

# Contributing Your Art to Charity: The Tax Benefits May Surprise You

~ Ric Gregoria & Elizabeth P. Diaz

## Donate Your Art in Lieu of Cash

Sarasota has grown into a nationally recognized center for the visual arts. This has been achieved through the commitment and generosity of individuals and organizations that have made charitable donations of time, money, and even works of art from their own collections. Most donors understand the tax implications of a charitable donation when it takes the form of cash or check, but many do not fully understand the tax implications of donating works of art in lieu of cash. If you want to make a donation of art, you need to consider many factors—and your donation must meet several requirements—to maximize the benefits of donating art during your lifetime. The tax consequences of your gift change, depending on the property's past ownership, the gift's intended use, and the charity's structure.



## Capital Gain vs. Ordinary Income Property

The income tax benefits to you, the donor, depend on how long you have owned the artwork before you make the gift. To maximize the tax deduction for art donations, the art must be long-term capital gain property. This generally means you have held the property for more than one year and it has appreciated in value during that time. A donation of long-term capital gain property has the potential to create a deduction equal to your property's fair market value at the date you make the gift.

A donation of ordinary income property may result in a smaller income tax deduction than a gift of long-term capital gain property. Ordinary income property is property that (i) you held for less than one year, (ii) you created, (iii) you received from the creator, or (iv) you, as an art dealer, held as inventory. A donation of ordinary income property generally results in a tax deduction equal to the property's fair market value less the amount ordinarily taxable to you if you were to sell the property at fair market value. This rule normally limits your charitable deduction to your tax basis in the property (or its original cost).

### Structure of the Donee Organization Matters

When you decide to donate a work of art, you should also consider which charitable organization will receive the artwork, because the structure of the organization governs your tax deduction. Generally, there are three types of charitable organizations: public charities, private operating foundations, and private non-operating foundations.

Public charities generally receive broad support from the general public and include churches, schools, hospitals, museums, and nonprofit groups that are religious, educational, scientific, or literary in purpose. Private foundations, on the other hand, both operating and non-operating, are not funded by the general public but instead are funded by one source, such as a family or a single donor. A private operating foundation invests and uses most of its assets directly for the active conduct of its own exempt purposes, while a private non-operating foundation uses most of its assets for other charitable organizations. You can confirm the type of the organization (i.e., public charity, private operating foundation, or private non-operating foundation) and its current exempt status through the online search engine Exempt Organizations Select Check on the IRS website ([www.irs.gov](http://www.irs.gov)).

In order to maximize your income tax charitable deduction, typically you should donate works of art to public charities or private operating foundations rather than to private non-operating foundations. Generally, when you donate cash to a public charity or a private operating foundation, you may deduct the full fair market value of your donation (up to 50 percent of your adjusted gross income). However, when you donate a work of art to a public charity or private operating foundation, you have two options: (i) you may deduct the fair market value less your tax basis in the work of art (up to 50 percent of your adjusted gross income) or (ii) you may elect to deduct the full fair market value of the work of art (but your deduction is limited to 30 percent of your adjusted gross income). When you make a gift of art to a private non-operating foundation, the deduction is limited to your tax basis in the artwork (and further capped by 20 percent of your adjusted gross income).

### Use of the Property by the Charity

You must also consider how the recipient charity intends to use the work of art. To maximize your income tax charitable deduction, the gift must pass the "related use" test. The related use test requires that the charitable organization use the artwork in a manner that is related to the organization's charitable purposes. For example, if you contribute a painting to Ringling College of Art and Design to be used by the institution for educational purposes by being displayed in its library to be studied by art students, then the use is a related use. However, if your painting is sold by Ringling College and the proceeds are used by the organization for educational purposes, its use is an "unrelated use."

If the charitable organization uses your work of art for an unrelated use, your income tax charitable deduction is limited to your tax basis in the art (or its cost), even if the charitable organization is a public charity or a private operating foundation. Accordingly, we recommend that you work with qualified legal counsel to draft a gifting agreement before making any gifts. The agreement should include provisions covering the donee's charitable status, the donee's intended use of the property at the time of the contribution, and your intent for the contribution. This type of agreement can help you maximize your tax benefits from making a charitable gift of art.

#### What if You Want to Continue to Enjoy Your Art?

Rather than donate your painting so that it is on permanent display in Ringling College's library, you may want to donate your painting for a portion of the year and retain the right to use the painting for the remainder of the year. This is known as a "fractional contribution" to charity. As with an outright contribution to charity, your charitable deduction for a fractional contribution to charity is based on the fair market value of the painting at the time of the contribution, taking into account whether the use of the painting will be related to the charitable organization's exempt purpose. For example, let's assume your painting is worth \$200,000 at the time you wish to donate it. If you were to donate an undivided one-quarter interest in your painting to Ringling College, you may be eligible for a \$50,000 ( $\$200,000 \times \frac{1}{4}$ ) income tax charitable deduction for the year of donation, assuming all of the other requirements are met, and you would still be able to enjoy your painting in your home for nine months of each year.

While fractional gifting presents an attractive charitable option that benefits you, the charitable organization, and the viewing public, it requires careful planning in order to ensure that you maximize your income tax charitable deduction and avoid any potential problems. Such problems may include:

- Who will pay for insurance on the work of art?
- Who will pay for the cost of transportation?
- What happens if the work of art is damaged?
- Which months will the charity be entitled to possession and which will be reserved for your use and enjoyment?

#### Don't Forget to Keep Records

You must complete IRS Form 8283 if the amount of your deduction for non-cash gifts is more than \$500. As with other non-cash donations, donations of art do not require a qualified appraisal unless the income tax charitable deduction is greater than \$5,000. If your deduction is more than \$5,000, you should obtain a qualified appraisal of your work of art by an unrelated qualified appraiser no earlier than 60 days prior to the gift date. The cost of an appraisal is not included as part of your charitable donation, but it may qualify as a miscellaneous deduction, subject to the 2 percent limit of your adjusted gross income. In addition, you may also request a Statement of Value from the Internal Revenue

Service's Art Appraisal Service, which you can rely on in filing your federal income and gift tax returns to substantiate the value of your work of art and the amount of your income tax charitable deduction. The request costs approximately \$5,400 for one to three items (\$270 for each additional item) and generally applies to a work of art that has been appraised at \$50,000 or more. Each Statement of Value is binding on the IRS but not on you, unless you agree to use it.

While gifting a work of art requires more careful consideration than does a cash contribution, a donation of this kind can provide not only an immediate income tax charitable deduction and the avoidance of capital gains tax, but it can also provide a lasting legacy for a charitable organization of your choice.



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