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## Summit

160 Bovet Road  
Suite 205  
San Mateo CA, 94402  
info@summit-advisors.com  
650-357-9410

## Mark Pietrofesa

mark@summit-advisors.com  
650-357-9410

## Rafael Velez

rafael@summit-advisors.com  
650-357-9410

## Michael Radakovich

michael@summit-  
advisors.com  
503-445-6661

## Cristina Petersen

cristina@summit-  
advisors.com  
650-357-8812

## Jean-Marie McIntosh

jean-marie@summit-  
advisors.com  
650-357-8812

## Estate Planning for Collectors

**FACTORING IN VALUABLE COLLECTIONS IS A NECESSARY PART OF SENSIBLE ESTATE PLANNING.**

When Michael Mendelsohn's client received an offer of \$1.5 million from a New York City gallery for a contemporary piece of art for which he paid \$4,500, the client thought he'd be looking at a huge profit. To his surprise, he was also going to be on the hook for a large capital gains bill. Luckily for the client, Mendelsohn—founder of Bridge Art Strategies, a firm that provides estate planning counsel for collectors and their financial advisors—was able to steer him to a tax attorney who then set up a charitable remainder trust (CRT). The trust sold the piece and the capital was pledged to a charity. The client was able to avoid \$500,000 in taxes and still earn income from the trust.

Mendelsohn's client is certainly not the only one who will be facing this predicament when it comes time to sell or pass on a collection. Over the next 45 years, baby boomers are expected to transfer more than \$40 trillion of wealth—15% of it in the form of art, antiques and other valuables, according to Mendelsohn.

The cars, coins or artwork that you've spent a lifetime collecting require careful estate planning, just like any other financial asset. Long-term gains on personal property are taxed up to 28% on the federal level compared to 15% for most financial assets. Without the proper planning and counsel, you or your family might suddenly find yourselves burdened with an unexpected tax.

### GETTING STARTED

The first step in estate planning with collections

is to catalogue what you own. Document what you paid for each piece or how you received it.

The next step is a little trickier—you need to determine your intent, says Rita Danylchuk, an estate planning attorney with Gibbons, Del Deo, Dolan, Griffinger & Vecchione. What do you want to happen to your most precious possessions? Maybe you'd like to donate them to a museum or a charity; or possibly you would rather see your collection remain in the family. Once you reach a decision, you can sit down with your financial advisor and map out the best strategy.

### GIVING IT AWAY

Much like the one Mendelsohn's client used, Danylchuk often recommends a charitable remainder trust for clients interested in leaving collections to charity. "Just because you are doing some charitable planning doesn't mean you have to give up all rights to the property," she says. A donor gifts assets to a CRT with a charity as the beneficiary for when the trust expires or the donor passes away. The CRT allows the donor to keep the proceeds from the sold property until he or she dies or the trust expires. There are several advantages to this plan. First, the value of your taxable estate is reduced and a charity receives the benefits. Second, you escape capital gains taxes when the assets are sold and you still earn income from the proceeds in the trust. Lastly, the donor gets a charitable deduction to offset adjusted gross income (AGI).

Another charitable option is to give fractional interests of a piece of art or other valuables to a

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*“The cars, coins or artwork that you’ve spent a lifetime collecting require careful estate planning, just like any other financial asset.”*

museum, or even a university library. By doing this you can keep the item longer and also take deductions on your taxes. For example, if you donate 10% each year, you are supposed to offer the painting to the museum or university for 36 days the first year, 72 the next, 108 the next, etc. After 10 years, the museum would typically get the painting. Donating a 10% interest yearly on a \$1 million painting results in a \$100,000 deduction to your AGI (you are allowed up to 30% of your AGI with a five-year carryover). But be careful if you’ve given away a 50% interest in the art over time and the painting has never left your house—the IRS might have some questions for you.

## ALL IN THE FAMILY

Many collectors that have spent a lifetime obtaining prized possessions want to keep the collections in the family. One option is to set up a family foundation that houses the collection and keeps the assets out of the

estate. Your heirs can lend out pieces to shows and museums, but still enjoy their use with careful planning.

Another strategy is to gift collections to heirs in a tax-efficient way. The IRS has strict guidelines concerning collections, so this strategy, as well as any other gifting program, requires an appraisal by a certified appraiser for any collection worth more than \$10,000, or \$3,000 for any one collectible. A donor and spouse can each donate \$12,000 in assets to as many people as they want without triggering the gift tax. You could also put the collection in a trust with your heirs as beneficiaries, but Danylchuk warns that you should be certain about that approach before you do it: “It is irrevocable when you make a gift like that.”

Unfortunately, instead of selecting a strategy with a financial advisor, many people rely on an impractical solution which Mendelsohn calls the “empty hook” strategy. When a collector dies, the artwork is quickly removed from the home by heirs (leaving an empty hook). For works not exhibited and without a paper trail from insurance or purchase, the heirs figure they are home free. But Mendelsohn thinks this strategy is a disaster waiting to happen. At some point, divorce or debt may affect a future generation and the inherited artwork will come to light. The lack of a paper trail makes it tough to sell, and if you do manage to unload it, the IRS is going to want back taxes and penalties—there is no statute of limitations on estate tax fraud. Danylchuk warns that multimillion dollar taxable estates are “subject to a higher level of

scrutiny in terms of being audited by the IRS.”

If you plan properly, personal collections can be very rewarding from both a personal and investment standpoint. There are a number of planning strategies you can implement, but the important thing is to work with your financial advisor to find a plan that suits your needs and helps you get the most out of your investment. “If you include valuable collections in your estate plan, you have a myriad of options available to you,” says Mendelsohn. “If you die without a plan, then your estate might be stuck with only one option: auctioning it off.”

*This article is only intended to provide general information regarding estate planning and legal and tax matters with respect to art and collectibles. As described in the article above, the transfer of such assets can have significant legal and tax consequences. No person should rely on such information as personalized estate planning, legal and/or tax advice. Prior to taking any action, we encourage you to consult with qualified estate planning, legal and tax professionals.*

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