs. 5.25% for most other assets). The combination creates a 40% total tax rate.
3. Costs of sale are deducted from capital gains in calculating the tax, so selling through a dealer or auctioneer who takes a commission can be less expensive than it seems (the government is paying roughly 40% of the cost of the sale in most cases).
4. Art sold through dealers or auction houses, or on your own if you sell frequently, is subject to sales tax, which must be collected from the buyer by the seller. If sales tax was required to be collected but was not, the seller can still be required to pay the sales tax.

If you give art to family members during your life:

1. Their tax basis in the art is your tax basis. Make sure that they have information about your acquisition costs along with any provenance information.
2. You may be subject to gift tax. You will need a qualified appraisal to find out.
3. Even if you don't actually owe gift tax, failure to file a gift tax return with an appraisal will allow the IRS to challenge the value of what you gave years later, and include it in your estate for estate tax purposes.

If you give art to charity during your life:

1. Your maximum charitable deduction for any one year is limited to 30% of your AGI (normal maximum is 50%). Any unused amounts can be carried forward, but only for five years.
2. Your maximum charitable deduction is further limited to 20% of AGI if you give to a private foundation.
3. Your charitable deduction is further limited to just your tax basis if you make a gift of art to a charity that will not actually use the art for its charitable purposes (this does not include a gift of art that is immediately sold).
4. In all cases you need an acknowledgement of the gift from the charity.
5. You should always obtain some sort of appraisal to document the value of the gift.
6. If your gift is worth more than $5,000 you need a qualified appraisal.
7. If your gift is more than $20,000 you may need special documentation so that the object can be reviewed by the IRS Art Advisory Panel.

If you give art to family members through your estate:

1. Your estate will have to obtain a qualified appraisal and possibly special documentation for the Art Advisory Panel, as with a lifetime gift.
2. Estate taxes are levied at the same tax rate for all assets.
3. Your heirs get a stepped up basis.

If you give art to charity through your estate:

There is no limit to the estate tax deduction on an estate gift of art to charity. It does not matter how valuable the art is relative to the size of the estate, what kind of charity receives the art, or what the charity will do with the art. In almost all cases, the effect of leaving art to charity through your estate is to simply take the art out of the estate for purposes of calculating estate tax.

How Do I Ensure My Wishes are Followed if I Donate It?

Research:

As was mentioned earlier in these materials, advance planning will result in better outcomes for your art and collectibles. Identify the institution or type of institution (museum, historic house, university, research center) you would want to receive the work. Discuss this in advance of the gift with the chosen charity. Often, a donor might think an institution is a good fit for their art work without first discussing it with the charity, only to find out they cannot accept the specific gift.

Negotiation:

Once a specific charity has been identified and expressed a potential interest, it is important to discuss several issues before finalizing the gift or gift plan:

- Copyright: will the donor gift the copyright along with the physical work (presuming the donor in fact holds the copyright)? If the donor does not hold the copyright to the work, it must be clearly articulated who owns the rights to the work.
- Reproductions: does the donor want to allow the charity to reproduce the work for educational or promotional purposes? What about reproductions for commercial purposes?
- Travel and display: once the work is gifted, the donor no longer has control over how and when the work is displayed or if it can be loaned to another institution.
- De-accessioning: unless special terms are negotiated, the institution may sell a work of art if it no longer fits with the collection, to buy additional works or otherwise expand its collection.
- Cash gift along with art: many cultural or research institutions will require a gift of cash in addition to a gift of art to provide for the acquisition, storage and care of the art work in perpetuity.
- Written gift agreement: donors should always memorialize the terms of a gift of art in a written gift agreement. Often, an independent appraisal of the work should accompany a written gift agreement.

Contact Us

Hemenway & Barnes professionals have helped generations of families, collectors, charitable organizations and artists manage and plan for their art and other collections. We would love to hear from you, whether you are considering documenting your collection for the first time, or are part of a family or charitable organization whose collection spans generations.

Nancy Dempze serves as a professional trustee, executor and estate planner for individuals and families, and advises non-profits on planned giving. Nancy helps clients develop and implement tax-efficient, wealth-transfer strategies for a variety of complex assets in ways that are consistent with clients' overall goals and values.

Charles Fayerweather works with clients in the areas of taxation of individuals, estates, and nonprofit organizations. As a professional fiduciary, he acts as a trustee of individual and family trusts and as an executor of estates. He frequently represents high net worth individuals using sophisticated estate planning and charitable giving techniques to allow the transfer of wealth to successive generations and to charities in a tax efficient manner.

Joan Garrity Flynn has practiced probate law for over 30 years. She joined Hemenway & Barnes in 2008, focusing her practice in the areas of estate and charitable planning; estate, trust and guardianship administration; and probate court equity matters. Joan also serves as trustee for private family trusts and charitable foundations.

Gioia Perugini works with individuals, families, advisors, charitable trusts and foundations to provide a range of philanthropic and client services. Her clients rely on her to design and implement charitable giving strategies, research particular charities, negotiate gifts of cash or tangible assets and coordinate family meetings.

Hemenway & Barnes LLP
60 State Street
Boston MA 02109
617-227-7940
www.hembar.com