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TAX IMPLICATIONS OF SELLING, DONATING, OR LENDING ART

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With works of art commanding record prices, today's art market has become a boon for sellers, who stand to realize significant returns on their investments, and a detriment to museums and other charitable organizations, which have grown increasingly dependent on private donations and loans. Complicating the situation, lack of understanding of federal and state tax laws and codes often results in unforeseen financial consequences for sellers and donors alike.

Is it possible for those who own valuable works to accomplish financial or charitable goals while avoiding or reducing taxes or other penalties? In two recent articles published in *Trusts & Estates*, Paul R. Comeau, chair of Hodgson Russ and a partner in the firm's State & Local Tax Practice Group, and Alexander M. Popovich, senior associate in the firm's Estates & Trusts Practice Group, explore this question, as well as potential transactions that can benefit sellers, donors, and recipients.

Selling or Transferring Art When No Charity Is Involved

When considering the sale of works of art, some state and federal taxes are expected and often unavoidable for the seller, as most art is considered tangible personal property. However, where, when, and how art is sold or transferred can result in substantial benefit or unintended burden, depending on how the transaction is structured.

In "Transferring Art When No Charity Is Involved" (*Trusts & Estates*, August 2008), Comeau and Popovich examine a number of scenarios sellers face. Those who own multiple residences in different states, for example, must deal with questions of residency at the time of sale, and seemingly simple decisions (should a work of art be sold before a move or after?) can have expensive and long-term consequences.

There are exceptions to most rules, of course, and transactions such as swaps, in which an "old" work can be exchanged for a "new" work, may result in deferred taxes. Other structures, such as entity transfers, may eliminate taxes altogether. However, many situations lack precedent, and when questions arise on the state or federal level, outcomes can be inconsistent.

Giving and Lending Art to Charity

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Benevolent intentions aside, many collectors have long used art donations or loans as a means of reducing taxes. Over the last several years, however, changes in tax codes have resulted in unwanted and often unintended negative outcomes for donors and recipients. In "Giving and Loaning Art to Charity" (*Trusts & Estates*, May 2008), Comeau and Popovich explore the implications of donating and lending works to museums or other charitable entities, as well as important ways in which recent changes to tax laws are impacting both.

When donating works to a charitable organization, for example, basic rules regarding the transfer of personal property apply. However, nuances in tax laws such as related use rules, fractional interests, bargain sales, subsequent sales of donated works by charities and state laws governing the transfer of ownership of lent works can have significant impact on the resulting charitable deduction. Other important considerations include laws regarding the (possibly unintended) transfer of ownership of a work of art on loan to a museum for long periods.

As explored in the article, there are other potential pitfalls for donors and lenders. For example, the Internal Revenue Service has the authority to deem transactions as having been developed specifically to circumvent tax implications. As a result, it is critical that gifts and loans be carefully structured to take advantage of available deductions without creating problems for either party.

Careful consideration of the timing, location and structure of the sale, donation or loan of art can significantly reduce and sometimes eliminate the tax burden. However, without clear understanding of the laws and variances state-to-state, sellers and donors are at risk of making costly mistakes.