

## Private Foundations Bulletin

# Private Foundations and Artwork: Key Considerations for Compliance and Stewardship

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Private foundations that own, manage or anticipate receiving art collections must understand the regulatory and operational requirements surrounding valuation, donation and preservation of these works. This is critical to maintain compliance with the Internal Revenue Service (IRS) requirements and ensure the artwork is utilized in line with the foundation's charitable mission.

### Determining Purpose: Charitable Versus Non-Charitable Use

The first and most important step for any private foundation acquiring or receiving artwork is to determine whether the artwork will be used to further the private foundation's exempt purpose (charitable use) or not (non-charitable use). The two classifications directly affect how the artwork is treated for IRS purposes, particularly regarding the private foundation's annual 5% minimum distribution requirement and valuation frequency.

#### Charitable Use

Artwork is deemed to be "held for use" in carrying out the private foundation's exempt purpose when the private foundation is actively using the artwork in activities that align with its charitable, educational, or similar to its mission. For example, if the artwork is publicly on display (in a museum, education institution, or at the foundation's own publicly accessible facility), if the artwork is used as part of educational programming or exhibitions, or if the artwork is on loan to qualifying charitable organizations as part of the private foundation's mission.

Artwork can also be considered "held for use" even if it is not currently in active use, as long as specific criteria are met for future planned use. For example, if the artwork demonstrates that immediate use is impractical (ongoing renovations, exhibition planning) or if the artwork provides evidence of definite plans to begin charitable use within a reasonable period of time.

Key implications for charitable use assets are that valuation is required only once, typically at the time of donation (or up to 60 days prior), the value of the artwork is excluded from the calculation of the private foundation's annual 5% charitable distribution amount, donors must obtain a qualified appraisal to substantiate the contribution if the claimed deduction exceeds \$5,000 and in the case of preserving charitable-use artwork, direct expenditures, which include any maintenance, storage and insurance, are considered qualifying distributions under IRS rules.

#### Non-Charitable Use

Artwork that is considered a non-charitable use asset is described by the IRS as being an asset used for the production of income or for investment purposes, rather than a purpose related directly to the foundation's tax-exempt status.

Non-charitable use assets must be valued on an annual basis and the fair value of the artwork must also be included in determining the annual distributable amount for the private foundation. Guidelines for valuation of non-charitable use assets are in the year of donation, private foundations must use the appraised value as of the date of donation (or within 60 days prior to the contribution/donation). For estate contributions, the artwork should be valued at the date of death. Estate appraisals are acceptable valuations as well and for subsequent years, valuation can be conducted by foundation employees or even disqualified persons (as defined by the IRS), which will minimize external appraisal costs.

Non-charitable use considerations are when a private foundation has significant collections, especially of a single artist, they may consider applying for a blockage discount on the value on the collection. A blockage discount reduces the fair market value to reflect the market impact of selling multiple similar works at once. Also, direct expenses incurred to maintain artwork held for non-charitable use can be deducted against the foundation's investment income.

### Charitable Distributions of Noncash Assets

Some private foundations make grants in the form of tangible personal property, such as artwork, to other charitable organizations. These grants should follow the same valuation and documentation standards applicable to charitable contributions. For example, for items valued at over \$5,000, a qualified appraisal must be obtained that meets IRS standards and is conducted by a qualified appraiser. The grant recipient must provide a written acknowledgement letter which confirms the receipt of the donated artwork and the foundation's role as the donor; this letter serves as key documentation for both audit and compliance purposes. Lastly, If the value of the contribution made is over \$500, the foundation should complete the IRS Form 8283.

### Art Management and Due Diligence

Private foundations should implement a due diligence process that reflects their operational scope and governance structure before accepting artwork or making grants of art. Recommended best practices include:

- Assessing the authenticity and title to ensure the artwork is genuine.
- Reviewing any restrictions or conditions associated with the gift.
- Ensuring the private foundation has the resources and capacity to preserve, manage and use the artwork appropriately.

Once the artwork is received, the artwork must be carefully preserved. This includes the use of professional storage environments, climate control and security.

Proper due diligence ensures that the foundation avoids potential legal, tax, or reputational risks, while also ensuring strategic alignment with its mission.

### Conclusion

Artwork held by private foundations offers unique opportunities but also presents regulatory complexities. Whether the artwork is held for display, educational use or public access, these assets must be properly classified, valued and managed in accordance with IRS guidelines. With careful planning and ongoing oversight, private foundations can ensure that their assets are not only compliant, but also a meaningful component to their mission.

### Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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