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## Private Foundations Bulletin

### The Private Foundation and Its Artwork

The flourishing contemporary art market paired with the tax benefits that accompany donations of highly appreciated assets have led to a significant increase in the number of private foundations encountering the complexities of valuing, accounting for and maintaining such works of art. The foundation has more to consider than just deciding on where to hang or display its artwork.

#### Valuation and Classification of Artwork between Charitable and Non-Charitable Use Assets

Prior to/upon receipt of artwork, private foundations should consider whether such artwork will be held for charitable or non-charitable use purposes. This differentiation is critical in determining the private foundation's annual distributable amount<sup>1</sup>, and, consequently, how often the artwork requires valuation. The Internal Revenue Service (IRS) provides the following guidance on determining whether an asset is deemed as used (or held for use) directly in carrying out the foundation's exempt purpose:

An asset is deemed used (or held for use) directly in carrying out the foundation's exempt purpose only if the asset is actually used by the foundation in carrying out its charitable, educational, or other similar (IRC 170(c)(2)(B)) purpose which gives rise to the exempt status of the foundation, or if the foundation owns the asset and establishes to the satisfaction of the IRS that its immediate use for such exempt purpose is not practical (based on the facts and circumstances of the particular case) and that definite plans exist to commence such use within a reasonable period of time.

Foundation management should document the determination based on the IRS guidance and the understanding of the private foundation's mission and long-term goals. If management determines the artwork is:

- **Held for charitable use:** no additional valuation is required other than the valuation at the date of donation (or not earlier than 60 days prior to the date of contribution of appraised property). This valuation is provided by the donor upon contributing the artwork; as any donation of artwork, to be deductible as a contribution to a qualified charity, it must be supported by a written appraisal from a qualified and reputable source, unless the deduction is \$5,000 or less.
- **Non-charitable use artwork:** the fair value must be included in calculating the annual distributable amount for the private foundation.

Artwork considered to be a non-charitable use asset must be valued on an annual basis. For the year of donation, as a practical matter, the appraised value at the date of contribution (or not earlier than 60 days before the date of contribution) often becomes the date and value used for assessment purposes.

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<sup>1</sup> In general, Section 4942 of the Internal Revenue Code requires private foundations to distribute 5% of the fair market value of their non-charitable use assets for the current year by the end of the next year.

Similarly, for contributions received under an estate plan after the donor's death, the artwork would be valued at the date of death. Estate appraisals are acceptable valuations.

For years thereafter, non-charitable use artwork must be valued as of the same date as the original valuation but may be made by private foundation employees or by any other person even if that person is a disqualified person (as defined by the IRS). This is important for private foundations with large amounts of artwork which may incur significant appraisal fees if a valuation was to be undertaken each year. In addition, for private foundations with a significant collection of a particular artist, management should investigate securing a blockage discount on the value of the collection. A blockage discount is a reduction to the fair market value of similar assets held in bulk to reflect the extent to which the selling price would be depressed were the assets to be sold at one time.

### **Donating Artwork as a Qualifying Disbursement for Charitable Purposes**

Certain private foundations are making contributions in the form of personal property, such as artwork. Contributions of artwork [to another charity] should be valued under the same rules applicable to a donor contributing artwork to a private foundation. The artwork should be appraised and supported by a written appraisal from a qualified and reputable source, unless the deduction is \$5,000 or less. Additionally, a written acknowledgement letter must be obtained from the donee.

### **Storing, Insuring and Handling Expenses**

Additionally, direct expenditures, such as the amounts paid for maintenance, storage and insurance of artwork held as a charitable-use asset, are deemed to be qualifying distributions. Direct expenses incurred to maintain non-charitable use artwork can be deducted against a private foundation's investment income.

### **Contact Us**

Should you have any questions, please contact the following experienced professionals in our Philanthropic and Private Foundation Services Practice: Thomas F. Blaney, CPA, CFE, Partner and Co-Director at [tblaney@pkfod.com](mailto:tblaney@pkfod.com) or Christopher D. Petermann, CPA, Partner and Co-Director at [cpetermann@pkfod.com](mailto:cpetermann@pkfod.com).

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