



By **Andrew S. Katzenberg**

A “How To” Guide When Gifting Artwork to Charities

Avoid traps for the unwary

As stock markets rise and fall with each tweet of our President, many wealthy clients may find comfort in the fact that they’ve invested a large portion of their estates in art. Typically, this action isn’t taken as a pure investment strategy but due to an appreciation of the work itself. That being said, these clients may find themselves with highly appreciated assets that may be useful for making current or future gifts to charities. However, there are a myriad of issues when it comes to gifting artwork, and clients should always seek the advice of counsel before doing so to maximize the charitable deduction and avoid traps for the unwary.

Deduction Limitations

Donors should be aware of the limitations on charitable deductions based on the type of charity receiving the donation. A donor may deduct up to 50 percent of her adjusted gross income (AGI) each year for gifts to public charities and private operating foundations.¹ However, this deduction is reduced to 30 percent of AGI for capital assets (that is, assets held for more than a year)² unless the donor elects to step down the amount of the deduction to the tax basis of the capital asset.³ Gifts to private non-operating foundations are limited to 20 percent of AGI for capital assets or 30 percent of AGI for ordinary income assets, with the deduction further limited to the donor’s basis in the contributed asset.⁴ Any donations over these limitations may be carried forward and applied to the following five tax years (subject to the same limitations).⁵

Gifts of tangible personal property (such as artwork)



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are subject to a different set of rules. A full fair market value (FMV) deduction, limited to 30 percent of the donor’s AGI, is permitted if the tangible personal property is: (1) a capital asset (2) that can or will be used to further the charity’s exempt purpose.⁶ The step-down election discussed above is also available for tangible personal property so long as it’s a capital asset. If the property is: (1) not a capital asset, (2) not used to further the donee’s exempt purpose, or (3) worth more than \$5,000, sold within three years of the contribution and Form 8282⁷ isn’t completed, then the deduction for a contribution of tangible personal property is limited to the cost basis but up to 50 percent of the donor’s AGI.⁸

Both sets of rules must be applied concurrently. For example, if a donor gave a piece of art that was a capital asset to her own private non-operating foundation, the donor’s deduction would be limited to 20 percent and based on the cost basis rather than 30 percent and based on the FMV. Alternatively, if the donor gave a piece of art that was a non-capital asset to a museum, the donor’s deduction would be limited to 50 percent but based on the cost basis rather than the FMV.

Related Use Rule

As described above, to receive a deduction for the FMV of artwork (rather than its cost basis), the use of the artwork must be related to the donee charity’s purpose.⁹ The regulations provide that this related use test will be met if: (1) the donor establishes that the art is in fact not put to an unrelated use by the donee, or (2) at the time of contribution, the donor reasonably anticipated that the art won’t be put to an unrelated use by the donee.¹⁰ A prototypical example satisfying this test is the donation of artwork to an art museum. The test would be met even if the museum doesn’t display the art or later sells or exchanges it.¹¹ Ultimately, the test turns on the facts and circumstances of each case. For example, a collection of porcelain art that was given to a retirement home (a



FEATURE: ART, AUCTIONS & ANTIQUES

public charity) met the related use test because the display of the art created a comfortable living environment for its residents.¹² However, the related use test wasn't met when an antique car was donated to a university, and the university didn't offer a class in antique car restoration.¹³

If the art¹⁴ is sold or disposed of within three years of the date of contribution, the related use test will fail, and recapture of the deduction will occur unless the donor obtains from the donee certification that: (1) the use prior to the sale was related to the donee's exempt purpose, or (2) the donee intended to use it in a related way but such use became impossible or infeasible.¹⁵ Donors should obtain a certified statement from the donee of the intended use of the art prior to the contribution to protect the value of the deduction.¹⁶

A gift agreement is a useful tool for highlighting and addressing ancillary issues that may accompany the gifting of art.

Fractional Interests

There are special rules for contributions of fractional interests of tangible personal property, such as a gift of a 20 percent interest in a work of art. If a donor makes a contribution of a fractional interest and doesn't contribute all of her remaining interest in the property to the same donee before the earlier of 10 years from the initial contribution or the donor's death, all deductions for the prior contributions will be recaptured with interest and a 10 percent penalty on the amount recaptured.¹⁷ Furthermore, when determining the deduction for each additional contribution of the interest, the FMV of the item is the lesser of: (1) the FMV used for the initial fractional contribution, or (2) the FMV of the property at the time of contribution.¹⁸ That is, if the asset doubles in value between contributions, the donor won't get the benefit of the subsequent higher value.¹⁹ The donee is also required to: (1) use the property for its exempt purpose, and (2) take physical possession of the item within one year of the gift for at least a period equal to its fractional ownership (for example, 20 percent of the year if

it owns 20 percent); otherwise, the charitable deduction will be recaptured with interest and penalty.²⁰

If the owner of the artwork also owns the copyright to the art, she can't retain the copyright and receive a charitable income tax deduction.²¹ The gift doesn't qualify as an undivided portion of the donor's entire interest in the property. If the owner doesn't want to give the copyright to a public charity, one possible solution is gifting the art to a public charity and the copyright to her own private foundation. Because the owner won't retain her interest in the copyright, the donation of the art should be a donation of the donor's entire interest.

Artists

A different set of rules applies when the art donated is from the artist who created it or from a recipient of a gift of art from the artist. In these situations, the art is always considered ordinary income property (that is, it's not a capital asset),²² and therefore, the deduction is limited to the cost basis of the art (determined by the cost of the materials to create the artwork).²³ The 50 percent AGI yearly limit (as explained above) applies in these scenarios because the art is tangible personal property and not a capital asset.

Because artists own the copyright to their own work, it's necessary to donate both the artwork and copyright to receive a charitable income tax deduction, as discussed above. However, artists may wish to forgo this option and keep the copyright, as their deduction would be limited to the cost of the materials used to create the artwork.

Valuation

Contributions of property (other than cash or publicly traded securities) worth more than \$5,000 require the donor to obtain a qualified appraisal from a qualified appraiser no earlier than 60 days prior to the date of contribution.²⁴ The appraiser should be familiar with the type of property being appraised.²⁵ For example, an appraiser who specializes in Chinese sculptures may not be qualified to appraise a contemporary painting.

The qualified appraiser must be independent of the donor (that is, she can't be anyone related to the donor or otherwise connected to the transaction). Additionally, if the donor has reason to believe that the appraiser has falsely stated the value, such appraiser shall not be a qualified appraiser.²⁶ Finally, Noncash Charitable Contributions Form 8283 must be filed with the donor's income tax return.

Any return selected for audit that claims an appraised



value in excess of \$50,000 for a piece of art is automatically referred to the Art Advisory Panel to determine the FMV. Accordingly, your client should consider which pieces of art to donate if she believes the value may be close to this mark to avoid this review, which may result in a lower value (hence a lower deduction) than initially appraised.

Gift Agreements

A gift agreement is a useful tool for highlighting and addressing ancillary issues that may accompany the gifting of art. For instance, as mentioned above, a certified statement of intent by the donee can be included in a gift agreement to help protect the income tax deduction from the later sale of the art. Alternatively, a donor could prohibit the sale of the donated artwork through a gift agreement. Though this would certainly protect the income tax deduction, it may have unintended consequences down the road as well, such as impeding the donee organization from taking financially reasonable steps to allocate resources and assets in the most appropriate ways.

Gift agreements can also be used to specify the manner and frequency with which the art will be displayed. Though a client's appreciation for her donated art may not dissipate over the years, the donee museum's capacity for the piece, as well as the piece's relevance to the museum's exhibits, may diminish. Finally, depending on what's donated, the donor may be able to negotiate the naming rights of a room or a hall in the museum. The gift agreement would also detail the consequences if the museum violates these provisions. 

Endnotes

1. Internal Revenue Code Section 170(b)(1)(A).
2. IRC Section 170(b)(1)(C)(iv) and IRC Section 1222(3).
3. Sections 170(b)(1)(C)(i) and (iii).
4. Section 170(b)(1)(D)(i) and Section 170(e)(1)(B)(ii); Section 170(b)(1)(B).
5. Section 170(d)(1)(A).
6. See Section 170(e)(1)(B). This section requires that the charity certify on Form 8282 that the use of the property was substantial and related to the organization's purpose or that the intended use of the property becomes impossible.
7. The charity certifies that use of the property was substantial and related to the organization's purpose or that intended use of the property becomes impossible.
8. *Supra* note 6.
9. Treasury Regulations Section 170A-4(b)(3).
10. Treas. Regs. Section 170A-4(b)(3)(ii).
11. But, actual knowledge of these facts at the time of the donation may cause the contribution to fail this test.

12. Private Letter Ruling 8143029 (July 29, 1981). The test was also met when lithographs were given to a camp for physically and mentally disabled children, and the art was used in connection with the art appreciation program. PLR 7751044 (Sept. 22, 1977).
13. PLR 8009027 (Nov. 29, 1979).
14. Must also exceed \$5,000 in value for the recapture rules to apply. Section 170(e)(7)(C).
15. Section 170(e)(7).
16. The certification must be a written statement signed under the penalty of perjury by an officer of the donee organization. Section 170(e)(7)(D).
17. Section 170(o)(3)(A)(i) and Section 170(o)(3)(B).
18. Section 170(o)(2).
19. The opposite is also true if the asset decreases in value. The donor won't benefit from the original higher value.
20. Section 170(o)(3)(A)(ii) and Treas. Regs. Section 1.170A-5(a)(2).
21. Treas. Regs. Section 1.170A-7(b)(1). The same restriction doesn't apply for gift or estate tax purposes. A piece of art and its copyright are treated as two separate pieces of property for gift and estate tax purposes. IRC Section 2522(c)(3) and IRC Section 2055(e)(4). Additionally, for estate tax purposes, for the art and the copyright to be considered separate property to receive an estate tax deduction, the donated art must meet the related use rule. Section 2055(e)(4)(C).
22. IRC Section 1221(a)(3).
23. Section 170(e)(1)(A).
24. Section 170(f)(11) and Treas. Regs. Section 170A-13(c).
25. Treas. Regs. Section 170A-13(c)(5)(i)(B).
26. Treas. Regs. Section 170A-13(c)(5)(ii).



SPOT LIGHT

Faces

Personnages Sur Fond Noir by Joan Miró sold for \$9,375 at Sotheby's recent Prints & Multiples auction in New York City on April 27-28, 2017. Miró's career was characterized by constant experimentation; he worked in a variety of mediums that ranged from painting and printmaking to sculpture and ceramics.