

A new rule may hamper donations to museums

Art museums rely upon donations from wealthy patrons and art lovers to extend and enhance their collections. Often, donors make their gifts by will. But lifetime gifts are fairly common as well. But, according to some museum administrators and collectors, a new rule included in tax legislation enacted last year, paints a cloudy future for certain lifetime gifts, referred to as gifts of “partial,” or “fractional,” interests in art.

The starting point

When a collector makes a donation of a work of art to a museum, generally, he or she is entitled to income, gift or estate tax deductions. But sometimes there is a tension between the love of a particular piece of art and a philanthropic impulse. One would think that the collector couldn't have it both ways, but, actually, there is a middle ground—a partial gift of the art.

Here's how it works: Let's say that Donor owns a painting that has been valued at \$10 million. He travels for three months a year and wants to give Museum the right to exhibit the painting every year during those three months. This right will be absolute and unconditional. The 25% interest that Museum now owns generates a \$2.5 million income tax deduction for Donor.

Gifts of partial interests in art account for only a small percentage of donations to museums. But they had been growing, and the gifts have been significant, including, for instance, 53 Impressionist and Post-Impressionist works in the Metropolitan Museum of Art's Annenberg Collection and Cezanne's *Boy in a Red Vest* at the Museum of Modern Art.

The new rules

Under the new rules, gifts of partial interests still are permitted, but with significant restrictions. First, a donor will no longer be allowed an income tax deduction unless the museum receives 100% ownership of the art within ten years, or at the death of the owner if earlier. Fail to follow this rule, and the benefit of the tax deduction is recaptured, and a 10% penalty imposed.

More: A Tax Court decision has held that the deduction is allowed whether or not the museum takes possession of the work for part of the year, as long as it had the legal right to do so. The new law reverses that decision—museums actually will have to take possession of the art for the time period specified.

Finally, tax deductions for all subsequent gifts of partial interests are limited to the value of the artwork when the first such gift was made. In short, there is no deduction for increases in value after the initial gift. That restriction may mean significant transfer tax costs for donors whose collections continue to appreciate in value.

More changes ahead?

The fear raised by the tightened rules, as articulated by Glenn D. Lowry, director of the Museum of Modern Art in New York, is that they remove many of the incentives for gifts of partial interests of art, and make the practice “almost impossible to use.” In a new year, and a new Congress, many museums and collectors are seeking changes to the rules in the next piece of tax legislation enacted this year.

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