



Contributing Appreciated Non-Cash Assets to Charity: Art

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Philanthropically minded art collectors can receive potential tax-advantages and other strategic benefits by donating art to charity. Contributing art to a 501(c)(3) charity (including donor-advised funds) may provide collectors with the ability to 1) potentially eliminate capital gains tax on the sale of the art; 2) take a same-year tax deduction for those who itemize; 3) time their donation for charitable support during their lifetime; and 4) minimize estate tax implications.

With thoughtful planning, the contribution of art to a donor-advised fund can provide support for a collector's charitable objectives by freeing up funds to support charitable causes over time and ensuring that charities receive the most money possible.

Charitable Deduction and Related Use:

When calculating the charitable deduction, a special rule applies to donations of art called the "related use" rule. If the art is donated to a charity that does not use art as part of its charitable purpose (typically most charities other than museums), the donor may only be able to deduct the lesser of cost basis or fair market value for tax purposes. If the art was received as a lifetime gift from the artist, the donor may only be able to deduct the cost of the materials used to create the art.

Potentially Minimize Capital Gains

Artwork owned by a collector or artwork that has been inherited and held for more than one year that has appreciated in value qualifies as a "collectible" under the Internal Revenue Code and is considered a capital asset. When sold by the owner, capital gains tax is typically owed on the difference between the current fair market value and the owner's cost basis. However, if prior to sale, the owner contributes appreciated art to a public charity (including a donor-advised fund), the collector potentially eliminates the capital gains tax that would otherwise be incurred in a sale resulting in more to give to charity.

For collectors, the cost basis is what the collector paid for the artwork. For inheritors, the cost basis is the fair market value of the artwork as of the date of the previous owner's death. The maximum collectible capital gains tax rate is currently 28%

and the Affordable Care Act layers an additional 3.8% Medicare surtax on top of unearned income bringing the total tax consequence to 31.8%.

Receive current year federal income tax deduction

When donating art to charity, collectors may receive a current year charitable income tax deduction subject to the "related use" rule described above, if they itemize. If the art is donated to a public charity (including a donor-advised fund) that does not use art as part of its charitable purpose, collectors may deduct the lesser of cost basis or fair market value up to 50% of their adjusted gross income (AGI) and carry the deduction forward for up to five years. If the art is donated to a private non-operating foundation, the related use rule also applies but the deduction is limited to 30% of AGI.

For collectors, artwork is generally considered capital gain property if it is held for longer than one year and cost basis is typically the purchase price. For inheritors, the cost basis is stepped up to the fair market value as of the date of the previous owner's death. If the art is donated shortly after inheritance, the cost basis could be the same as the fair market value on the date of donation. Inherited capital gain property is considered a long-term gain asset regardless of the actual holding period.

If collectors and inheritors sell the art and then contribute the proceeds to a donor-advised fund, they may be able to deduct the full fair market value of the net sale proceeds up to 60% of their AGI with a carry forward of five years. However, they will be required to recognize and pay income tax on the capital gains described above.

Timing of Contributions

Contributing art to a donor-advised fund can potentially allow a collector to maximize the tax benefits of charitable giving as well as ensure that the recipient charities receive the most money possible. The funds from the sale of the contributed art can be invested to potentially grow over time and be granted to charity at the donor's convenience.

Minimize Estate Tax Implications

Artwork owned at death is included in the estate. If a collector is philanthropically minded and plans to leave a bequest to charity after their lifetime, utilizing an art collection rather than liquid funds may be a better choice as the collector's family will not need to handle insurance, maintenance, and/or the sale of the art if they don't plan to keep it.

If the value of the collector's estate exceeds the current exemption amount of \$11.2 million* per person the excess is taxed at a top federal rate of 40% plus any state inheritance or estate taxes that may apply.

As with other charitable contributions upon death, the contribution not only removes the value of the art from the collector's estate, it can provide assets for the next generation to use for philanthropic purposes.

Selling the art first to maximize a charitable deduction:

In some cases where the need for a charitable deduction outweighs the importance for minimizing capital gains tax, it may make sense

to sell the art, recognize the income and offset it by making a charitable contribution to a donor advised fund. This allows the art collector to possibly maximize their tax situation while unlocking art for charitable dollars.

Appraisal Considerations:

Collectors and inheritors wishing to donate artwork should note that the IRS requires a qualified appraisal for claimed deductions of \$5,000 or more. Additionally, the IRS will typically give more weight to an appraisal if the qualified appraiser specializes in the specific type of artwork donated. Donors must attach a complete copy of the signed appraisal to the tax return and photo documentation for claimed deductions of \$20,000 or more. The appraisal may be completed within 60 days of the contribution up until the donor files his or her tax return for the year of contribution, including extensions.

Case Study:

THE COLLECTOR: Trimming a collection in order to give back

Johann has built a collection of German abstract art over 40 years. As a young collector, his focus was much different, and his early acquisitions no longer fit the current goals of his collection. When considering the sale of some of these early buys, Johann is also considering his desire to provide charitable funding for various non-profits that support young artists from underserved neighborhoods. He thinks about how the proceeds from one or two pieces of his collection could be used to fund these types of initiatives. Johann is also mindful of the tax considerations connected with gifts of art and wants to fund a giving vehicle that can realize the maximum proceeds from the sale. Using a donor-advised fund as a giving vehicle can provide Johann with:

- Simplified conversion of artwork into philanthropic assets
- Tax benefits to realize maximum charitable value from the sale including the potential elimination of capital gains tax on the sale of the art and the ability to remove the value of the art from his taxable estate
- An investment account for flexible granting to his favorite charities over time
- The ability for the growth over time of proceeds from sales of his artwork for additional charitable impact

* The federal estate tax exemption is adjusted for inflation. The estate tax exemption for 2018 is \$11,180,000.

Art owner	Sell art and donate proceeds to charity	Donate art directly to charity
Asset Value (FMV)	\$1,000,000	\$1,000,000
Capital Gains (100% Long-Term)	\$950,000	\$950,000
Capital Gains Tax and Expenses Paid	\$366,000 [†]	\$124,000 [§]
Value of Gift to Charity	\$634,000	\$1,000,000
Available to Grant	\$634,000	\$876,000
Donor Total Tax Savings	\$234,580 [‡]	\$284,500 ^{**}

[†] Hypothetical, for illustrative purposes only. Assumes sales expenses of 10% to include transportation, insurance, and auction fees, cost basis of \$50,000, that the art has been held for more than a year and that all realized gains are subject to the 28% federal long-term capital gains tax for collectibles. Does not take into account any state or local taxes.

[§] Assumes 12.4% for expenses related to transportation, insurance, liquidation, and auction fees, paid after contribution to charity.

[‡] Reflects the charitable income tax deduction based on the charitable gift of \$634,000 and assumes a 37% federal income tax rate.

^{**} Reflects the capital gains tax avoided plus a charitable deduction based on the cost basis of \$50,000, assuming no related use of the art.

A note for artists:

If the donor of the art is the creator of the art or received the art as a lifetime gift from the creator, art is considered an ordinary income asset, not a capital asset. The donor may only deduct the cost of the materials used to create the art because

proceeds from the sale are considered to be ordinary income. The cost basis of the art is based on the cost of the materials used to create it. If the art is gifted to someone during the artist's lifetime and the art is then sold by that recipient, the seller not only shares the artist's cost basis, the proceeds of the sale are considered ordinary income.

For more information:

Call Schwab Charitable: 800-746-6216

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Gifts of appreciated privately held business interests can involve complicated tax analysis and advanced planning. The above article is meant only to be a general overview of some of the considerations and is not intended to provide tax or legal guidance. If you would like to consider a donation, please consult with your qualified legal or tax advisor.

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