

Fiduciary Perspective

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ESTATE PLANNING FOR ART, ANTIQUES AND PERSONAL PROPERTY: *Considering the financial and emotional value of your personal property*

Introduction

Fiduciary Trust Company counsels numerous families in the management and generational transfer of their financial assets. While most estate plans deal with the disposition of financial and real property assets, we've found that many do not comprehensively address the disposition of tangible personal property. Tangible personal property generally includes all of one's physical property, excluding real property and financial assets. Examples are works of art, furniture, sterling silver, porcelain, rare stamp and coin collections, and tapestries.

In addition to the financial value of tangible personal property, which in some cases can be significant and may impact estate planning objectives, many items of tangible personal property have considerable emotional value to the extent that they are comprised of family heirlooms or otherwise reflect family history. Therefore, we believe that developing a comprehensive plan for the disposition of tangible personal property should be an integral part of our clients' estate planning.

First Steps

Understanding the value of your tangible property is necessary before developing a succession plan for your art, antiques and other tangibles. In some cases, clients are very aware of the value of items they have acquired or inherited. In others, we have witnessed the surprise of family members inheriting items that no one knew were rare or of significant value. Many people believe that their most valuable possessions are the large or more obvious items such as artwork, antique furniture, sterling silver, crystal and fine china. But what else might be hidden in the attic?

In settling estates, we frequently encounter situations like the following: A woman passed away after having lived most of



Source: Skinner, Inc.
Rare Queen Anne Japanned Maple and Pine High Chest
of Drawers signed "Rob Davis" Boston, 1735-39.

her life in a home that had been in her family for several generations. In order to properly value the estate's tangible property, we retained a qualified appraiser to determine the value of the contents of the home. The home contained many items of furniture, rugs and artwork of obvious quality and value. When the appraiser inventoried the attic, however, we found many more items of significant value that

had been passed down through the generations, includ-

ing an antique cast iron doorstep, a collection of *Steiff* stuffed animals and several pieces of Venetian glass.

We recommend obtaining an appraisal from a qualified independent appraiser to establish the value of your tangible property. These specialists can often separate the folklore from the facts and determine whether the antique chest actually came with the family's ancestors on the Mayflower. Or not. They can also tell whether the oil painting purchased from the gallery on Nantucket 30 years ago has risen in value. Or not. Independent appraisers can help clients understand the present value of items of tangible property. In estate planning, it is

important to know the value of your tangible personal property. If this property is worth more than you originally thought, your estate may bear an additional estate tax liability, which could in turn affect the planned disposition of your other assets.

The IRS Also Takes Notice

The Internal Revenue Service (“IRS”) has specific requirements for when qualified appraisals must be obtained and submitted. The general rule for federal estate, gift and income taxes is that transferred property is to be valued at fair market value. For estate tax purposes, an appraisal of items must be submitted with the estate tax return where any one item is valued at more than \$3,000 or where any collection of similar items is worth more than \$10,000. With respect to donated property for which the donor is seeking a charitable income tax deduction, an appraisal must be submitted with the tax return reporting the transfer if the value of the property is more than \$5,000.

Tax returns that report a gift of any item of art or furnishings with a value of \$20,000 or more are referred to the Internal Revenue Service Art Advisory Panel. The Art Panel consists of approximately 20 art experts, including curators, dealers and auction house representatives, who meet several times a year to review art appraisals submitted to the IRS. Based upon the recommendations of the Art Panel, the IRS regularly makes adjustments to valuations contained in submitted appraisals. Adjustments usually come when the Panel concludes that an appraisal has exaggerated the value of artwork contributed to charities or placed too small a value on artwork left to heirs. According to *The Chronicle of Philanthropy* (March 23, 2006), the Art Advisory Panel disagreed with almost one-fourth of the appraisals submitted in 2005 and recommended adjustments totaling more than \$62.9 million!

Estate Planning for the Emotional Value

After taking the first step of determining the financial value of your tangible property, it is important to ensure that your estate plan accommodates the disposition of items of familial importance, which may have emotional value to you and those to

whom such items may be bequeathed. As such, further reflection on the disposition of personal property should be considered. The often seen generic tangible personal property clause, *I give all my tangible personal property to my surviving spouse, or if my spouse does not survive me, to my children in equal shares*, may not be sufficient. Your will might also then refer to the possibility of leaving a memorandum expressing wishes as to the disposition of specific items.

The Smith Family (Fictionalized but based upon real circumstances)

Consider the following estate planning scenario that is similar to situations we often encounter with our clients. It is an example of successful estate planning.

The Art Advisory Panel disagreed with almost one-fourth of the appraisals submitted in 2005 and recommended adjustments totaling more than \$62.9 million!

Mr. Smith, a widower, desired that all of his property be shared equally among his four sons, with the caveat that certain items would be distributed to individual sons having greater appreciation for them. The items of tangible personal property within the Smith estate were spread across three homes and included valuable artwork (including several original paintings by renowned maritime artist John

Stobart), musical instruments, crystal and china, a rare collection of backgammon and chess sets, which had been collected from around the globe, and many fine furnishings.

Mr. Smith’s estate plan acknowledged the emotional value of these items of tangible personal property by bequeathing them to the legatees who would have the greatest appreciation and stewardship of such items. For example, Mr. Smith’s plan specifically bequeathed his maritime artwork to his son who is an avid sailor and most appreciates the maritime history of Westport Harbor, Massachusetts that is presented in John Stobart’s historical maritime paintings. For another son who is a professional pianist, Mr. Smith specifically directed that he receive the family’s Steinway Louis XV grand piano. For his two daughters-in-law, Mr. Smith bequeathed specific items of jewelry belonging to his late wife.

In order to fulfill his objective that all of his sons share in his estate equally while also directing that certain sons should

receive specific items, Mr. Smith's estate plan included an important equalization clause. This clause provided that the value of the tangible items specifically bequeathed would be considered and equalizing distributions of cash made to his sons if necessary. This planning ensured that the disposition of Mr. Smith's tangible property furthered the continued familial stewardship of certain assets while providing an equal division of Mr. Smith's estate among the legatees.



Source: Skinner, Inc.

Painting by Fitz Hugh Lane, View of West Beach, Beverly, Massachusetts, c. 1863

Understanding the Tax Consequences

An overall estate plan for the transfer of wealth from generation to generation may combine both regular and systematic lifetime gifts as well as transfers at death. In reviewing your personal property, you may also decide to sell certain items. In all instances, certain tax consequences will result and should be considered as part of any plan.

S a l e s

The gain on any sale of tangible assets is subject to income taxes. The income tax consequences vary depending upon at least two factors. The first factor is your tax basis. If you purchased the item, your basis will equal the purchase price. If you received it by gift, your basis generally will be the donor's basis "carried over" to you. If you inherited it, your basis will be the value of the item as reported on the decedent's estate tax return. Once the tax basis has been determined, the second factor affecting the tax consequences is the tax rate. The rate of tax is determined by the character of the gain being reported. Any gain on the sale of an item will qualify for long-term capital gain

treatment if you have held it for more than one year. If you received it by gift, your holding period will include the period of time it was held by the donor. If you inherited it, you will be considered to have a holding period of more than one year. However, if the objects sold are within the category of "collectibles," they will not be taxed at the lower capital gains rate of 15%, but instead at a higher rate of 28%. "Collectibles" are defined by the IRS as (a) any work of art; (b) any rug or antique; (c) any metal or gem; (d) any stamp or coin (with some exceptions); (e) any alcoholic beverage; or (f) any other items of tangible personal property specified by the IRS.

G i f t s t o I n d i v i d u a l s

Tangible assets can be included in a lifetime gifting plan and gifts of these assets, or fractional shares thereof, can qualify for federal annual and lifetime gift tax exclusions. The amount of the gift will be the fair market value of the property transferred at the date of gift, and in many cases, an appraisal will need to be obtained for this purpose. These lifetime gifts may be subject to gift taxes if they are not gifts to qualifying charitable organizations. However, you can plan to avoid these taxes through the use of annual gift tax exclusions and your lifetime gift tax exemption. For 2006, the annual gift tax exclusion is \$12,000 per donee. Your lifetime exemption is \$1 million and is in addition to annual exclusions.

The drawback of lifetime giving to individuals is the recipient will receive a cost basis in the property equal to the donor's. This carry-over cost basis rule creates a significant disadvantage to gifting valuable tangible assets during life, as the recipient's later sale of an appreciated gift of property may generate a sizable income tax on the gain.

Gifts of tangible property to individuals may also be made upon death under the donor's will. As previously mentioned, this can be done by leaving your executor a separate memorandum. You could amend such a memorandum anytime to accommodate changes in your thinking or other circumstances without having to go through the formalities of executing a codicil to the will. Although such a memorandum would not be legally binding, your executor most likely would follow it in administering your estate.

Alternatively, your will could provide that specific items will go to specific beneficiaries. An advantage of such specific

bequests is that they are legally binding. You might consider combining a limited number of specific bequests for key items with a class bequest for your remaining possessions. If you include specific bequests in your will, you might include an equalization clause under which cash would be distributed to your beneficiaries to compensate for the disparate values of bequeathed property items.

Gifts to Charity

The income tax charitable deduction for a gift of artwork or tangible personal property to a charity during the donor's lifetime depends on whether the charity's use of the property is determined to be 'related' or 'unrelated' to its charitable purposes. Obvious examples of 'related' gifts are a gift of artwork to a museum or a rare book collection to a library. If the gift is related to the donee's charitable purpose, the donor will receive a deduction equal to the fair market value of the property at the date of gift. This deduction will be limited to 30% of adjusted gross income, and any excess can be carried forward as a deduction for five years.

If the gift is unrelated to the donee's charitable purpose, the donor is only entitled to a deduction equal to the donor's cost basis in the property. The deduction is limited to 50% of adjusted gross income and a five-year carry forward is available. In all circumstances, donations valued in excess of \$5,000 must be substantiated by a qualified appraisal dated within 60 days of the donation.

A charitable gift technique known as 'fractional gifting' has become increasingly popular with those families who own and wish to donate a valuable piece of artwork or large collections of artwork. Using an example of a single piece of artwork, a donor would gift to a museum a fixed percentage of the piece, say 50% of a piece now worth \$1,000,000. With the 50% fractional gift, the museum is entitled to hold and display the piece for six months each year. The donor, in turn, receives a current income tax deduction of \$500,000 and also continues to have the right to hold and display the artwork in his or her home for six months of each year.

There are several tax advantages to making a fractional gift. If the charitable deduction in making a gift of the entire artwork

would exceed the IRS deduction limits (though the unused portion can be carried forward for five years), gifting the artwork in stages can be helpful in maximizing the charitable deduction. With each subsequent donation, the gift must be reappraised. If it is anticipated that the artwork will appreciate in value, a higher charitable deduction will result. Gifts of tangible property to charity can also be made upon death under the donor's will. Although the fair market value of the item will be included in the value of the donor's gross estate for estate tax purposes, it will be offset by a charitable deduction of equal amount.



Source: Skinner, Inc.
Gibson Mandolin, c. 1920

Last Thoughts

It is important to understand the value of your tangible assets and develop a meaningful plan for the disposition of those assets. While you need to understand the financial value of your art, antiques and collectibles, it is important to consider the tax implications and emotional value of these items to your heirs. A plan that considers the emotional as well as financial implications of specific gifts can make for a smoother distribution of estate assets.

The *Perspective* is a Fiduciary Trust publication in which its professionals share their best thinking on timely wealth management topics. This commentary was authored by Stacy K. Mullaney, Esq., Vice President and Trust Counsel, who specializes in income and estate tax and other financial planning issues.

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