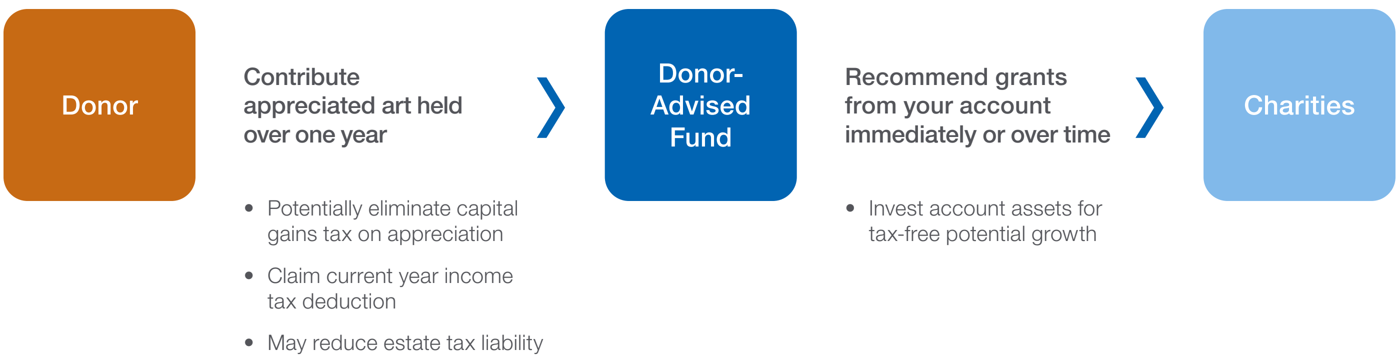
Benefits of Donating Fine Art and Collectibles to Charity

A tax-smart approach to maximize your philanthropic impact

by the Charitable Strategies Group at Schwab Charitable

For collectors who are charitably minded, donating fine art and other collectibles—such as precious metals, jewelry, and antiques—to charity may provide a tax-smart way to achieve strategic planning advantages. In particular, donations of art that you have owned for more than one year may enable you to potentially eliminate capital gains taxes, claim a current year income tax deduction (if you itemize deductions), and potentially reduce estate tax liability.

Donor-advised funds, which are 501(c)(3) public charities, can support your holistic wealth planning objectives, while also freeing up more money for charitable causes that you care about. How does donating art to a donor-advised fund work?



Please be aware that gifts of appreciated non-cash assets can involve complicated tax analysis and advanced planning. This article is only intended to be a general overview of some donation considerations and is not intended to provide tax or legal guidance. In addition, all gifts to donor-advised funds are irrevocable. Please consult with your tax or legal advisor.

Special tax rules may apply to gifts of art and collectibles

You should be aware of the IRS's "related use" rule, which may impact the value of your charitable income tax deduction when donating art (or other collectibles) to a donor-advised fund or other public charity. What is the related use rule? Generally, if you donate art or collectibles to a charity that does not use the gift as part of its charitable purpose, then your deduction is limited to the lesser of cost basis (the value at which you acquired or inherited the art) and fair market value.

When weighing the pros and cons of donating art to charity you might consider whether the need for a charitable deduction outweighs the importance of minimizing capital gains taxes if the art were sold. If you itemize your deductions and need a charitable deduction more than elimination of capital gains tax liability (e.g., your basis is high with limited or no appreciation), then it may make more sense for you to sell your art, recognize any taxable gains, and then make a cash gift of net proceeds to charity. Please consult with your tax or legal advisor on your specific situation.

Even if your income tax deduction is limited to the lesser of cost basis and fair market value, you may find that the key benefit to an art donation (where held more than one year) is the potential elimination of capital gains taxes. Why? Because the maximum capital gains tax rate applicable to art and collectibles held longer than one year is 31.8% (28% long-term capital gains rate plus Medicare surtax of 3.8%), which is higher than the maximum 23.8% rate for other capital assets, such as long-term held publicly traded stock or real estate.

Benefits of a donation to a donor-advised fund

If you have held your art or other collectible for more than one year as an investment (i.e., you are not the artist), then your charitable donation of art or another collectible to a donor-advised fund may provide you with the following benefits, including:

- **Simplified conversion of artwork into a funding stream for your philanthropic goals**
- **Potential elimination of capital gains taxes you would pay on the art's appreciation**
- **Removal of a highly appreciated illiquid asset from your estate for estate tax purposes**
- **A charitable account with flexible granting options to your favorite charities**

Case study: achieving strategic planning advantages

John has built a collection of abstract art over 40 years. As a young collector, his focus was much different and his earlier acquisitions no longer fit the current goals of his collection. John is considering selling one of his early abstract art acquisitions—valued at $1 million, with a cost basis of $50,000—as a means to have cash available to support his favorite charities. A sale, however, would result in a potential long-term capital gains tax and Medicare net investment income surtax of $302,100 (31.8% multiplied by projected capital gains of $950,000) as well as sale expenses.

As an alternative option, John's advisor has recommended donating the early abstract art acquisition directly to charity as a way to potentially eliminate capital gains taxes. To aid John in his decision-making process, John's advisor prepares the chart below to illustrate the potential tax and charitable benefits of the two options. Option 1 is to sell the art, pay capital gains taxes on the appreciation, pay sale expenses, and contribute the net cash proceeds to a donor-advised fund as a way to make regular gifts to various charities. Option 2 is to donate the early acquisition directly to his donor-advised fund, with a subsequent sale at auction after the donation.

Original cost (cost basis) of art: **$50,000**

Federal long-term capital gains tax rate (28%)
+ Medicare net investment income surtax rate (3.8%): **31.8%**

Fair market value of art:
$1,000,000

	Option 1: Sell art and then donate proceeds to Schwab Charitable	vs.	**Option 2:** Contribute art directly to Schwab Charitable	
Capital gains taxes and sale expenses paid	$402,100[1]		$124,000[2]	
Charitable contribution and tax deduction	$597,900	vs.	$876,000[3]	Additional amount available to charities: **$278,100**
Estimated tax savings	$0[4]		$18,500[5]	Additional amount saved on taxes: **$18,500**

This hypothetical example is only for illustrative purposes. The cost basis shown assumes no adjustments.

1 Assumes sale expenses of 10% of fair market value for transportation, insurance, and auction. All expenses are paid before contribution to charity.

2 Assumes sale expenses of 10% of fair market value for transportation, insurance, and auction, plus 2.4% if a third party handles the contribution. All expenses are paid by the charity after contribution.

3 Assumes tax deduction is limited to cost basis ($50,000) because there is no related use by the donor-advised fund.

4 The tax savings shown is the tax deduction, multiplied by the donor's income tax rate (37% in this example), minus the long-term capital gains taxes paid. There are no tax savings in this instance because of the high capital gains taxes paid.

5 The tax savings shown is the tax deduction (limited to cost basis), multiplied by the donor's income tax rate (37% in this example). Assumes no related use.

Additional considerations

In addition to the potential benefits described above, the following considerations may apply.

1. The related use rule applies to gifts of art and collectibles.

As discussed above, when calculating your charitable income tax deduction, you should consider the IRS's related use rule. While charities that exhibit or display art or other collectibles (e.g., museums) may meet the related use rule, most other charities do not. If the art or collectible is donated to a charitable organization that does not use the item as part of its charitable mission, your deduction, assuming you itemize deductions, is limited to the lesser of cost basis or fair market value.

If you are the artist, even if you donate to a charity that meets the related use rule, your deduction is nonetheless limited to the lesser of the cost of the materials used to create the art and fair market value. Also note, if you as the artist gift your art to someone during your lifetime and the art is then sold, the donee not only shares your (likely very low) cost basis, but the proceeds of the sale are considered ordinary income at the donee's ordinary income tax rate.

2. You may potentially eliminate capital gains taxes.

Artwork, whether purchased or inherited, that has been held for more than one year and has appreciated in value qualifies as a "collectible" under the Internal Revenue Code and is considered a capital asset. Upon sale of artwork, capital gains tax is typically owed on the difference between the current fair market value and your cost basis. However, if prior to sale you donate appreciated art to a public charity, including a donor-advised fund, you potentially eliminate the capital gains tax that otherwise would be incurred in a sale. The effect is more money available for your favorite charities.

For collectors, the cost basis is what you paid for the artwork. For inheritors, the cost basis is the fair market value of the artwork as of the date of the previous owner's death. The maximum collectible capital gains tax rate is currently 28%. The Affordable Care Act layers an additional 3.8% Medicare surtax on top of unearned income, bringing the total tax consequence to 31.8%.

3. You may potentially minimize estate tax exposure.

Artwork owned at death is included in the decedent's gross estate. If you are charitably minded and plan to leave a bequest to charity after your lifetime, then donating art rather than liquid funds may be a better choice as your family will not need to handle insurance, maintenance, and sale of the art if they do not plan to keep it.

If the value of your gross estate exceeds the current federal exemption amount, then the excess is taxed at a top federal rate of 40%, not including any state estate or inheritance taxes that may apply. You might also consider a during-life donation of art to charity as an option for removing assets from your gross estate.

4. A qualified appraisal is required to substantiate your deduction.

If you are a collector or inheritor wishing to donate artwork, you should note that the IRS requires a qualified appraisal for claimed deductions of $5,000 or more. You must attach a complete copy of the signed appraisal to the tax return and, upon request from the IRS, photo documentation for claimed deductions of $20,000 or more. The appraisal may be completed within 60 days of the contribution and up until you file your tax return for the year of contribution, including extensions.

5. Annual deduction limits apply.

When donating art to charity, collectors may receive a current year income tax deduction if they itemize deductions. For art gifts to donor-advised funds and other public charities that do not meet the related use requirements, you may deduct the lesser of cost basis or fair market value up to 50% of your adjusted gross income (AGI) for cost basis and 30% for fair market value, and you may carry the deduction over for up to five years. If you sell art that you have held for longer than one year, pay capital gains taxes, and then contribute net cash proceeds to a donor-advised fund or other public charity, you may be able to deduct up to 60% of your AGI with a carryover of five years.

Interested in learning more?

The Charitable Strategies Group at Schwab Charitable is a team of professionals with specialized knowledge about non-cash asset contributions to charities. Our team stands ready to support you and your advisors, from initial consultation through asset evaluation, receipt, processing, and sale. We strive to provide unbiased guidance and frequent communication at every step of the process to help you and your advisors make informed decisions and stay aware of the time required for your transaction.

For more information about the advantages of contributing appreciated non-cash assets, you can review our infographic, read an overview article, or call us at 800-746-6216.

If you would like to learn more about Schwab Charitable donor-advised fund accounts, click here.