

New legislation could lead to the end of partial gifts to museums

Changes to US tax law could discourage collectors from giving

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New York. US museums fear that a new law, passed by President Bush on 17 August, could result in a steep drop in donations due to a significantly less favourable tax regime for fractional gifts.

In the past, collectors could donate part of a work of art to a museum, with the remainder passing to the museum by a set date or on the donor's death. So, if the donor gave a 25% share, the work would be available to the museum for three months a year (an offer a museum did not have to take up) and could remain at the collector's home the rest of the time. The donor was entitled to a tax deduction on the donated percentage of the market value of the work of art each time an increment was given. If the value increased, so did the deduction.

But under the new Pensions Protection Act 2006, donors are prevented from increasing their deductions in line with the value of the works. The amount is now tied to the value of the work on the date of the initial donation and if the value of the work goes down, the fractional deductions are based on the lower value.

The new law also requires the museum to acquire complete ownership of the work within ten years, or at the donor's death if sooner. Because the government puts a cap on how much an individual can deduct each year, this means the donor may not receive the full deduction for works with a

value so high that the full deduction cannot be realised in ten years.

A senior counsel for the Senate Finance Committee explained that legislators were concerned that wealthy people were taking huge deductions while donated works remained in their homes. In response, the new law requires the museum to take “substantial physical possession” of the item during the ten years. Donors failing to comply with the new law must repay all previous tax deductions on the gift, plus interest and a 10% penalty.

Art lawyers also believe that the act has a flaw that could lead to a donor paying gift tax on future increments of the promised work, if the value of the work has increased over the period. Equally, if the value of a work promised in a bequest has increased, the estate may only be able to deduct the remaining percentage of the work’s original market value, but its increased value would appear on the estate’s books and would require payment of estate tax on the difference.

“I doubt there are many, or maybe any, collectors willing to risk paying these gift taxes or burdening their estates with extra taxes,” says John Silberman, a prominent art tax lawyer in New York. He predicts that unless the law is repealed or amended, “it means the end of fractional gifts of art to museums”.

The American Association of Museums, the Association of Art Museum Directors and other groups are lobbying the Senate Finance Committee to revise the tax law. They note that 80% of US museum acquisitions are donated, the most valuable often by fractional gift. The lobbyists believe that Congress is likely to consider a technical corrections bill to address the problem. They want the law to require donors to promise the gift in writing and to convey it by the time of their or their spouses’ deaths. Museums would be required to inform the IRS of failure to meet the agreement and donors who do not comply would have to repay deductions plus interest.

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