

Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors



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The Art of Tax Planning - Part 3

This is the third installment of an article about tax as it applies to the unique subject of art. You can find the previous articles [here](#).

Fine art is increasingly making headlines as record breaking auction prices steal the attention of collectors, hopeful artists, and art market enthusiasts. At the same time, the perception of a rising art market has brought fine art to the attention of investors around the world, who now consider it an alternative asset class to be evaluated alongside real estate, hedge funds and other investments. Many collectors have realized tremendous appreciation on their accumulation of emerging and contemporary art, and a select few artists are experiencing strong financial success from their creations. However, unlike traditional investments, fine art can be incredibly illiquid and difficult to manage. A highly appreciated art collection belonging to an art investor, or a body of work in the possession of a successful artist, can become a significant liability if not properly planned for prior to the owner's passing.

Enter the Art Foundation

For many collectors and successful artists, the prospect of losing the family's connection to an art collection, losing control of the artist's brand name, or handing a large portion of a collection's value to the tax authorities is too much to bear. A "fire sale" of an art collection in order to pay estate taxes can depress the value of individual pieces and the collection as a whole and, in the case of a successful artist, severely tarnish the artist's long-term value. If the collector or artist is charitably inclined, a private foundation endowed with art could be one solution to this problem.

A private foundation is a special type of tax-exempt organization that does not receive its support from the public. For an art foundation, financial resources to cover operating expenses typically come from sales of art and income on investments. Private foundations can carry out direct charitable activities, make grants of money and artwork, or perform a combination of activities, according to the founder's wishes. Examples of direct charitable activities could include funding art education, compiling an artist's catalogue raisonné, archiving and conserving artwork, or hosting an artist-in-residence program.

Forming an art foundation involves several considerations which can vary between a collector and an artist. An art collector has the option to decide whether to donate the art during life or at death. Donating during life could provide the benefit of an income tax charitable deduction, although the rules are more restrictive than donations to a public charity and subject to rules to ensure related charitable use of the art. A charitable bequest will reduce the taxable estate at death, and also provide full enjoyment of the artworks during life.

For an artist, however, the available choices are different. As we saw earlier, an artist receives no benefit from donations during life, so the only advisable way of contributing art directly to a private foundation is at death. Alternatively, if the artist is survived by his or her spouse, the surviving spouse can benefit from an income tax deduction by donating his or her inherited artworks to the foundation. As discussed, inheriting artworks from a deceased artist resets the character, thereby avoiding the limitation on donations of self-created artwork. Again, there are many technical rules and limitations that must be kept in mind, so anyone considering forming an art foundation would be well advised to consult qualified accountants and attorneys who are familiar with the issues.

One feature of private foundations that charitably-minded individuals may find appealing is that the founder can exert a very significant influence on a private foundation, even during life. If set up ahead of time, the mission of the organization, its initial directors, and even the staff can be outlined and selected before the founder passes away.

Another advantage of private foundations is that family members can be directors of the foundation and receive a reasonable salary for their efforts, so long as the rules of the Internal Revenue Service are strictly followed. In fact, it is advisable to involve family members and future heirs early in the process. With proper education and planning, heirs can feel personally vested in the success of the foundation, and can understand that their inheritance is aided by the reduction in estate taxes that a charitable bequest may provide.

The time to plan is now

Effective planning can minimize estate taxes and increase the amount of assets available to heirs and to fund philanthropic goals. For large art collections, however, estate planning involves many time-consuming considerations, including recording and identifying artwork, determining who will receive which works, updating title to assets, arranging for insurance coverage, obtaining qualified appraisals, and putting the artist or collector's wishes into legal form. If an art foundation is appropriate and desirable, the process of setting up a foundation and complying with the requirements of the Internal Revenue Service and the relevant state's Attorney General is best done in advance, so that the eventual transfer of artwork goes smoothly. It is best to begin this process early and in conjunction with family. The earlier an artist or collector starts planning, the more options are available, and the longer he or she can enjoy the peace of mind that effective estate planning can bring.

For more information, please contact your Anchin Relationship Partner, Gary Castle or Michael Belfer, Co-Practice Leaders of Anchin's Art Specialty Group, at 212.840.3456.



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