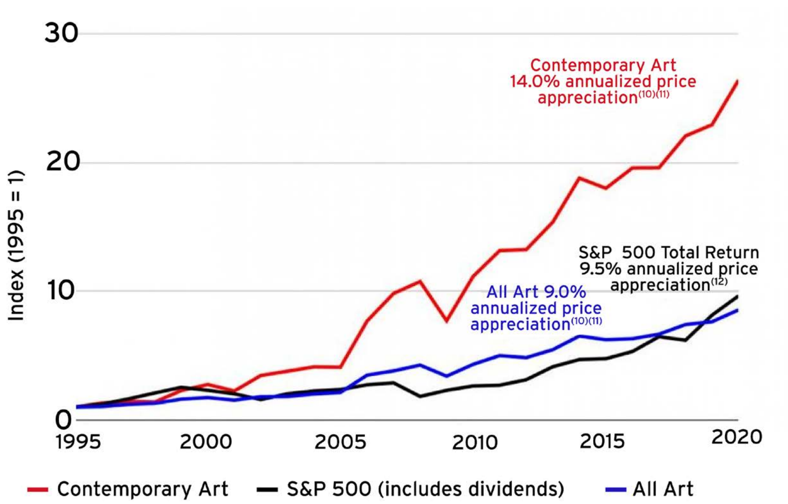
Integrating Art and Collectibles into An Estate Plan

The collection of fine art and other rarities may have begun as a personal passion project, as a natural outcome of informal education in a particular field, or as the result of an inheritance from a family member. Regardless, fine art and other collectibles are a novel approach to long-term investing as a means to build net worth, especially as volatility and inflation impact the market.

As an asset class, the art market has a total estimated global value of $1.7 trillion[1], and contemporary art, defined as art made and produced by living artists, has seen a 14% annualized price appreciation since 1995. Thus, retaining art and collectibles as part of an estate is a solid decision for preserving wealth in your family. However, integrating them into your estate plan can be a complex process. Below are some considerations that can help ease the planning process for your estate.

Figure 1: Value-Weighted Art Indicies vs. S&P 500 (Total Return) Indices Since 1995

Based on repeat-sales from 1995 to 2020



Source: Investing in the art market: a $1.7 trillion asset class. (2021, July 22). Portfolio for the Future | CAIA. https://caia.org/blog/2021/07/22/investing-art-market-17-trillion-asset-class

Catalog Each Item

If you have a robust assortment of art and other collectibles, it is best to take the time to get organized before getting your items appraised. This can be done in a variety of ways based on your organizational style. You can choose to classify pieces by medium, artist, genre/style, or period. By grouping your items this way, you will be able to easily visualize what you have and can store them in the appropriate settings for preservation.

Additionally, you can photograph, label, and document your collectibles by the title of the piece, dimensions, place of origin, and prior ownership, and also attach the certificate of authenticity and appraised value. Furthermore, if you want your pieces to be sold following your passing, you can list the names of dealers and auction houses that specialize in a specific type of collectible to increase efficiency in the settlement of your estate.

Hire an Appraiser

Artwork, antiques, rugs, metals, gems, stamps, coins, and certain alcoholic beverages like wine are considered collectibles as defined by the Internal Revenue Service (IRS). Often, these items are deemed valuable based on their condition, rarity, perceived cultural influence, and market trends[2]. Establishing the financial value of a collectible should be the first step for high-net-worth individuals to determine the value of assets.

To better understand the value of your collection, you can enlist the help of an appraiser who can determine the proper value and discover the provenance of art pieces and antiques. It is not uncommon for art collectors to worry about their appraiser's expertise in valuation as inaccurate valuation can result in collectors having to pay additional taxes or owe penalties. To prevent this from happening, collectors can utilize the Internal Revenue Service Art Appraisal Services (AAS) for both advice and assistance. It includes appraisers who are professionally trained in appraisal methodology and the Uniform Standards of Professional Appraisal Practice (USPAP) and are educated and experienced in fine and decorative arts and collectibles.

For art and collectibles that have individual values above $150,000, the AAS relies on advice and recommendations from the IRS Commissioner's Art Advisory Panel, a group of around 25 renowned art experts who serve without compensation. Leveraging the IRS' services can provide peace of mind for your executor and beneficiaries when filling out a United States Estate and Generation-Skipping Transfer Tax Return (Form 706).

Discuss the Estate With Beneficiaries

Though art and collectibles typically carry sentimental value for the owner, their beneficiaries might not share the same feelings or even know what to do when they acquire art. One of the most famous examples of this is the battle over Pablo Picasso's work. Picasso, who died in 1973, did not have a will or estate plan despite having over 45,000 pieces of work, cash, properties, and a large portfolio. This decision left his children, former wives, and mistresses, fighting over his estate for six years.

What Piccasso's heirs faced is not an anomaly. When an owner fails to discuss their estate plan with its beneficiaries, it can cause confusion and animosity between the parties and be expensive due to attorney fees and appraisal costs. To circumvent this, the owner can discuss expectations for the future of their collection with its beneficiaries or even decide to gift it to them while they are still alive. By doing the latter, you can help make sure beneficiaries are adhering to your principles and are properly preserving and caring for your precious pieces.

For more information on how to gift art and collectibles, please read the IRS FAQ page on Gift Tax.

Weigh Alternatives

There are a few other feasible options that may lower the tax burden on an art enthusiast's estate besides transferring the pieces to beneficiaries. Below is a list of alternatives to preservation:

01 | SELL

If art and collectibles are sold at a gain, then they are subjected to a long-term capital gains tax of up to 28%, which is higher than the tax on most other assets. If you elect to sell, you may also have to pay a sales commission as high as 25% and shipping costs. If the collection is sold after your passing, the capital gains tax can be avoided, but estate taxes will remain. Make sure your beneficiaries know the market value of the collection or they may undersell.

02 | PLACE THE COLLECTION IN AN LLC

Transferring your collection to a limited liability company (LLC) bypasses many of the complications of assigning individual pieces to your beneficiaries. An LLC will own pieces of the collection in a trust. This alleviates the tax burden for beneficiaries while enabling them to share responsibility for managing the collection and jointly profit from lease payments and any sales made. Specific heirs can manage the display or storage of items, but the financial and personal interest in these items will be mutual.

03 | DONATE

Donation is a straightforward process that can yield a tax deduction of up to 50% of your adjusted gross income (AGI) and allow for the deduction to carry forward for up to five years. If the art is donated to a private non-operating foundation, the deduction is limited to 30% AGI for up to five years[3]. Donating at the time of death yields a reduction in the estate tax in proportion to the valuation of the artwork. Be sure to specify how you would want the collection to be displayed and whether you would like to be recognized for the donation.

FINAL THOUGHTS

Whatever you choose to do, plan well ahead of time, and obtain professional help. Contact an estate attorney, investment adviser, or CPA and make sure your collection is expertly appraised. Moreover, carefully document your wishes and conduct thorough conversations with your beneficiaries so your plan is not misinterpreted. With enough foresight, your

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[1] Investing in the art market: a $1.7 trillion asset class. (2021, July 22). Portfolio for the Future | CAIA. https://caia.org/blog/2021/07/22/investing-art-market-17-trillion-asset-class[2] ssa.gov, "Fact Sheet: 2023 Social Security Changes" (https://www.ssa.gov/news/press/factsheets/colafacts2023.pdf)

[2] Smithsonian American Art Museum. (n.d.). How much is your object worth? https://americanart.si.edu/research/my-art/object-worth

[3] Benware, B. (2018). Contributing Appreciated Non-Cash Assets to Charity: Art. San Francisco; Schwab Charitable Fund.