Estate Planning Strategies for Art and Collectibles

For even the savviest families, art and other collectibles are often neglected in their estate plan. Many collectors, passionate about purchasing art and expanding their collections, pay little attention to the ultimate disposition of their treasured collections. But, caring about the fate of one's collectibles (not to mention one's family) is precisely the reason to adequately plan for the future.

The art landscape is diverse and constantly evolving. Wealth planning with art and collectibles offers many opportunities, but also significant challenges. Acquiring, managing, valuing and transferring art require thoughtful planning and advice from trusted experts and advisors. We encourage you to begin the dialogue now to ensure that your deepest desires for your art and collections are realized.

Reflect on the Desired Recipient(s)

Where to begin? The first step in ensuring a smooth disposition strategy that does not harm recipients is to unearth and clearly articulate your deepest desire for the art and collectibles you hold dear. Once you clearly define your desires, the next step is to open a dialogue with your family to determine if they are interested in the art collection - not just its financial value. It may be disheartening at first, but oftentimes family members will not share the collector's level of interest in the art. After honest, open family conversations take place to determine your family's interest in the collection, the planning may begin.

Exploring Disposition Strategies

Below we explore three basic options collectors should ponder in planning for the ultimate disposition of their collections. Collectors commonly incorporate multiple strategies into the wealth transfer and tax plans to achieve a desired outcome. As part of a plan for disposition of an art collection, consider whether to:

- Transfer part, or all of the collection to family or another non-charitable beneficiary
- Transfer part, or all of the collection to charity
- Sell or exchange part, or all of the collection

You must also determine if the disposition will take place during your life or at death. The default "do nothing" alternative can be a financial and emotional burden on beneficiaries and very expensive when settling your estate.

Transfers to Family:

Transferring art to next-generation beneficiaries is both a gift of value and values. Now that you have determined who will benefit, the questions are when (during life or at death) and how (outright or otherwise). Many advantages are associated with lifetime gifts and testamentary bequests. But 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. When considering transfer opportunities, it is important to assess options and the most tax-efficient transfer strategy, considering income tax, gift tax and estate tax consequences.

Gift During Life: A lifetime gift of art to family may be advantageous for a few reasons. First, the artwork will no longer be included in your estate, which reduces your estate's value, and thus, 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 grows free of additional gift tax. However, there are associated income tax considerations, since the recipient must use your tax basis (the purchase price or fair market value, whichever is lower) upon future disposition to compute gain or loss for federal income tax purposes.

Testamentary Bequest: One of the major tax advantages of holding appreciated assets until death is the ability to obtain a fair market value income tax basis adjustment at the date of death or alternate valuation date. After considering your family's unique goals for the collection, holding the collection until death and having your executor or trustee provide for disposition may be an appropriate option.

Transfer to Trust: By transferring a collection to a trust, it can be used and enjoyed by beneficiaries without facing claims by creditors or divorcing spouses, as it would if transferred to beneficiaries outright. Although using trusts for art succession planning may provide advantages over outright gifts, it presents several practical challenges. If you intend to transfer art into trust, you should work with an experienced attorney to draft the trust document and be very thoughtful about selecting a trustee with experience in managing art. Trust administration will also be more complex than, for example, a trust holding marketable securities. This is due to the complexity of art ownership and significant ongoing care and maintenance.

Transfers to Charity:

Some collectors choose to donate their precious art collections to charity during their lifetime because they have a desire to support specific organizations or give back to their communities. In addition, many donors are interested in obtaining a charitable deduction for income, gift, or estate taxes. However, in order to enjoy these tax benefits, donors must consider many factors.

For federal income tax purposes, the charitable deduction of art to a public charity is deductible up to 50% of Adjusted Gross Income (AGI). Donations exceeding the AGI limitation may be carried forward and deducted for up to five years. But arduous requirements around the gift could jeopardize the charitable deduction or reduce the value of the collection. Donors who wish to maximize their income tax charitable donation must carefully follow complex IRS rules. Be sure to engage trusted advisors who can make the process easier to navigate and help ensure that your tax and charitable goals are achieved.

If you are considering leaving art to a not-for-profit organization in your estate plan, it is imperative that you notify the organization while you are still alive to negotiate an acceptable Gift Agreement. Gift

Agreement templates may be readily available online, but it is well worth the expense to engage an experienced attorney or philanthropic advisor to develop an agreement that accurately represents your goals and expectations. Without a carefully negotiated Gift Agreement, the organization could decide your cherished work of art does not fit into its plan and could choose to sell the artwork, which may not be in harmony with your deepest desires for the gift.

Selling Art:

An auction (physical or online) or private sale are options to considered if you, your beneficiaries, trustees or charitable beneficiary decide to sell the art. An auction is a transparent, often public process that exposes art to a bidding audience. In some cases, a private sale is preferred because the parties may want to remain anonymous or avoid publicity. There is a tectonic shift taking place in the art market today as this desire for anonymity and privacy has influenced many high-profile collectors to opt for private gallery sales instead of big auction houses.

The classification of a taxpayer as a collector or an investor is critical to determine tax treatment of the sale of art. But generally, art sale gains held for one year or less are subject to ordinary federal income tax rates as high as 37% plus the Affordable Care Act surtax of 3.8%. By contrast, gains on art held for more than one year are subject to a tax rate as high as 31.8% (28% capital gains tax plus 3.8%). Some important things to take into consideration are the recent repeal of the 1031 exchange rules regarding art and collectibles, and the costs that a seller is often responsible for, such as the sales commission and shipping, as well as taxes. Be sure to consult a seasoned art consultant or tax expert to explore the tax treatment of a particular transaction.

Protecting Your Collection:

Beyond proper physical maintenance - storage, transfer, and restoration – it is also crucial for collectors to adequately catalog, photograph, appraise (including qualified appraisals), and insure. This not only protects your collectibles today but eases future transitions. Many insurance companies insure artwork, but your choice of coverage will depend on the amount and value of your art collection and also the kind of coverage you want. There are two types of art insurance coverage that offer protection for a work of fine art: title and property coverage. Title Insurance insures against a defective title. This type of insurance is important for high-value artworks that have passed through several owners or whose history is unclear. Property insurance, on the other hand, is similar to homeowner's insurance as it insures against theft or damage. If you have a significant piece or collection of art, however, you would likely be better served by a policy underwritten by a separate fine art insurance company. Consult your art or financial advisor to explore the option(s) that are right for your collection.

Transporting Art:

Customs duties, treaties and international agreements on the transfer of cultural goods must be carefully understood and considered. Freeports, which are warehouses in tax friendly jurisdictions, such as Switzerland or Luxembourg (and increasingly in U.S. jurisdictions such as Delaware), have the potential to become important hubs for collectors and their advisors to hold artwork. As the art market is becoming increasingly global in nature, the demand for storage facilities and duty-free zones is likely to increase.

A Love of Art; An Appreciation for Planning:

Your art collection is a unique and personal asset. Beyond building and maintaining a collection, creating a thoughtful plan for its future disposition requires balancing special rules applied to collectibles and the personal and financial realities of you and your family. This requires planning well in advance. When collectors, their families and their team of expert advisors engages in purposeful planning for art collections, they will be well positioned to preserve their collections, ensure a seamless ownership transition, and maintain family harmony.

If you would like to talk about your unique planning needs, please contact the experienced Legacy Family Office team at 239-949-1982 or email us at admin@LegacyFamilyOffice.com.

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