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Ultra-Rich Are Enjoying Tax Breaks by Splitting Their Art in Two

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By Heather Perlberg

(Bloomberg) -- For billionaire art lovers, the Rothko, Basquiat or Banksy hanging in the front hall can be a source of pride and joy. It's also a great way to get a tax break.

Lawyers, already scrambling to help clients prepare for tax changes in Washington that threaten to soak the rich, say they're increasingly getting requests from art collectors to find strategies to shield their wealth from the Internal Revenue Service. The solution: giving away just a fraction of their ownership.

It's an opportunity to get a tax benefit tied to surging art values without donating a painting outright. In a typical arrangement, the piece goes back and forth between the donor and a museum, like divorced parents sharing custody of their kids. The owner gets an income-tax deduction based on the fair market value, potentially giving away more slices over time, for as long as 10 years. The art then goes to the charity for good.

While fractional donations aren't new, lawyers and tax advisers say they're growing in popularity as values climb and the Covid-19 pandemic leads to shifts in where people live. It's particularly suitable for those who've decided to split their time between New York and tax-friendly Florida, leaving behind empty Park Avenue penthouses for part of the year, according to John Mezzanotte, managing partner in the Greenwich, Connecticut, office of accounting and tax-advisory firm Marcum.

"If you're dividing time between two places, you won't even miss the art," said Mezzanotte, who has helped clients arrange fractional gifts.

Dividing art ownership is another example of how the ultra-rich are finding creative ways to wring tax benefits from their fortunes, especially as Democrats look to impose new levies on high earners. Last week, President Joe Biden outlined a social-spending framework that includes a so-called millionaire surtax of 5% on incomes above $10 million and an additional 3% on incomes of more than $25 million. Still, the rich avoided far harsher treatment after various measures, including a proposal targeting trillions in wealth held by U.S. billionaires, were shot down.

Higher values of just about everything — from real estate to wine to sports memorabilia — have added urgency to financial planning. And art has been on a particular tear. A Francis Bacon triptych sold last year for $84.6 million. In October, a half-shredded Banksy painting of a girl with a red balloon fetched $25.4 million, an auction record for the artist.

The IRS doesn't release data on how often taxpayers claim deductions for these types of donations, so it's impossible to track how much tax is being avoided with the strategy. Wealthy investors don't typically tout it with the same publicity they might for donating an entire piece of work to a museum.

New York's Metropolitan Museum of Art, the Museum of Modern Art and the Los Angeles County Museum of Art are among institutions that take fractional gifts, according to their collections policies. The Met accepted a partial interest in 17 works for its last fiscal year.

One prominent example is a drawing of a mother nursing her baby by the French post-impressionist Paul Gauguin. The museum accepted a 10% interest in the artwork, according to an annual report for fiscal year 2019 to 2020. A representative for the Met declined to comment.

"It makes sense when you don't necessarily want to own something for the rest of your life, but you can still hang it on your wall and enjoy it for years," said Laura Beck, a lawyer with Cummings & Lockwood who specializes in estate planning and wealth protection.

Logistics can be a hassle, according to tax experts. Owners have to find a charity, usually a museum, that's willing to play. And the museum has to actually take possession of the art within the first year. There are transportation and insurance costs, along with the risks that come with sending the piece back and forth.

Fractional gifts used to come with even better terms. Before 2006, the deductible amount was based on the fair market value on each slice of artwork the time it is given, rather than the initial value of the contribution. So as art appreciated, the savings for the wealthy got larger too. A tax-law change in the Pension Protection Act put an end to that.

Soaring prices for fine works are also helping to popularize yet another tactic that comes with tax advantages: art financing. Borrowing against the value of artwork allows people to get ample cash without having to sell, which means no capital gains taxes due.

Colleen Boyle, national sales director at advisory firm Fine Art Group, has seen increasing demand for art and jewelry lending in the past couple of years. It's all tied to mounting interest in how to manage family fortunes, she said. "Particularly with Covid, people are paying more attention to their estate planning," she said.

--With assistance from Ben Steverman.