

# **What Every Serious Collector Needs To Know About Art Succession Planning**

Compliments of InKnowVision, LLC

*Advanced Planning for the High Net Worth*

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## Have you planned for your Fine Art, Antiques, and Collectibles?

In 2009 art was estimated to be a \$40 Billion industry<sup>1</sup>. There are approximately 17,500 museums, 25,000 galleries, 25,000 historical societies, and 50,000 art shows in the United States alone. Business Week reported that approximately 1/3 of families with a net worth in excess of \$10 million are art collectors. And those personal collections, valued at \$4 - \$6 Trillion nationally, will be transferred to others over the next two generations. Recent trends show the dramatic increase to much higher possibilities.<sup>3</sup> Those numbers are stunning, but what's even more surprising is that the great majority of these collectors haven't given a thought to that succession process.

A composite of studies of trust and estate attorneys, trust officers, and financial planners revealed that:

- Fewer than 10% of plans for their clients addressed art, antiques, and collectibles
- Fewer than 10% used art assets in intergenerational planning
- Fewer than 15% used art assets in philanthropic planning
- Fewer than 5% realize that the true cost of selling a million dollar painting at auction is approximately 35%
- Fewer than 1% used the services of an art succession planning specialist

So what's the problem? The problem is that collectors and their families can lose, at minimum, as much as 75% in the value of the collection if upon death items are sold through traditional means.

And the collections of which we write are not all Rembrandts, Monets, and Picassos. The collection could consist of antique firearms, Western American art, African ritual masks, textiles, folk art, stamps and coins, classic cars or just about anything else!

There are several reasons why the collecting community is not taking the proper precautions in their planning. First of all, traditional estate planning advisors, even the best in the country, are not generally well-versed in how to plan for art, antiques, and collectibles. In fact, most of the advisors don't list these things on their client asset profiles, except perhaps as part of the general category "personal effects."

But challenges exist on the collector's side of the table as well. Sometimes collectors just think of their collections as a hobby, and don't realize the true long-term financial value of what they own. (In fact, according to a Mei Moses Fine Art Index<sup>2</sup> report, art performed almost as well as the Standard & Poor's index for the last 50 years!) Others think it's enough to just put a sticker on each piece designating who it goes to, or worse yet, simply instruct the children to come in and help themselves after the collector's death.

All of these practices can lead to serious tax and financial problems for those left behind. In fact, the collection itself may have to be sold to pay estate taxes! And what if the children aren't really interested in the collection beyond its liquidation value – an attitude more commonplace than you might think? Most collectors would like to see their art and collectibles go where they will be appreciated and enjoyed.

### **Why Plan for Art and Fine Collections?**

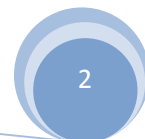
Like every other valuable asset the collector owns art, antiques, and collectibles must be part of the comprehensive plan and be considered by all planning team members. Art and collectibles comprise a special asset class. It requires all of these experts to analyze, value, and incorporate the assets into general estate plans.

There may be issues with the collection concerning title, valuation, provenance, restoration, insurance, investment strategies, taxes, and much more – so every team member plays a role in the planning. Traditional financial and estate planners are much more familiar with securities, real estate, insurance, and business interests. Many have no training, experience, or expertise in art, antiques, and collectibles; and that's why an art succession planning expert must also be part of the collector's planning team.

When your planning is complete, you should understand such things as: how your collection will be provided for in your absence; how best to transfer your collection to your heirs if that's what you desire; how to remove the collection from the estate for estate tax purposes; how cash flow might impact your planning choices; how to discuss the disposition of the collection with your heirs; and more.

### **How does Art Succession Planning Work?**

The planning process necessarily begins with a thorough understanding of the collector's goals for the collection. After all, the collection represents a lifetime of passion, love, research, and acquisition. For most collectors, the collection is a representation of who they are and who they aspire to be. It may even be a substantial portion of your financial net worth. Whether you've verbalized it (or even considered it) before, you do have goals for your collection's future.



Virtually every collector would like to maintain (or increase) the value of the collection. Most would agree that the collection should be protected from loss or damage, be kept from the claims of creditors in this and future generations, and avoid taxation to the extent possible. However, beyond those basics, goals vary widely.

You may wish to sell some pieces to provide a stream of income for a surviving spouse, or you may wish to leave the collection intact as a legacy to children, grandchildren, and future generations of your family. Perhaps you'd like the collection preserved by lending or gifting it to a museum or a local charity. Perhaps the charity is a family foundation so that future generations of the family can control the ultimate charitable disposition. Perhaps you'd even like to send it out for exhibition on a world tour. Plans for collections are as varied and unique as the collectors who own them.

As a result, good advisors always begin by listening carefully to what the collector has to say about the past, present, and future of the collection.

### **What Steps are Part of Art Succession Planning?**

When it comes to art succession planning, we recommend that each client/collector go through the same 6 steps in order to consistently provide the best outcomes. Those six steps include:

#### **1. *Discovery (The past, present, and future of your collection)***

We begin by developing a history of the collection which may include method of acquisition, previous ownership, cost basis, copyright issues, provenance, and other information. Our experts can assist in building an electronic inventory, including photos, artist bios, and collector's recollections.

The inventory step, for example, is extremely important, and is the first step in establishing provenance – the ownership history of each piece.

Inventory involves an assessment of what the collector actually owns, how they acquired it, and what they paid for it. Research is undertaken to determine if each piece is authentic or is just a good reproduction. The advisors will also check to see if any piece is listed in the Art Loss Register as a work that has been missing or stolen. (After WWII private collections across Europe were pillaged. Once in awhile, pieces of these collections show up in a museum or private collection. The current owners often don't know the piece was stolen because it was purchased from a legitimate art dealer in a normal transaction.)

Your advisors may suggest that you have a catalog of the collection prepared, well in advance of death, and not just for exhibition or sale. This inventory and the resultant impressive glossy document (with color photographs, detailed descriptions, artist biographies, the collector's stories and recollections of the piece's history, etc.) will alone usually increase the value of the collection by at least 10%.

## 2. **Diagnosis** (*Uncover risks and possibilities*)

Next, a team of experts analyzes each piece in the collection to determine aesthetic quality and historical importance. Auction records and dealer prices are examined to develop a current opinion of valuation. Items are identified which may be in need of conservation or restoration. Finally, this information is integrated with our three-tiered grading system to provide a foundation for formal plan design.

Working with a Rolodex of national and international art experts the team has proven access to expert opinions to grasp the significance of your collection and to thoroughly explore myriad opportunities for maximizing its potential.

The world of collecting is a complex place, and an experienced art succession planning advisor pulls together all the various elements that impact the value of a piece in the marketplace; providing you an objective assessment of each piece's value at a specific point in time.

There are a wide variety of factors such as: construction materials and methods, condition, aging effects, art history, auction results of comparable pieces, museum interest and much more – each factor which may change in importance and priority from piece to piece. Once all the individual components are understood, the relationship of all the pieces to one another is considered and establishes the potential for the entire collection.

With a solid appreciation of the collection, its parts, and its connection to a larger context, we are ready to act to fulfill your wishes - some of which have certainly been enhanced through our thorough diagnosis.



While we have focused on discussing art thus far, we apply the same methodology and rigor to any collection we are presented with. Whether it is fine art, fine autos or fine wine we provide the same attention to every detail and any resource available to us to maximize the value of the collection and to transfer it effectively.

### 3. **Design** (*Construct a comprehensive art succession plan*)

The design step begins with careful listening to the goals and wishes of the collector. It's crucial to understand the client's desires and wishes for the collection. Only then can a strategic plan be constructed. After listening, the team of experts explores all the various options for the collection, each from his or her professional discipline.

Depending on the collector's goals, the possibilities are many and varied. After consultation and collaboration, the collector is presented with a formal, easy to understand, written plan that leverages the opportunities and mitigates the collector's risks.

This is where professional teamwork is especially important. When the attorney, CPA, financial advisor, insurance specialist, art succession planner, appraiser, and other members of the team work together on your behalf, you receive proposals that are integrated and united in approach.

You avoid wasting time going from advisor to advisor and getting conflicting advice that must somehow be reconciled with your goals. The advisors are able to engage in profitable discussion, sharing and refining ideas with one another, as they strive to achieve the best outcome for you, your family, and your collection.

The end results depend on your open communication and expression of your wishes and goals. You are the expert on your collection – the advisory team members are the experts in estate, tax, and financial planning. Both of you need full and complete input from the other to succeed.

### 4. **Delivery** (*A drafted and fully implemented set of planning strategies*)



A beautiful plan design isn't of value unless and until it is fully implemented. Your team of experts will draft all legal documentation, establish all legal entities, change title when appropriate, calculate tax liabilities or savings, file appropriate returns, and take care of every implementation detail. Those experts will also participate as needed to perform ongoing maintenance of the plan or to make future changes.

You will no doubt be amazed by the variety of comprehensive solutions that can be implemented on your behalf. There are strategies for reducing, deferring, or avoiding income, capital gains, and estate taxes. There are other strategies for benefiting the charities and causes you are passionate about. Still other solutions maximize the current value of the collection, and provide a system to enhance cash flow during retirement years or for a surviving spouse. And still others will enable you to keep the collection intact for generations to come. Virtually any goal you can conceive can be achieved by your professional team of advisors working together.

#### **5. Direction** (*Train beneficiaries and charities for future roles and responsibilities*)

Communication with beneficiaries, both current and future, is absolutely critical to the successful implementation of the plan. It is preferable to open that conversation while you, the collector, are still available to participate. The advisors can provide training so that everyone impacted will have a thorough understanding of the plan and their individual role in its implementation.

And like a general estate plan, an art succession plan is not a one-time transaction. It is an ongoing implementation that should be monitored by you and the plan's professional designers. A plan maintenance program is essential, because nothing is as certain as change. Your family situation may change. Your goals may change. The tax laws may change. The make-up and valuation of the collection will likely change from year to year, and your advisors will monitor those changes to ensure that the plan continues to operate effectively; fine-tuning and making changes to the plan as required.

## 6. **Distribution** (*Expert post-mortem advice*)

Sometimes even with a great plan and trained beneficiaries, it is helpful to have experts overseeing the transfer of the collection. Your team of experts is available to assist as needed or requested in the ultimate distribution of the collection.

### **What Benefits can be Achieved Through Art Succession Planning?**

While it is beyond the scope of this paper to go into great detail on any particular planning strategy, it would be illustrative to consider just a few of the things that can be accomplished through a comprehensive art succession plan. Here, to engage your imagination, are three examples of strategies we have used (usually in combination with other strategies) for actual collectors. Keep in mind that there are dozens of possible strategies and combinations of strategies with which to perform estate planning and art succession planning.

*[Special Note: Every attempt is made to ensure that tax information provided herein is accurate, but we don't know when you might be reading this, and tax laws are constantly in a state of flux. Therefore, the author and publishers of this paper are simply explaining possible techniques used in the past in other cases – we are not offering specific legal, financial, or tax advice for your circumstances. For such advice, we recommend that you consult your professional legal, tax, and financial advisors, or engage the services of the professionals of an Art Succession Planner™.]*

#### **The Charitable Remainder Trust (CRT)**

If a collector decides to sell part or all of a collection to create cash for living expenses, he or she will be subject to a capital gains tax (a tax on the increase in value from the time a piece is acquired until it is sold). This is a federal tax that impacts every collector, but some collectors will also face a state-imposed capital gains tax, depending on their state of residence. Of course, this tax reduces the amount of cash available for the collector's ongoing support.

Furthermore, any cash proceeds from the sale that remain unspent at the time of death will be part of the collector's taxable estate, and those proceeds will be reduced again by federal estate taxes and perhaps state inheritance taxes. The result is that a collection valued at \$1,000,000 may end up passing to the next generation as an investment reduced by more than 75%.

But by transferring the collection as a gift to a Charitable Remainder Trust (CRT), several benefits can be obtained. The trust can sell the gifted pieces and invest the proceeds in a wide variety of investments. This creates liquidity, cash flow, and income which, by the terms of the trust, must be paid to the collector for the remainder of his or her life.



At the collector's death, the *remainder* of the trust principal is left to a charitable entity, thus creating a large charitable donation, reducing or avoiding capital gains and estate taxation.

In addition to these benefits, the collector can take a charitable income tax deduction in the year the collection is gifted to the CRT. If the entire deduction is not required that year, the collector can take additional deductions for several additional years. If the collector wishes to leave some part of the value of the collection to children or grandchildren, part of the income paid from the trust during life can be used to purchase a life insurance policy for the benefit of the heirs.

### The Irrevocable Life Insurance Trust (ILIT)

In the example above, we suggest using life insurance to replace, for heirs, the value of the collection that was donated to charity. However, if the collector were simply to purchase and own a life insurance on his or her own life, the death benefit of that insurance policy would be included in the collector's estate for estate tax purposes. Therefore, although estate taxes were reduced or avoided on the art collection, they are levied on the insurance proceeds instead. The latter seems to cancel out the benefit of the former.

The solution is to avoid owning life insurance personally. Instead, the life insurance policy is purchase and owned by an Irrevocable Life Insurance Trust (ILIT). This trust, also known as a "wealth replacement trust," is commonly used when insurance is to be substituted to benefit heirs after other assets have been distributed philanthropically.

In a nutshell, (and necessarily leaving out many rules or details that your advisors will review with you), here's how the ILIT works. The collector (or collector and spouse) can be the "insured lives" on the policy, but the policy is not owned by them, and once established, the collector irrevocably transfers control of the trust assets to another person or entity as trustee, preferably at arm's length – possibly a CPA or trust company. By giving up control, the assets gifted to the trust by the collector are removed from the collector's taxable estate.

An irrevocable cash gift (that means you can't take it back) is then made to the ILIT by the collector. The trustee, after following some administrative rules, can use those funds to purchase a life insurance policy on the collector(s). The trustee applies for the policy, naming the ILIT as both owner and beneficiary of the life insurance policy.

Within the ILIT, the collector has named the eventual beneficiaries who will receive the insurance proceeds from the trust after the collector's demise. The trust controls the terms of the distribution by following the instructions originally provided by the collector.

Those beneficiaries are often the same as the beneficiaries of the collector's overarching estate plan. If so, the insurance proceeds can be combined with other assets that are being passed to those beneficiaries and, like other assets, be provided a wide array of creditor and predator protections within the plan.

Note that even when not replacing assets that have been given to charity, all insurance on the collector's life can (and probably should) be held in an ILIT to keep it from being part of the collector's taxable estate.

Some typical situations when collectors should consider an ILIT include:

1. The collector wants to make a significant gift of art to their favorite museum while still leaving a meaningful bequest to family members. Insurance in the ILIT is used for wealth replacement for the children.
2. The collector may have certain pieces in mind for each child based on the child's personality, preferences, and other factors. However, the various pieces vary widely in value. Insurance in the ILIT is used to equalize the bequests between the children.
3. The heirs may want the art collection, and wish to keep it intact for generations to come. In that case, the insurance in the ILIT can be used for liquidity to pay estate taxes so that pieces from the collection do not need to be sold to pay the IRS.

### Private Operating Foundations

We mentioned above the possible distribution of your collection to a charity. However, that charity does not have to be a public charity like a museum or the American Red Cross. Instead, it can be a private operating foundation – The Smith Family Foundation, for example. The thought of a family foundation might be intimidating at first glance. It causes us to think of the Fords, Rockefellers, Gates, and other members of the “very rich and famous.” However, a private operating foundation is simply a nonprofit organization that is typically created with a primary donation from an individual or family, and whose funds and programs are managed by the family's selected trustees or directors.

Where a public foundation funds its operations by ongoing donations, a private foundation usually generates income by investing its initial donation, and distributing that investment income to charitable activities. A private *non-operating* foundation simply disburses funds to other charities, while a private *operating* foundation actually runs the charitable activities they fund with their investment income.



The use of a private operating foundation allows the collector to keep the collection under family control while still reducing tax liability. After all, not every collector wants the collection to go to a museum because the museum may store the collection instead of displaying it, and may even sell it at some point. The collector has lost all control.

### Donate

With the world at their disposal, a collector can pick charities that may have nothing to do with art. Choosing charitable organizations that a collector is passionate about could be the bridge to greater philanthropic opportunity. Places such as hospitals, education centers, social service organizations, can benefit greatly if the planning for the collection is done properly.

A collector's favorite charity might not know how to properly evaluate and use the collection. However with the assistance of a skilled Art Advisory team, a collector can seize the opportunity and deliver the benefits that every charity hopes for today.

Helping the charity assist in designing a philanthropic plan for the collection is done by introducing your Art Advisory team to the charity. Through a unique process, the non-art related charity will learn ways to leverage a collector's wishes through the gift of their collection. This is rare. However, it will be the future bridge to philanthropic giving from the art world to the rest of the charitable world.

### Conclusion

As mentioned above, there are dozens of possible strategies (and combinations of strategies) with which to perform estate planning and art succession planning. These are just a few ideas to inspire you.

Although art succession planning may sound like a lot of work (and it is), the outcome is worth every minute invested in the process. And lifetime planning is always better than post-mortem planning. It was also a lot of work to build the collection in the first place, so why not protect that investment for generations to come?

Our experience, and the experience of hundreds of clients, is that proper planning will bring peace of mind and a deep satisfaction for the legacy you are able to leave behind. With proper planning, you can turn mere *success* into lasting *significance*!

1. <http://artmarketmonitor.com/2009/10/01/how-big-is-the-art-market>
2. <http://www.artasanasset.com/market/>
3. [http://imgpublic.artprice.com/pdf/trends2011\\_en.pdf](http://imgpublic.artprice.com/pdf/trends2011_en.pdf)

## ABOUT US

InKnowVision is a national consulting firm and the leader in design and development of business succession planning, wealth transfer planning and income tax solutions. We consult and market for independent advisors who serve high net worth families and business owners. Our core services include Advanced Estate Planning, Business Transfer Planning and High End Income Tax Planning for families and business owners with a net worth in excess of \$20M."

We use an unbiased fee-based team approach to design and deliver estate tax, income tax and wealth transfer solutions for high net worth families. We work as a strategic outsource with attorneys, financial professionals, insurance advisors and CPAs throughout the country.

Our ultimate goal is to collaborate with our advisors to deliver the highest level of expertise and service possible so that the planning they do with their high net worth clients is successfully implemented.

Our proprietary design and presentation software allows the integration of multiple strategies with varying assumptions, resulting in an excellent presentation tool for working with your high net worth clients.

We take complex issues and make them simple.

We can help you. Visit our website at <http://www.inknowvision.com>. Follow us on LinkedIn: <http://www.linkedin.com/company/inknowvision-llc> .