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CHARITABLE GIFT AGREEMENTS

**Fractional Interest Gifts of Art to Museums and
Other Charities**

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1. Reasons for Giving. For various tax and nontax reasons a collector or owner of a work of art may prefer to give a fractional interest in the collection or in a particular work to charity instead of giving 100 percent ownership to charity at one time. Some of these reasons may relate to the collector's desire to implement a long-range plan for the ultimate disposition of a collection while retaining a portion of the use and enjoyment. In other situations the motivating factor may be the desire to develop a program of partial gifts over several years designed to match the donor's income tax charitable deduction limitations.
2. Attitude of Charities. Museums and other charities encourage fractional giving as a means of cultivating certain potential donors and building collections. Fractional giving can be an incentive for other donors who wish to support a museum and enhance the cultural offerings of the locality. Art dealers may encourage fractional giving as part of the original sale as a means of identifying an ultimate repository for the artist's work.
3. Increase in Value. Once a fractional interest has been given to a museum, the work of art may increase in value, thereby entitling the donor to a greater deduction the next time a fractional gift is made. The result could be that by the time the donor has given away the entire item, the aggregate charitable deductions may substantially exceed the value of the work of art at the time of the first gift. The tax savings produced by the charitable deductions may generate sufficient cash flow for the donor to make cash gifts to the charity to cover its costs of the fractional ownership arrangement and to fund other worthwhile activities of the charity.
4. Steps to Take. A fractional interest gift of art entails the following steps, frequently with the assistance of an art strategy advisor in addition to the donor's attorney, the donor's other wealth planning advisors, and the charity's development and curatorial staff:
 - Selection of an appropriate museum, university, or other charity to be the recipient of the gift.
 - Confirmation of a related use by the charity.
 - Determination of the desired income tax charitable deduction and coordination with the donor's income tax planning for the current and succeeding years.
 - Discussion of the details of the co-ownership arrangement with the charity.
 - Consideration of a cash gift to provide funding for the charity's ownership and use.
 - Verification of continued insurance coverage and security arrangements.
 - Execution and delivery of a deed of gift or other gift agreement assigning legal ownership of an undivided fractional interest in the work of art to the charity.

- Completion of the qualified appraisal for the gifted interest and completion of all required tax forms.
 - Review of the donor's estate plan and updating of art bequests for consistency with the gift agreement.
 - Development of a calendar for sharing possession and use of the work of art.
5. Ownership Relationship. The gift creates a tenant-in-common ownership arrangement between the charity and the collector.
- Each is entitled to possess and use the work of art based on the party's proportionate ownership.
 - More than one charity may own a fractional interest in the one or more items in the collection.
 - An agreement between the parties details the terms of the co-ownership arrangement.
 - Expenses such as insurance and shipping require special attention.
 - Sales proceeds are shared proportionately based on the actual ownership at the time the work of art is sold.
6. Terms of Gift. Generally, the following subjects should be addressed in the deed of gift or gift agreement.
- Responsibility for insurance, security, packing and shipping, condition reports, and curatorial work.
 - Consequences if damage occurs to the collection or item.
 - Nature of any copyright and permission to make and sell copies of the work.
 - Conditions of the gift such as inclusion in special exhibitions.
 - Collaboration over use and exhibitions if two or more charities own an interest or if the donor's remaining interest is to be loaned to another charity.
 - Editorial control over publicity concerning the gift and catalogs that include references to the gifted item or collection.
 - Loans by the donee institution to other institutions.
 - Binding nature of the ultimate gift of donor's remaining ownership percentage.
 - Gift-over provisions when appropriate.
7. Tax Rules. The following is a summary of the tax rules applicable to fractional gifts of art or other tangibles to charity.

Income Tax Charitable Deductions

- A donor who itemizes deductions is entitled to an income tax charitable deduction for contributions to qualified charitable organizations.
- Certain higher income taxpayers must reduce their itemized deductions by the lesser of three percent of the excess of their adjusted gross income over a certain dollar amount (as adjusted for inflation each year) or 80 percent of the amount of itemized deductions otherwise allowable for the tax year.

- If the gift is to a "50 percent-type" organization (for example, universities, hospitals, and other broadly supported charities), the donor is generally entitled to deduct the full amount of the contribution up to 50 percent of the donor's adjusted gross income (the "50 percent ceiling" rule).
- For gifts to a "50 percent-type" organization of capital gain property held more than one year that has appreciated, the donor may deduct the full fair market value of the gift up to 30 percent of the donor's adjusted gross income (the "30 percent ceiling" rule).
- If the gift is of related use tangible personal property, the full fair market value deduction is subject to the 30 percent ceiling. An election is available to use the 50 percent ceiling, but the deduction is limited to the lower of basis or fair market value. If the use is unrelated to the charity's exempt function or if the item has not been held more than one year, the deduction is limited to the lower of basis or fair market value and the 50 percent ceiling applies.
- Generally no charitable income tax deduction is allowable for a gift of a partial interest in property (that is, a gift of less than the donor's entire interest in the property); however, a special exception is made to allow the deduction for an undivided portion of the donor's entire interest in the property (for example, a gift of a 25 percent interest as a tenant in common in the property).
- A five-year carry-over applies to any portion of a charitable deduction that cannot be deducted because of the percentage limitations.

Estate and Gift Tax Deductions

- Generally, contributions to organizations that qualify for the income tax deduction qualify for the estate and gift tax charitable deductions.
- For estate and gift tax purposes there are no limitations on the amount of the deduction for qualifying contributions.
- There is no related use requirement for tangible personal property for either the estate tax or the gift tax charitable deduction.

Value of Fractional Interest

- Contrary to the valuation discount rules that apply to noncharitable gifts, the amount of the charitable deduction for the gift of an undivided fractional interest generally equals a corresponding percentage of the full fair market value of the entire property.
- *Winokur v. Commissioner*, 90 T.C. 733 (1988), involved the gift of an undivided interest in 44 works of art to the Carnegie Institute which elected not to exercise its right to take possession. An undiscounted percentage was allowed because the charity had the right to possession, dominion, and control for the specified period of time.
- Regulation section 1.170A-7(b)(1) states that a charitable deduction is allowed under section 170 if the charity "is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in the property." Regulation section 1.170A-7(d), Example 2 deals with the gift of a half interest in 100 acres of land, states that the value of the

contributed property is \$50,000, and holds that the taxpayer is allowed a deduction for his charitable contribution of \$50,000. The example does not specify the fair market value of the entire 100 acres.

- Rev. Rul. 57-293, 1957-2 C.B. 153, holds that the allowable income tax charitable deduction for an undivided present interest in a work of art is a percentage of the whole value. Presumably the same result applies for purposes of the gift tax charitable deduction. For estate tax purposes, no discount should apply if the retained interest is left to the same charity. If a discount does apply to the value of the retained fractional interest, the value included and the value bequeathed to charity should be the same and result in a wash. See *Scull v. Commissioner*, T. C. Memo. 1994-211, where decedent's 65 percent undivided interest in an art collection was discounted by five percent to reflect uncertainties involved in any acquisition of the interest as a result of a divorce action on appeal at death.
- PLR 9218067 involved a donor's contribution of art to a museum where the museum did not immediately take possession of the gift because the museum was not to open until one year after the execution and delivery of the deed of gift. The donor retained and displayed the art in her home. The ruling found that the gift was not a future interest and could be deducted under section 170 because the museum was entitled to possession. The agreement between the parties did not result in a reservation by the donor of a present right of possession. Citing *Winokur*, the ruling states that a donee's failure to exercise a right of current possession does not convert a present interest to a future interest even if the donee cannot put the property to use immediately.
- PLR 9303007 ruled that the gift of an undivided fractional interest equals the product of the fraction times the fair market value of the entire work of art. The gift-loan agreement imposed conditions on the charity with a reverter in favor of the donor or his heirs, but chance of reversion was considered so remote as to be negligible.
- PLRs 200223013 and 200223014 involved donations of fractional interests in art to a museum pursuant to detailed gift and loan agreements. The rulings hold that any works of art in the collections accepted by the donee museum subject to the agreements will qualify for an income tax charitable deduction and that the value of the gift and the charitable deduction will be the fair market value of the artwork multiplied by the fractional interest that is transferred to the Donee.

Substantiation, Reporting, and Appraisals

- No income tax charitable deduction is available for a separate contribution of \$250 or more unless the taxpayer has a written receipt or other acknowledgment from the charity (which must be received before the tax return claiming the deduction is filed) of the contribution (including a good faith estimate of the value of any goods or services provided to the taxpayer in exchange for making the gift).
- To claim an income tax deduction for a contribution of property (other than cash) valued at more than \$500, the donor must obtain a receipt from the donee organization showing the name of the donee, the date and location of the contribution, and a description of the property in reasonably sufficient detail. The donor must also complete and file Section A of Form 8283 with the Internal Revenue Service.

- If the contributed property (other than cash or publicly traded securities) has an aggregate value in excess of \$5,000 (\$10,000 in the case of nonpublicly traded stock), the donor must obtain a qualified appraisal of the property. In addition, the donor must complete the appraisal summary on Form 8283.
- In the case of a gift of artwork with an aggregate value of \$20,000 or more, a complete copy of the signed appraisal must be submitted with Form 8283. An 8" x 10" color photograph must be provided upon request.
- For art valued at \$50,000 or more, the donor may request a Statement of Value for that item from the IRS. This must be done before filing the income tax return that reports the donation. The request must include the following:
 - A copy of a qualified appraisal.
 - A \$2,500 check or money order payable to the IRS for the user fee that applies for one, two, or three items of art (additional \$250 for each item in excess of three).
 - A completed appraisal summary (Section B of Form 8283).
 - The location of the IRS District Office that has examination responsibility for the donor's area.
- The request may be withdrawn at any time before it is issued, but the user fee is forfeited.
- If the IRS declines to issue a Statement of Value, the IRS will refund the user fee.
- Although the authenticity of the donated art must be determined by the appraiser, certificates of authenticity may be useful, depending on the genuineness of the certificate and the qualifications of the authenticator.
- Physical condition and the extent of restoration are important items in the valuation of art. Because these have a significant effect on the value, they must be fully reported in the appraisal.
- More weight will usually be given to an appraisal prepared by an individual specializing in the kind and price range of the art being appraised. Their opinions on the authenticity and desirability of such art are usually given more weight than the opinions of more generalized art appraisers.
- If, within two years after the gift, the donee charity sells property for which an appraisal summary was filed, the charity must report the sale on Form 8282.

Penalties

- A donor is subject to an "accuracy-related penalty" of 20 percent of the portion of understatements of tax to which the penalty applies and which is attributable to "substantial" understatements of income tax, valuation overstatements, and negligence.
 - The charity is subject to a penalty for the failure to file a timely, complete, and accurate Form 8282.
8. Conclusion. Although the art legacy and other nontax reasons for a fractional gift may far outweigh the tax reasons, the process usually begins with a focus on lifetime income tax planning and ends with an estate tax charitable deduction at death.

9. Case Study for Discussion. Collector has a small collection of abstract paintings by Canadian artists with a fair market value of \$1 million and a basis of \$150,000. Collection is increasing about 20 percent a year. Collector is approached by Development Officer for a pledge to Museum's capital campaign of \$75,000 over the next 3 to 5 years. Collector consults his tax advisor who points out that his cash flow is already suffering and the sale of a painting would generate a federal capital gain taxed at 28 percent. After hearing this, Development Officer suggests a fractional gift. Collector likes this and gives a 1/4th interest in the collection to Museum and claims a \$250,000 deduction which saves him about \$90,000 in income taxes at the outset, assuming gross income of approximately \$800,000. This gives him sufficient available cash to pay the \$75,000 pledge over the next three years in addition to an up-front gift of \$10,000 to defray Museum's cost of fractional ownership, leaving \$5,000 to cover the modest fee charged by Collector's tax lawyer.

10. Bibliography and Resources.

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- IRS Publication 561, Determining the Value of Donated Property.
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- *Guide to Tax Benefits For Collectors, Dealers & Investors*, Third Edition by Robert Persky, The Consultant Press, NY, 1998, softbound, 256 pages, 8 1/2 by 11 inches, \$49.95. Available from The Consultant Press, 163 Amsterdam Ave. #201, NY, NY 10023 or call 1-212-838-8640.
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