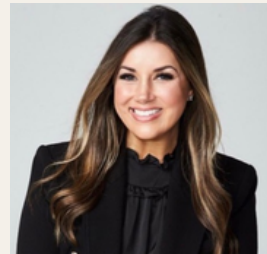


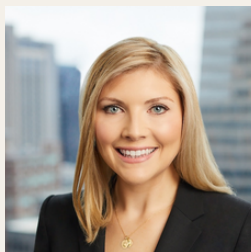
THE ART OF PLANNING: PRACTICAL CONSIDERATIONS FOR ART AND COLLECTIBLES



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APPRAISING FINE ART & COLLECTIBLES

APPRAISALS FOR TAX PURPOSES

If an appraisal is for tax-related purposes, Treasury regulations are generally consistent in their approaches to the valuation of art and collectibles for income, gift and estate tax purposes. The value for tax purposes is the item's fair market value at the time of the contribution or transfer, either during life or at death. As set forth in Treasury Estate Tax Regulation §20.2031-1(b), 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**. Further assumptions for determining fair market value include that there is no time constraint on the sale, the transaction takes place in an appropriate marketplace and the buyer's premium, the amount above the successful bid price that is paid as part of the total purchase price at auction, is included.

APPRAISALS FOR INSURANCE PURPOSES

Insurance appraisals are a risk management measure that protects art assets from theft, accidental damage, fire, flood or other unfortunate situation. Insurance appraisals are generally based on replacement value. Replacement value is defined as **the amount it would cost to replace an item with one similar and like quality purchased in the most appropriate marketplace within a reasonable amount of time**. Replacement value includes not only the costs of acquiring or replicating the property, but also all the relevant costs associated with replacement. These other costs may include all applicable taxes and duties, framing, crating and transportation.



Kashmir Sapphire, Diamond, Platinum, Gold Ring, Schlumberger for Tiffany & Co.

FAIR MARKET VALUE

\$250,000

REPLACEMENT VALUE

\$400,000

APPRAISING FINE ART & COLLECTIBLES

CHARITABLE GIFTS

Appraisal requirements of art and collectibles for income tax deduction purposes are somewhat more involved than for gift or estate tax purposes. For any contribution valued in excess of \$5,000, the donor must obtain a qualified appraisal from a "qualified appraiser" within 60 days of the contribution date.

WHAT IS A QUALIFIED APPRAISAL?

A qualified appraisal is an appraisal that meets the requirements set forth by the Internal Revenue Service (IRS) and is conducted by a qualified appraiser. A qualified appraiser is an individual who has earned an appraisal designation from a professional appraiser organization. This designation is awarded on the basis of demonstrated competence in valuing the type of property for which the appraisal is performed. When hiring an appraiser, it is also good practice to choose one that is USPAP-compliant. USPAP is the acronym for the Uniform Standards of Professional Appraisal Practice issued by The Appraisal Foundation and updated periodically. A USPAP-compliant appraiser will have been trained and tested in appraisal methodology, ethical standards, and advanced report-writing skills.

Understanding the collection's value is critical for several reasons

- Determining and maintaining appropriate types and levels of insurance
- Making gifts to charity and substantiating associated income tax deduction
- Making gifts to family and other individuals and complying with applicable gift tax requirements
- Settling an estate, including making distributions and determining estate taxes
- Engaging in art-based lending transactions
- Engaging in sales and exchanges and related tax reporting

PLANNING CONSIDERATIONS: TANGIBLE PERSONAL PROPERTY

In planning for the eventual disposition of a collection, the very first thing you should do is determine if your family is interested in the collection - not just its financial value. After determining your family's interest, the planning can begin. Most collectors incorporate multiple strategies in their wealth transfer and tax plans to achieve a desired outcome.

- Transfer part or all of the collection to family or non-charitable beneficiaries
- Transfer part or all of the collection to charity
- Sell part or all of the collection

TRANSFERS TO FAMILY

There are many advantages with making lifetime gifts and testamentary bequest to next-generation beneficiaries. Regardless of whether the transfers are made during life or at death, they will be subject to federal transfer taxes: gift tax if made during life, and estate tax if made at death.

Gifts

Federal law provides that the threshold for lifetime gifts and the estate tax exemption for transfer at death are the same amount, but the law allows for increases considering inflation. For a death or gift in 2023, the exemption amount is \$12.92 million per individual. Gift tax rates start at 18% and can reach up to 40% on certain gift amounts. The tax responsibility typically lies with the donor, not the individual receiving the gift.

A lifetime gift of tangible personal property to family may be advantageous for a few reasons. First, the property will no longer be included in your estate, which reduces your estate's value, and therefore, the federal estate taxes that may be due upon death. Second, any post-transfer appreciation in the collection's value occurs outside the estate and inures to the benefit of recipients free of additional gift tax.

Apart from potential tax benefits, gifting part or all of a collection during life allows collectors to have conversations with next-generation heirs about the qualities that make their collection personally and financially valuable.

PLANNING CONSIDERATIONS: TANGIBLE PERSONAL PROPERTY

Bequests

A major tax advantage of holding appreciated assets until death is the ability to obtain a fair market value income tax basis adjustment at no tax cost. When included in your taxable estate, the collection's tax basis is generally the fair market value at the date of your death or alternate valuation date.

If you and your family decide to place your collection into a trust, work with an experienced estate planning attorney to draft the trust document. A will is only a supplement to the trust that will assure that any assets that have not already been transferred into your trust (retitled) will shift into the trust at the time of your death. Remember, only assets that have been retitled in the name of the trust will be valid transfers that will accomplish the objective of the trust. Once your collection is held in a trust, the trust document will dictate how your collection is managed. Using art as an example, in the trust provisions, you can isolate certain works of art to specific individuals or direct the trustee to select which beneficiaries receive or use certain works of art. Transferring the collection into a trust allows your beneficiaries to use and enjoy the collection as you desire.

Case Study: Transferring by Gift versus Bequest

Donald owns a sculpture with a current fair market value of \$1 million. The sculpture's value is expected to appreciate at a rate of 6% per year. Donald has already used his annual gift tax exclusion in 2024 and his applicable exclusion of \$13.61 million. He wants his daughter to have the sculpture, but considers whether to transfer the sculpture today as a gift or wait to transfer it upon his death. Assume Donald lives for another 10 years, with gift and estate taxes and exclusions the same as in 2024. If Donald makes the transfer now, he would owe approximately \$400,000 in federal gift tax (based on \$1 million fair market value in 2024). If he transfers the sculpture by bequest at his death, he would owe approximately \$716,339 in federal estate tax (based on \$1.79 million fair market value in 2034, an increase of 6% per year). Thus, Donald could save about \$316,339 in gift and estate taxes by making the transfer now. However, as discussed below, Donald's daughter will receive his basis in the art in a lifetime transfer.

	TRANSFER BY GIFT (2024)	TRANSFER BY BEQUEST (2034)
Fair Market Value	\$1,000,000	\$1,790,848
Transfer Tax Rate	40%	40%
Transfer Tax Due	\$400,000	\$716,339
Transfer Tax Benefit	\$316,339	(\$316,339)

PLANNING CONSIDERATIONS: TANGIBLE PERSONAL PROPERTY

TRANSFERS TO CHARITY

Collectors often donate their artwork to charity because they have a desire to support specific organizations. In addition, many donors are interested in obtaining a charitable deduction for income, gift or estate taxes. To optimize tax benefits, donors must consider many factors. For federal income tax purposes, the charitable deduction amount depends on the type of property contributed, the type of recipient and how the recipient intends to use the property.

Art held by collectors and investors for more than one year is generally considered long-term capital gain property; income tax deduction for donating long-term capital gain property to public charities is generally based on fair market value of the property, and donors may deduct up to 30% of their adjusted gross income (AGI). By contrast, the income tax deduction for a donation of long-term capital gain property to a private charity is based on the tax basis (usually the cost) of the property and is deductible up to 20% of the donor's AGI.

Charitable transfers at death are not subject to the same extensive tax deduction requirements (such as AGI limitations and the related use test) as transfers during life. Instead, transfers at death are eligible for unlimited federal estate tax deductions. A charitable transfer at death allows you to benefit from full ownership of the collection during life, and may allow your estate to obtain an estate tax charitable deduction based on the fair market value of transferred items.

PLANNING CONSIDERATIONS: TANGIBLE PERSONAL PROPERTY

Donation Considerations

If a collector decides to gift their collection to a charity with a purpose unrelated to its mission, consider whether it is better to donate the works to the organization or to sell the works and donate cash.

If the collection is not used in a way that relates to the organization's charitable mission, the donation will not satisfy the related use rule. In that case, the amount that you may deduct (before applying other limitations) will be reduced by the capital gain you would have realized had you sold the property for its fair market value at the time of the gift. Accordingly, your deduction would be limited to the property's basis.

There is another reason you may wish to sell the artwork and simply donate the proceeds to the charity. If you itemize deductions and make charitable contributions, you may be able to deduct on your federal income tax return the amount of such contributions, limited by the application of certain percentages of your contribution base. Your contribution base is your adjusted gross income (AGI) computed without regard to any net operating loss carryback to the taxable year. Cash contributions to public charities made before January 1, 2026 are deductible up to 60% of your AGI.

In addition, donating the cash from a sale of an item doesn't often generate the same concern for an IRS audit as does a tangible gift which requires an appraisal. An auction sale almost always complies with the very definition of fair market value and determines the charitable donation valuation for tax purposes.

PLANNING CONSIDERATIONS: TANGIBLE PERSONAL PROPERTY

Selling a collection

Last, a collector may wish to sell all or a portion of the collection – again, either during lifetime or by their executor at death. There are many different reasons that may drive the collector to sell: for example, diversification of the collection, increased liquidity to acquire a new piece or payment of taxes.

Compared to other assets, art and collectibles are expensive to sell regardless of whether they are sold during your lifetime or after your death. This is due to additional costs associated with the sale: auction house fees, sales commissions, insurance, taxes and shipping costs. Strategies to minimize tax costs associated with a sale or exchange depend on timing and the relationship between the taxpayer and the art or collectible. Broadly, whether you are classified by the IRS as a collector or an investor will determine income tax rates and deductions. You will need to work with your advisors to make these determinations, although, generally, the federal long-term capital gain tax rate on collectibles is 28% compared to a top rate of 20% for investments.

The most common ways to sell a piece or collection when or if the time comes:

Auction

An auction is a transparent process that exposes the artwork or object to a bidding audience. The location of the marketplace is critical to a successful auction sale. An appropriate time to start considering an auction is between three and four months before the scheduled sale season. During that time, sellers should have the artwork inspected by a qualified expert; obtain auction estimates; engage the auction house; pack the collection; ship the collection to the auction house; catalogue the works; create marketing materials; and, preview the collection to potential buyers.

Private Sale

In some cases, those who wish to remain anonymous will opt for a private sale; in others, the auction cycle may not match the parties' required timeline, or a work can realize stronger prices through private sales than at an auction.

THE COLLECTOR CHECKLIST

Essential questions to ask your collector-clients

1	Are there heirs who will want the collection from a collector's standpoint?
2	Where are the objects kept?
3	Where is the inventory of the collectibles kept?
4	Has the collection been appraised? Was the collection appraised by a qualified appraiser? Where is the appraisal and does it need to be updated?
5	Do you have legal title to the collectibles in your possession? If the collectibles in your possession belong to someone else, do you have power as Agent, Trustee, Guardian, or Executor to deal with them?
6	Are there certain dealers or other experts such as an auction house representative you trust to provide guidance to your heirs?
7	Is there a firm that you and your heirs wish to use in the collection's disposition after your death? Is that firm noted somewhere in your estate plans?