Q: Please talk about the artist and estate taxes, gift tax, donations, and other IRS tax liabilities and implications for art, artists and collectors. What can an artist or collector do who will be leaving a large inventory of paintings or other works of art at the time of his or her death?

A: This is a relatively complex field, but a few basic tips will come in handy for just about everyone. Before getting started, any reasonably successful artist who waits until near the time of his or her death to do something about estate taxes has waited far too long. Estate planning should begin as soon as possible especially if you're successful and are accumulating increasing amounts of your own art. To the Internal Revenue Service, successful means that your entire estate, art included, is valued at over $5,120,000 if you die during 2012 (adjusted for inflation from $5 million in 2011). Under that amount, you have nothing to worry about taxwise, at least at the federal level. Over that amount, better line up a good accountant, an art attorney familiar with tax implications, an art appraiser, and related professionals. In 2012, the maximum total dollar amount that can be given tax-free as gifts is $5,120,000 million for an individual ($10,240,000 for a married couple). Please note that I am neither an attorney nor an accountant and this article does not constitute legal advice; please consult professionals familiar with IRS tax laws and procedures before taking action.

The single best device for passing on property and minimizing estate taxes is by giving non-taxable gifts during your lifetime. According to IRS regulations, you can give a maximum of $13,000 per year (raised in 2009 from $12K) to any one individual, charity, museum or other entity except to an employee or as an incentive to enter into a business transaction. For example, you might decide to give $13,000 worth of art to each of the following: three children, fifteen grandchildren, five nephews and nieces, four charities, three museums, your hairdresser, the man who repairs your car, and the woman who delivers your mail. Just in case you're counting, that's $429,000 that won't be included in any estate tax calculations made at the time of your death.

In order to avoid any confusion as to when gifts are given, supply the IRS with full documentation as to dates, recipients, and amounts by filing the proper documentation-- Form 709, United States Gift and Generation-Skipping Transfer Tax Return (don't worry, it's not that complicated). If you wish to give gifts or donations of over $13,000, particularly to museums or charities, you'll need to consult a qualified tax accountant or consultant to determine whether you can work out any type of arrangement where the fair market appreciated value of that gift can be taken as a tax deduction. As of 2008, artists are not allowed to take fair market value deductions when donating their own work (they can only deduct cost of materials). People other than the artists can take fair market value for the art-- including artists who donate the work of other artists-- but be aware that certain rules, conditions and restrictions apply, so always consult qualified professionals on these matters first.
Now for the sticky part: determining the fair market value of the art that you're gifting or donating. According to Internal Revenue Code, fair market value is defined as the amount which an informed willing buyer will pay a similarly informed willing seller in an arms-length transaction and in a market in which such items are commonly sold, with neither party under any undue pressure to either buy or sell. With art, dollar amounts are not written in stone. Nevertheless, how you interpret or determine prices may well be scrutinized by the IRS which means that you have to be careful in stating dollar values. The IRS has the right to challenge valuations on any gifts of over $5000 for a period of four years after they've been given so be accurate in your assessments.

Consulting a professional appraiser and paying for an appraisal is highly advisable if you have any questions as to how to value your art, and required for donations of over $5000. FYI, You can reduce appraisal bills by maintaining records that show your art repeatedly changing hands in the marketplace for comparable amounts to what you claim it's worth as gifts or donations. The more of these records you have, the less work the appraiser has to do.

Certain valuation problems arise on a regular basis. For example, when people give art to close friends, family and relatives, their natural inclinations are to give as much as possible and value it as low as possible in order to maximize the amounts that they can give tax-free. On the other hand, when people donate art to museums, charities, or similar institutions, their natural inclinations are to give as little as possible and value it as high as possible in order to maximize their income, gift or estate tax deductions. The Internal Revenue Service is well aware of both inclinations and will go after you if they think something strange is going on. Both you and your appraiser can be penalized for misstating dollar values on tax returns, so be accurate and be able to support donation valuations with facts about the current market for the art. Again, keep in mind that the artist cannot personally take fair market value when donating or gifting their own art; someone other than the artist can, however certain restrictions apply so consult a professional on this matter.

For those of you whose net worth will still be well in excess of $5,120,000 regardless of how much art you gift or donate during your lifetime, there are ways to minimize estate taxes at the time of your death. Without getting bogged down in technical details and previous court rulings, here are several variables that normally come into play:

- The salability of the art. Art that is highly salable or in great demand by collectors is worth more than art that takes longer to sell, even though they both may eventually sell for comparable amounts of money. In other words, "slow-sellers" can be appraised lower.
- The "bulk discount" phenomenon. Hypothetically, if all of the art in an estate is placed up for sale at once, there will be more art than there will be collectors to absorb it, overall prices will drop and each individual piece will, therefore, be worth less. Viewed from this standpoint, an estate can be appraised lower than the sum total of the current
Retail values totaled on a piece by piece basis. "Bulk discount" appraisals have met with a certain degree of success when challenged in court.

- **Auction vs retail value.** Art generally sells for less at auction than it does at retail galleries which means that appraising it at auction values (generally considered to be in the vicinity of FMV or fair market value) is often (but not always) more representative of its true transactionary value than appraising it at retail levels. Keep in mind that for IRS purposes, fair market values are required. There is a certain flexibility when considering where in the range of auction vs retail a work of art is valued, but remember that penalties do apply if the appraisal is reviewed and the IRS concludes that the art has been valued either too high or too low.

- **With respect to drawings, sketches, notebooks, incomplete works, and similar less significant pieces,** artists can ordinarily ascribe relatively minimal values to these items. They need not be categorized as significant finished works of art.

The bottom line here is that if your estate is substantial, you'd better start planning for its tax implications and dispersal immediately. Get names of qualified appraisers, attorneys and tax consultants from fellow artists, preferably those whose levels of success approximate your own. If your estate is extremely substantial, such as Warhol's or Mapplethorpe's, chances are good that the art will be contested in one form or another no matter what you do so make doubly sure that you have the right people working for you and good solid substantiated reasonings as to why your art has been valued the way it has.

Explain exactly what your intentions are to every professional you contact. Don't simply show them a pile of art and expect them to automatically know what to do. Be prepared to tell them everything you can including details about the extent and history of your career, your sales history, your typical selling prices, the current market for your art, who you would like to receive what, what you want to happen to the bulk of your estate, and anything else regarding your long term aspirations.

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