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assets

a business, tax, and financial newsletter

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Tax Deductions for Donating Art

If you collect art, donating a painting, sculpture, or other object of fine art to a museum or a favorite charity can be a great way to share your passion with a wider audience, support your institution of choice, and get a break on your Federal income taxes. But before donating artwork, it is important to consider the nature of the organization receiving the gift, as well as how the institution will handle the gift, as these factors can make a big difference in how much you are permitted to deduct from your taxes.

You can expect to receive a higher income tax deduction for your gift if you are donating an art object that has appreciated in value over the time you have owned it. Generally, you can deduct the full fair market value (FMV) of the donation as of the date of the contribution, if you have held the object for at least one year, and if the item's FMV sale on the date of the contribution would have resulted in a long-term capital gain.

In order to claim a deduction for the FMV, it is, however, imperative that you know what the organization or charity intends to do with your gift. The tax code provides incentives for taxpayers to donate works of art to tax-exempt organizations, such as qualified museums, universities, and other public charities, that display and use works for art to further their tax-exempt purposes. For an appreciated work of art to receive a full current value deduction, the donation must be "of related use," or it will be used in the ordinary course of the organization's tax-exempt activities, i.e., exhibits or displays of artwork.

If, however, the organization's purpose does not involve displaying artwork, or if the charity sells the object to raise money, your deduction will be limited to your cost basis, or the FMV, if it is less than the price you originally paid. This also applies if you have owned the object for less than a year, or if you are the artist who created the object.

If, for example, you paid $1,500 for a painting 10 years ago that is now valued at $5,000, you are allowed to take a $5,000 deduction if the work goes to a museum or to your alma mater's art department. If, however, you donate the painting to a local television station's auction and the item is sold, you are only permitted to take a $1,500 deduction. Similarly, if you donate the painting to a public charity, such as a hospital, which has an exempt purpose that is unrelated to the donated painting, you will only be able to claim a deduction of $1,500.

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Your Credit Report and Identity Theft Detection

Identity theft is a serious crime, with increasingly greater numbers of consumers being affected every year. As part of a protection strategy, the Federal Trade Commission (FTC) and other consumer credit organizations recommend a proactive approach to safeguarding your identity: checking your **credit report** annually.

A credit report records information about your bills and loan and repayment history, available credit, and outstanding debts, and is typically used by lenders when deciding to accept a loan or credit application. In addition, credit reports can alert you to accounts that have been fraudulently opened in your name, unauthorized charges made to your existing accounts, and other crimes committed by someone using your personal information.

According to the **Fair Credit Reporting Act (FCRA)**, you can request a free copy of your credit reports from each of the three major credit bureaus (Equifax, Experian, and TransUnion) once a year. For your convenience, you can access all three agencies through a single website, www.annualcreditreport.com. The FTC suggests that you order all three reports, even if you choose to stagger your report requests throughout the calendar year, as the information may differ from each bureau. This is because credit reporting is voluntary, and therefore creditors may subscribe and report information to just one agency, or all three.

Reviewing Your Reports

Usually, a credit report is divided into four major sections: identifying information, credit history, public records, and inquiries. The **identifying information** on your report will include your name, current (and previous) address, Social Security number, driver's license number, telephone number, birth date, current and previous employers, and your spouse's name, if applicable.

The **credit history** section details your payment history with banks, retail stores, finance companies, mortgage companies, and others who have given you credit. Each account, sometimes called a trade line, will appear with the following information: name of creditor, account number, type of credit (i.e., installment loan or revolving credit), account participation (e.g., joint owner, individual account, or authorized user), date opened, last activity (date of last payment or charge), high credit (the credit limit or original loan amount), terms (number of installments or amount of monthly payments), balance at the time of reporting, past due balance at the time of reporting, status of the account (open, closed, inactive, etc.), and date of last report. It is in this section that accounts opened or affected by identity thieves may become apparent.

The **public records** section includes documents that reflect your history of meeting financial obligations, such as bankruptcies, collection accounts, judgments, and tax liens. Since public records can have a serious, negative effect on your credit, verify that the information belongs to you, not someone who used your personal information.

Finally, the **inquiry** section lists all the businesses that have received your credit report during the last 24 months. Inquiries are categorized as hard or soft. Hard inquires are those you initiate by filing a credit or loan application. Soft inquiries often come from marketers who want to sell you something. If you do not recognize a listed business, be sure to find out the nature of the business and why they are looking at your credit report.

A Mistake or Identity Theft?

If you find a mistake on your credit report, immediately contact the credit bureau that issued the report using the form provided or by following that particular agency's instructions. If the error is serious, and you suspect that your identity has been stolen, contact the FTC's Identity Theft Hotline at 1-877-IDTHEFT (877-438-4338). Be sure to keep detailed documentation of all communications with creditors, agencies, and the FTC.

You can help safeguard your identity by continually monitoring your credit reports. For more information about identity theft, visit the FTC's website at www.ftc.gov.

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Before making a donation, be sure that the institution wants the artwork for its collection. After discussing the prospective donation with representatives of the organization, you should ask them to provide you with a written acceptance indicating that the organization is a qualified public charity, and that it satisfies the related use rule regarding the particular donation.

The IRS requires any deducted item over $5,000 to be appraised by a qualified appraiser no earlier than 60 days before the gift is transacted. The appraiser should be encouraged to be conservative in estimating the value of the artwork, as larger donations may be audited, and the value could be adjusted downward. Additional documentation is generally required for objects appraised at $20,000 or more.

In order to qualify for a tax deduction, you must donate the artwork as an outright gift, not as a permanent loan. But instead of making the entire donation at one time, you also have the option of transferring a percentage, or “fractional interest,” in the artwork each year. This method is useful if the total deduction exceeds 30% of your adjusted gross income (AGI), the maximum for charitable deductions. However, all of your fractions must be donated within 10 years, and the receiving institution must take substantial physical possession or make use of the object during its allotted time period each year, or penalties may apply. Other planned giving strategies for donating artwork while maximizing tax deductions include the use of charitable remainder trusts, charitable gift annuities, and donor-advised funds.

If a qualified charitable organization is interested in purchasing your artwork, you may also want to consider a bargain sale, which will provide you with both a lump sum of cash and a charitable tax deduction. A bargain sale, which involves the sale or exchange of the item for

less than its FMV, is partly a charitable contribution, and partly a sale or exchange. In addition to collecting cash for the sale, you can take a charitable income tax deduction for the difference between the amount you received for the sale, and what you could have received if you had sold the object for its full FMV. ■

What Causes Inflation?

Inflation, defined as the increase in the average price level of *all* goods and services, is often caused by changes in supply and demand on a broad scale. For example, suppose business is booming, unemployment is low, and workers’ wages are increasing. As a result, consumers have more disposable income, and therefore are able to purchase more goods and services. Average prices will tend to rise due to the increase in *demand* for all goods and services.

Suppose the economy is suffering. As unemployment rises and wages remain stagnant, consumers are unable to buy additional goods and services. In response, production slows down and prices rise in order to cut losses. In this case, average prices increase due to a decrease in the *supply* of all goods and services.

In addition to creating higher costs for goods and services, inflation creates depreciation in currency values. As prices go up, the purchasing power of your income—dollar for dollar—decreases; that is, more dollars are needed to purchase the same amount of goods and services. In time, your personal savings and investments will have to work harder to keep up with or exceed inflation. It is important to consider inflation as you continue to save for retirement and make major purchasing decisions. ■

Who'll Be in Control When You Can't Be?

One thing is for certain: Life is unpredictable. But, it is still important to prepare for the future and whatever it may hold. Have you ever considered what would happen if you were to experience an accident or illness that left you incapacitated and no longer able to make important financial decisions? While this unpleasant prospect may be difficult to think about, you can prepare to establish a measure of control in your life should you become incapacitated. One strategy is to establish a **durable power of attorney**—a legal document that appoints someone you trust to handle your financial decisions.

An attorney is a licensed professional who has been granted legal authority to conduct business on your behalf. However, you have the right to provide anyone with this power. If the **power of attorney (POA)** is *limited*, the individual you choose can conduct only that business specified in your agreement. If the POA is *general*, the person's authority is more extensive but still assumes you are competent to review and approve decisions. If the agreement contains what is known as "durable" language (according to the passage of certain state laws), it allows the designated individual, also known as the **attorney in fact**, to make decisions on your behalf in the event of physical or mental incapacity.

The Time to Prepare Is Now

Generally speaking, a durable power of attorney allows you to specify, in advance, the person you want to make decisions regarding your personal finances and business matters, if you ever become incapable of making those decisions for yourself. By contrast, a **health care proxy** allows you to designate an individual to make decisions regarding your medical care and well-being, and a **living will** allows you to specify your preferences regarding the giving or withholding of life-sustaining medical treatments. These documents are known as **advance directives**, and they are essential estate planning tools for all individuals, regardless of age. Without such documents, court intervention—involving a great deal of time, expense, and stress—may be necessary.

In addition to your own advance directives, consider the important role these documents can play in your *parents'* estate planning. For many of us, discussing such matters with a parent may be uncomfortable. Nevertheless, an open conversation about expectations may strengthen familial bonds and help ensure that your loved ones' preferences for the future will be met.

It is important to note that a will, which only becomes operative *at death*, is not the appropriate vehicle for specifying a durable power of attorney, health care proxy, or living will. Rather, these documents should be created separately by a qualified legal professional who is familiar with the language appropriate for your particular state. Taking the steps to designate your durable power of attorney can help ensure that your financial decisions will be handled by someone you trust, in the event that you are unable to do so. ■

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