

## Succession planning for art and collectibles

Most people are collectors of some kind. Some own art that has been passed down through generations, and their collections may be worth millions of dollars. Others start collections based upon their special interests—as common as coins and stamps or as unusual as musical wind-up toys and fishing lures.

What all collections have in common is value, either in dollars or in the simple pleasure that having the objects brings. In either case, developing what is sometimes referred to as an art succession plan is an important element of a collector's overall estate planning.

The goal of an art succession plan is to preserve and distribute the collection to heirs with the least possible turmoil and expense. Here are a few suggestions offered by collectors and art succession professionals.

### **Keep a comprehensive list of the items in the collection**

A collector always should maintain a complete and up-to-date inventory of the items in his or her collection.

Along with the inventory, a collector should record all purchase and sale transactions. If available, authentication documents and the provenances (origins or sources of the collectibles and histories of subsequent owners) should be included. If the collection is small, a simple computer spreadsheet might suffice. Specially designed software is available for larger, more complex collections.

### **Know the collection's value**

The general rule for federal estate, gift and income taxes is that property is transferred at its "fair market value." When dealing with publicly traded securities, that's easy enough to determine. For collectibles of any significant worth, an appraisal or valuation of each item in the collection from a qualified professional, one who will meet the standards set by the IRS, may be needed.

When a collector or his or her estate seeks a tax deduction for the transfer to charity of items in the collection, the IRS requires a "qualified appraisal" for property valued at over \$5,000, and when the value claimed is over \$20,000, the appraisal must be submitted to IRS along with the proper tax form. An IRS Art Advisory Panel reviews appraisals reported on income, gift and estate tax returns to determine their accuracy when the collection or work of art is valued at over \$50,000.

When looking for an appraiser, most professionals suggest choosing a member of either the American Society of Appraisers, the Appraisers Association of America or the International Society of Appraisers.

### **Plan now, not later**

Michael Mendelsohn, a principal at Bridge Art Strategies, Ltd., an art succession planning firm, is the author of *Life Is Short, Art Is Long—Maximizing Estate Planning Strategies for Collectors of Art, Antiques and Collectibles* and recognized by *Arts and Antiques* magazine as one of the top 100 collectors in the U.S. He has seen at firsthand what can happen when a collector fails to plan adequately for a valuable collection. The following is a short summary of a situation that he recently related to *Registered Rep.*, a publication for investment professionals:

Collector had amassed a substantial collection of sports cars. Although he had done some general estate planning, it did not include the collection. Succession planning *did* begin when Collector decided that the cars should be put on display. He met with Mendelsohn and his financial advisors. A plan was put in place hastily. A private museum would be set up to house and preserve the cars. Collector would purchase a life insurance policy on his and his wife's lives. After they died, part of the proceeds would be used to fund the museum; museum profits would go to a charity for terminally ill children; and the balance would provide income for Collector's children.

Unfortunately, a few months before the plan was completed, Collector died. The collection passed to his wife and children. With no completed succession plan and a limited time to pay a hefty federal estate tax on the value of the cars, the wife and children began auctioning off the cars and arguing over who would get what. The unfortunate and unnecessary result was that a cherished collection was dismantled; a charity lost a significant gift; and Collector's heirs were hit with a large tax bill.

### **Consider charitable gifts**

When philanthropy is one of the goals of an art succession plan, a collector can reap a number of tax rewards. For one, the 28% long-term capital gain tax rate on the appreciation in value of a collectible is avoided when it is donated to charity rather than sold. The collector is entitled to an income tax deduction for the gift as well (subject to certain caps). And, because the collection is no longer part of the collector's estate, there's no tax bill looming in the future.

When a collector wants to make a charitable gift and still provide for his or her family, a *charitable remainder trust* may be a good solution. The collectibles transferred to the trust can be sold free of capital gains tax, and the income from the reinvested proceeds can be paid to the collector or designated beneficiaries for life. The collector receives a partial income tax deduction for the donation (the amount that represents the value of the gift to the charity).

If the collector still is concerned about smaller bequests to his or her heirs as a result of the charitable gift, another trust can be established. This trust purchases a life insurance policy on the collector's life, often equal to the value of the collectibles that were transferred to the charitable remainder trust. After the collector's death, heirs can receive the proceeds from the insurance free of both income tax and estate tax (as long as the collector lives at least three years after the trust was created). Of course, this approach comes at a price: the cost of insurance premiums on the policy.

### **Communicate**

Finally, experts recommend strongly that a collector take into consideration what family members have to say. Are they interested in keeping the collection intact? Do any of them want specific pieces in the collection for themselves, or do they prefer to receive the proceeds from sale of the collection? The answers may have a major bearing on the ultimate shape that a succession plan takes.

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