



FEATURE: PHILANTHROPY

By **Conrad Teitell**, **Laura Weintraub Beck** & **Sarah A. Ricciardi**

Deducting Charitable Art Donations

Avoid pitfalls and pratfalls—seize windfalls

Girl With a Balloon by British street artist Banksy was shredded in its frame seconds after the winning telephone bid of \$1.4 million at a Sotheby’s London auction on Oct. 6, 2018. The prank—believed to be arranged by the artist himself—was accomplished by a remote-control device at the back of the frame. The artwork can be restored and is believed to now be worth more than the winning \$1.4 million bid!

Knowing the tax laws on charitable gifts of artwork will avoid the Internal Revenue Service’s shredding claimed charitable deductions. (How’s that for a tie-in?) This is especially true in today’s environment, in which a painting by a living artist can sell for more than a Monet. Just last year, David Hockney’s 1972 painting, *Portrait of an Artist (Pool with Two Figures)*, sold for \$90 million, shattering the prior record of \$58.4 million held by Jeff Koons.¹ With numbers like these, donors must follow the IRS’ requirements to get valuable deductions.

What’s Art?

Like beauty, it may be in the eye of the beholder. For the IRS, art includes “paintings, sculpture, watercolors, prints, drawings, ceramics, antique furniture, decorative arts, textiles, carpets, silver, rare manuscripts,

historical memorabilia and other similar objects.”²

Deductions Primer

The federal government encourages generosity by allowing itemizers to deduct their gifts to charities on their income tax returns. A donor may deduct the fair market value (FMV) of art given to a public charity when the related use test is met.

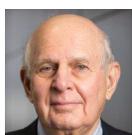
When appreciated art is held for one year or less, the deduction is limited to the lower of the cost basis or FMV.³ And, an artist who contributes her own painting has a deduction limited to the lower of her basis or FMV.⁴ Further, if a donor’s art activity is tantamount to being a dealer, or the FMV of the property is no greater than the property’s cost basis, the deduction is limited to the cost basis.

Related use test. For long-term appreciated gifts of artwork, antiques, books and other tangible personal property, the deductibility rules depend on how the public charity uses the gift.⁵ When the charity’s use of the property is related to its exempt function (for example, a painting given to an art museum or to a school for its art gallery), the donor can deduct the full present FMV.⁶ If the gift is unrelated to the donee’s exempt function (for example, the charity sells the property), the deduction is for the cost basis or FMV, whichever is lower.⁷

For a donor to prove that a gift is related to the donee’s exempt function, she must establish either: (1) the property isn’t in fact put to an unrelated use by the donee, or (2) at the time of the contribution, it’s reasonable to anticipate that the property won’t be put to an unrelated use by the donee.⁸

Fortunately, omniscience by the taxpayer isn’t required. For example, when an item is contributed to a museum that’s of a general type typically retained by the museum for museum purposes, the IRS considers it reasonable for the donor to anticipate, unless she has actual

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knowledge to the contrary, that the item won't be put to an unrelated use by the donee, regardless of whether the item is later sold by the donee.⁹ A letter from the donee stating its intended use is particularly helpful to show that the donor reasonably anticipates that the charity's use will be related.

The IRS won't rule on a fact situation prior to the transaction. For the wary taxpayer, however, there are plenty of private letter rulings on the topic. Keep in mind, however, that a PLR is authority for the recipient, but not for the rest of the world.

In PLR 7751044 (Sept. 22, 1977), the IRS ruled on a taxpayer's contemplated gifts of three sets of lithographs to X Museum, Y Council and Z Foundation. All three donees confirmed in writing that the lithographs would be used to further the appreciation of art by displaying them at their various facilities that cater to disabled children. The IRS ruled that the taxpayer could deduct the full FMV of the lithographs. Based on the charities' written statements, it was reasonable for the donor to anticipate that the lithographs wouldn't be put to an unrelated use by the donees.¹⁰

In PLR 8347062 (Aug. 23, 1983), a retirement center collected paintings, sculpture and graphics for display in its corridors, lounges and other public areas "to enrich and enhance the residents' lives and to provide the stimulation necessary to keep the residents motivated and alert." The donor gave a painting to the center, and the center displayed it in its facilities. The IRS ruled the retirement center's use of the painting would be related to its exempt function of providing care for aged men and women.¹¹

In PLR 8202059 (Oct. 15, 1981), the IRS held that the related use requirement was met when a donor gave his stamp collection to a college because the college planned on exhibiting the collection and had, as part of its curriculum, a course in engraving skills.

Pitfall. A charity's sale of donated property can turn what would otherwise be a related use into an unrelated one.¹² However, if a collection of tangible personal property is contributed to a charity that sells or otherwise disposes of only an insubstantial portion of the collection, the use isn't unrelated.¹³ Under most circumstances, the charity must report on Form 8282 to both the IRS and

the donor if it disposes of the gift within three years.¹⁴

Differentiate between amount deemed contributed and the allowable deduction. Gifts are deductible up to 30 percent of adjusted gross income (AGI), with a 5-year carryover for any excess.¹⁵ The ceiling can be raised to 50 percent of AGI, with a 5-year carryover for any excess if the donor chooses to deduct the gift at its cost basis.¹⁶

Valuation and Substantiation

For a donor to take advantage of FMV deductions, strict, detailed and overlapping valuation and substantiation requirements must be met. And, generally, there's no

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second chance if deadlines are missed or requirements aren't satisfied. Not surprisingly, these requirements become more stringent as the value of the gifts increase. First, to receive a charitable deduction for a noncash charitable gift over \$500 (a piece of artwork, for example), a Form 8283 must be timely filed with the taxpayer's income tax return.

Appraisals. An appraisal is a requirement for all noncash gifts over \$5,000. This requirement also applies when a taxpayer gives "similar items of property" with a total value above \$5,000—even if the items were given to different charities. According to the IRS, "similar items of property" are items of the same generic type, including stamps, coins, lithographs, paintings, books, nonpublicly traded stock, land and buildings. So, if a donor has six paintings worth \$1,000 each and contributes each to one of six different charities, the appraisal rules apply.

The appraisal must be completed by a qualified appraiser. A qualified appraiser may not be related



to—or regularly employed by—the donor or the charitable donee and may not be a party to the transaction by which the donor acquired the property being appraised.¹⁷ Under the current definition, a “qualified appraiser” is an individual who: (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements (established by the IRS in regulations); (2) regularly performs appraisals for which she receives compensation; and (3) can demonstrate verifiable education and experience in valuing the type of property for which the appraisal is being performed.¹⁸

You’re responsible for requesting and obtaining the written receipt from the charity.

An appraisal isn’t a qualified appraisal, even if all the other requirements are met, if the donor either failed to disclose or misrepresented facts, and a reasonable person would expect that this failure or misrepresentation would cause the appraiser to misstate the value of the contributed property.

Generally, no part of the appraisal fee can be based on a percentage of the property’s appraised value. An appraisal fee isn’t a charitable gift. Before 2018, itemizers could deduct appraisal fees as a miscellaneous deduction—together with other miscellaneous deductions—that exceeded a 2 percent of the adjusted gross income floor. The Tax Cuts and Jobs Act of 2017 suspended the 2 percent miscellaneous deduction for 2018 through 2025.¹⁹

If the appraisal is obtained before the gift is made, the gift must be made within 60 days after the appraisal date. The property can be appraised after the date of the gift, but the donor must receive the appraisal by the due date (including extensions) of the return on which the deduction is first claimed. The date of delivery for gifts of artwork is the date the charity receives the property. Both the physical property and title to the artwork must be transferred to the charity to complete delivery.

Last-minute filers beware. If an appraisal is required,

Form 8283 must be signed by the appraiser and by the charity that received the gift.

If the value of the donated artworks totals \$20,000 or more, the return must include a copy of the signed appraisal itself, not just Section B of Form 8283.²⁰ If any single artwork is worth \$20,000 or more, the IRS may ask for an 8 x 10 color photo (or a 4 x 5 color slide) of the donated property.

Practice tip. Even if the gift doesn’t require an appraisal, the donor might want to get one anyway in case she has to convince the IRS of the property’s value. Further, Form 8283 asks how the donor valued her gift.

Substantiation. Though appraisals are only required for noncash gifts over \$5,000, strict substantiation requirements must be satisfied for gifts of any value to be deductible.

An income tax charitable deduction is only allowed for noncash charitable contributions of less than \$250 if the donor maintains for each contribution a receipt from the donee showing: (1) the name and address of the donee; (2) the date of the contribution; and (3) a description of the property in sufficient detail under the circumstances (taking into account the value of the property) for a person who isn’t generally familiar with the type of property to ascertain that the described property is the contributed property.

To deduct a gift of \$250 or more, the donor must have a written receipt from the charity describing (but not valuing) the gift. If any goods or services were given in exchange for the gift, the receipt must describe them and contain a good faith estimate of their value. If the charity provided no goods or services in consideration of the gift, the written receipt must state so.

Donor beware. You’re responsible for requesting and obtaining the written receipt from the charity.²¹

When a receipt is required to substantiate a deduction, the donor must have the receipt in her possession before she files her income tax return. If the return is filed after the due date (or after an extended due date), the receipt must nevertheless have been in the donor’s hand by the due date (plus any extensions).

Artwork Sold at Auction

Sometimes, purchasers of artwork pay a 10 percent buyer’s premium directly to the auction house. This payment is in addition to the hammer price, which is what the item sells for at auction. Whether the buyer’s



premium is includible in the FMV of the artwork has been debated.

In Private Letter Ruling 9235005 (Aug. 28, 1992), a case not dealing with a charitable gift, an estate received the net proceeds of the sale (the total paid by the buyer less the commission paid to the auction house) and reported that amount as the FMV for inclusion in the gross estate. The IRS ruled the FMV of work sold at a public auction is the sales price, including any premium paid by the buyer to the auction house on the purchase. This is a particularly harsh result because an estate doesn't receive the buyer's premium, and, therefore, the premium isn't available for distribution to the beneficiaries.

For charitable deduction purposes, the buyer's premium is less of an issue. As mentioned above, a sale by a charity soon after the gift generally makes the use unrelated. So, the higher FMV (the addition of the 10 percent buyer's premium) won't increase a donor's charitable deduction on a gift of appreciated artwork. Instead, the deduction would be limited to the basis. Suppose, however, that the FMV is less than the basis. In that case, the deduction is for the FMV, and if that value can be increased under the 10 percent buyer's premium rule, the donor would have an argument that the higher FMV should be allowed (as long as it's still lower than the basis).

Post-contribution developments may affect valuation. In *Doherty v. Commissioner*,²² the Dohertys donated a painting to a museum and claimed a \$350,000 charitable deduction, believing that it had been painted by a famous artist. The IRS said the painting was a forgery worth \$100. In computing the painting's value, the Tax Court considered the doubts about the painting's authenticity. The Dohertys appealed, arguing that the Tax Court shouldn't have considered the dispute over authenticity because it didn't arise until after the painting was donated. The U.S. Court of Appeals for the Ninth Circuit affirmed, holding that the facts forming the basis of the authenticity dispute existed when the painting was donated and would have affected the price a buyer was willing to pay for the painting.

The Art Advisory Panel

The Commissioner's Art Advisory Panel (the Panel) reviews appraisals of artwork valued at \$50,000 or more that are submitted on a federal tax return. At stake are income tax deductions for charitable donors and gift

and estate taxes for gifts to family members and other non-charities.

The Panel's primary role is to provide advice and make recommendations to the Art Appraisal Services (AAS) unit in the Office of Appeals for the IRS. In Fiscal Year 2017, the AAS adopted 67 percent of the Panel's recommendations.²³

The Panel consists of museum directors, curators, art scholars and dealers. The Panel's specialty areas include paintings and sculpture, decorative arts and antiques. The Panel has two subcommittees: the Fine Arts Panel, which reviews paintings, sculpture, watercolors, prints and drawings; and the Decorative Arts Panel, which

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reviews items such as antique furniture, decorative art, ceramics, textiles, carpets and silver.

Given today's tight-knit art community, the Panel must take steps to ensure objectivity and taxpayer privacy. Information provided to the panelists doesn't include the taxpayer's name, the type of tax, the tax consequences of any adjustments to the value or who did the appraisal. To minimize the possibility that panelists recognize a taxpayer's entire collection, the artwork is usually discussed in alphabetical order by artist or, in the case of decorative art, by object type. If there's a conflict of interest with a panelist and a work of art under review, the panelist doesn't participate in the discussion and is excused from that portion of the meeting.

Before the Panel meetings, the AAS appraisers send photographs and written materials to the panelists about the works of art under review. The materials include information from the taxpayer's appraisal, such as size, medium, physical condition, provenance, any comparable sales and appraised value and the AAS appraiser's own research, including available information on public and private sales of relevant art work.



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During the Panel meetings, the panelists review the information provided, along with the research and findings of both the panelists and the AAS appraisers. After discussing each item individually, the Panel reaches consensus on the value of a subject work. According to the IRS, the Panel discussions are lively and serious. Despite the different perspectives of dealers, museum curators and scholars, substantial disagreements are rare. When disagreements occur, they generally result from insufficient information. In these cases, the panelists may recommend additional research, such as inspecting the property or consulting with additional experts, before making a recommendation as to value. Once the AAS appraiser completes the additional work, the item may be brought up for review at a subsequent Panel meeting. While the Panel's meetings aren't open to the public, the donor of the artwork under review may ask to see the Panel's notes.²⁴

The Panel's recommendations are strictly advisory. The AAS staff reviews all the Panel's recommendations, which become the position of the IRS only with AAS concurrence.²⁵ Past Annual Reports are good indicators as to the likelihood that the AAS will adopt the Panel's recommendation in certain situations.

The Panel's 2017 Annual Report (the latest report as this goes to press) indicated that in 2017, the Panel reviewed 365 items with an aggregate taxpayer valuation of \$205,433,138 on 66 taxpayer cases under examination.²⁶ The average claimed value for an item reviewed by the Panel was \$562,831. The Panel recommended accepting the value of 143 items or 39 percent of the items presented. It adjusted 222 items or 61 percent of the appraisals it reviewed. On the 222 items adjusted, the Panel recommended total net adjustments of \$28,236,211 to the appraised values, a 13.7 percent increase. The Panel reconsidered two items originally valued at \$2.75 million by the taxpayers and \$7.9 million by the Panel. After reviewing the additional information, the Panel made no revisions to its original recommendations. The items reconsidered weren't included in the above information. The AAS accepted the Panel's recommendations on 245 items.

In an intentional break from prior year reports, beginning with the 2015 Annual Report, the items reviewed and adjusted are no longer broken down to show which adjustments were for estate and gift tax appraisals and which were for charitable contributions. According to the 2016 Annual Report, this format

avoids potential Internal Revenue Code Section 6103 disclosure concerns in situations in which there may be too few items in a particular category (estate, gift or charitable contribution) to report separately.²⁷ In prior reports that gave a breakdown of the adjustments, it was the immutable pattern year after year: The IRS viewed taxpayers' valuations as high for charitable transfers (for which income tax deductions are claimed) and low for noncharitable transfers (on which the IRS wants estate and gift taxes). Not surprisingly, taxpayers saw it the other way around. Although the specific breakdown wasn't given in the 2017 report, we can presume that this view of valuations by the IRS hasn't changed, and the pattern of adjustments continues.

If a donor of a work of art appraised at \$50,000 or more would rather not be surprised by the AAS' determination, she can proactively obtain a Statement of Value from the IRS that establishes the value of art gifts for income, gift and estate tax purposes. By paying a user fee, taxpayers may obtain an advance review of art valuation claims before filing the return. The Statement of Value may then be used to complete the taxpayer's return. The donor must request the Statement of Value after making the gift but before filing a tax return claiming the charitable deduction. The fee is \$6,500 for a Statement of Value for one to three items, plus \$300 for each additional item.²⁸

Next Up

Tune in next month and you'll learn about donating fractional interests in artwork and how to satisfy the stringent (and unforgiving!) rules for deducting them. Not knowing about the dire consequences of failing to meet these tough fractional rules could be dangerous to your client's wealth. For example, a donor who gifts a fractional interest in a piece of artwork and then neglects to gift the remainder of her interest within 10 years must give back all previous deductions plus interest and penalties.

Hang in, and you'll also learn how transferring appreciated artwork to a charitable remainder trust can be a substitute for the no longer available tax-free IRC Section 1031 exchange. With this tool in your belt, you'll help your clients reduce or avoid entirely the dreaded capital gains tax. 

Endnotes

1. Scott Reyburn and Robin Pogrebin, "David Hockney Painting Sells for \$90 Million, Smashing Record for Living Artist," *The New York Times*



FEATURE: PHILANTHROPY

- (Nov. 15, 2018).
2. Revenue Procedure 96-15.
 3. Internal Revenue Code Section 170(e)(1)(A).
 4. The artist's basis would be the cost of canvas, paints and brushes.
 5. See Treasury Regulations Section 1.170A-4.
 6. IRC Section 170(e)(1)(B)(i).
 7. Section 170(e)(1)(B).
 8. Treas. Regs. Section 1.170A-4(b)(3)(ii).
 9. Treas. Regs. Section 1.170A-4(b)(3)(ii)(b).
 10. See also Private Letter Ruling 7911109 (Dec. 18, 1978).
 11. See also PLR 8143029 (July 29, 1981).
 12. See Treas. Regs. Section 1.170A-4(b)(3)(i).
 13. For example, in PLR 9833011 (Aug. 14, 1998), an exempt religious community center solicited art gifts to display at their facilities. The center didn't intend to sell or dispose of any of the artwork except on a limited and infrequent basis—if, for example, the art collection exceeded the available display space or if it would be too expensive to provide security for a particular item. The Internal Revenue Service held that, even though some items could be sold, gifts to the center were deductible at full fair market value.
 14. Treas. Regs. Section 1.6050L-1. The charity, however, doesn't need to report its disposal of an item that the taxpayer certifies is worth \$500 or less. Form 8283 has a section for that purpose (Section B, Part II).
 15. Sections 170(b)(1)(D)(i) and 170(d)(1). Thus, unrelated gifts are deductible up to 50 percent of adjusted gross income, with a 5-year carryover for any excess.
 16. Such an election will then also apply to all gifts of long-term appreciated tangible personal property, securities and real estate. Section 170(b)(1)(C)(iii).
 17. Treas. Regs. Section 1.170A-17(b)(5). There's an exception if the property being appraised is donated within two months of the date of acquisition, and its appraised value doesn't exceed the purchase price.
 18. Section 170(f)(11)(E)(i)-(ii). An individual has education and experience in valuing the relevant type of property, as of the date the individual signs the appraisal, if the individual has: successfully completed (for example, received a passing grade on a final examination) professional or college-level coursework in valuing the relevant type of property and two or more years of experience in valuing the relevant type of property; or earned a recognized appraisal designation for the relevant type of property. Treas. Regs. Section 1.170A-17(b)(2).
 19. The Tax Cuts and Jobs Act of 2017 (PL 115-97).
 20. Likewise, for all gifts valued at over \$500,000, the donor must attach the qualified appraisal—as well as Section B of Form 8283—to his tax return. For purposes of the dollar thresholds, property and all similar items of property donated to one or more charitable donees are treated as one property. An appraisal, however, needn't be attached for contributions of cash, inventory, publicly traded stock or intellectual property. Section 170(c)(1).
 21. See IRS Publication 557 (January 2018), "Tax Exempt Status for Your Organization."
 22. *Doherty v. Commissioner*, 16 F.3d 338 (9th Cir. 1994).

23. www.irs.gov/pub/irs-utl/annrep2017.pdf.
24. See *Bernardo v. Comm'r*, 104 T.C. 677 (1995).
25. When reviewing charitable contributions, Art Appraisal Services not only considers the Art Advisory Panel's recommendations but also the substantiation requirements set forth in the IRC and corresponding regulations.
26. www.irs.gov/pub/irs-utl/annrep2017.pdf.
27. IRC Section 6103 governs the Confidentiality and Disclosure of Returns and Return Information.
28. See Rev. Proc. 2017-1, Appendix A, 2017-1 (Jan. 3, 2017); Rev. Proc. 96-15.



SPOT LIGHT

Happy Hour

Rue de la belle étoile by Elisée Maclet sold for \$1,500 at Bonhams British and European Art auction on March 20, 2019 in London. A French naive artist, Maclet is known for his paintings of Parisian streets. Maclet didn't come from a wealthy family and took on odd jobs to support himself while working to establish a name as an artist. He finally gathered momentum after World War I and remained prominent, even painting while battling with mental illness.