Association of Art Museum Directors

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October 30, 2006

Honorable Charles E. Grassley, Chairman
Honorable Max Baucus, Ranking Member
Committee on Finance
U.S. Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Honorable William M. Thomas, Chairman
Honorable Charles B. Rangel, Ranking Member
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Re: Pension Protection Act of 2006 (the "Act") H.R. 4 - Gifts of Fractional Interests Section 1218

Gentlemen:

The Association of Art Museum Directors, founded in 1916, represents 170 art museums nationwide. On behalf of the membership, we write to express concern about the amendments to the Internal Revenue Code of 1986, as amended (the "Code") dealing with gifts of fractional interests contained in the Act. As we review the legislation, we believe that Congress's intention was to permit fractional gifts to be made, but to curb perceived abuses under the old law. Unfortunately, we hear from our members that various provisions in the law will effectively end fractional gifts, thereby depriving museums of a means to acquire great works of art for the benefit of the public. The loss will be to the public, to the nation's art museums and to the communities that they serve in all states. In order to avoid this result, certain technical corrections should be made as soon as practicable to avoid what appear to be unintended consequences that will paralyze the completion of gifts in progress.

1. **Grandfather existing gift programs.** To avoid the disruption of pre-existing acquisition, program and development plans by museums, the new law should not apply to subsequent gifts of fractional interests in property if the donee institution already owned a fractional interest in such property on the effective date. Because the exception would apply only to works in which fractional interests were given prior to enactment, there is no risk that the recommended provision will give rise to a pre-effective date flurry of fractional gifts. Without this change, donors who have already made gifts of fractional interests will be unlikely to give additional interests out of fear of becoming subject to the new law's uncertainties and harsh penalties, which means that the next installment of fractional gifts already in process will most likely not come to the museum until the death of the donor.

2. **Correct the mismatch between the estate and gift tax consequences.** The Act restricts a decedent's charitable deduction for subsequent fractional interest gifts (after the first such gift) in a work of art to the initial value at the time of the first fractional gift, but Sections 2031 and 2512 of the Code provide that for purposes of computing the estate tax and the gift tax, the valuation will be the fair market value on the date of death or date of the gift. The result is a limitation on the amount of the charitable deduction which, assuming that the work of art has increased in value from the time of the first fractional gift, will be significantly less than the valuation for estate or gift tax purposes.

   For example:

   For purposes of the gift tax, a donor could conceivably give the entire interest in a work of art to a museum during his/her lifetime (and within the 10 years provided by the statute) and incur a gift tax because the value of the work increases between the first fractional gift and any subsequent fractional gift;

   For purposes of the estate tax, a donor could donate fractional interests during his/her lifetime and complete the transfer as part of his/her estate plan (and within the 10 years provided by the statute), i.e., as part of a disposition by will or trust, and incur an estate tax because the value of the work increases between the first fractional gift and the donation after death.

   Many have indicated to us that this potential mismatch, because it could result in an unintended estate or gift tax, will preclude fractional gift giving in the future because the risk is simply too great.

3. **Eliminate the recapture of income and gift tax deductions and recapture penalty when property is transferred to a charity at death.** The new statute provides that any income or gift tax deductions are recaptured if the remaining interest in the work is not transferred before the earlier of 10 years of the initial fractional contribution or the date of death. In addition, there is a 10% recapture

penalty on the amount recaptured. This language could be construed to mean that the gift must be completed before death and would not allow a gift of the remainder interest by will or trust after death.

For example:

If a donor is on schedule to complete a gift in 10 years, but dies in year eight, his/her estate could be responsible for recapture, interest and penalties because the gift was not completed BEFORE the death of the donor.

We suggest in such circumstances there be no recapture since the work of art ultimately is owned by the museum.

We are mindful of concerns that have been expressed that fractional gifts could result in a current income tax deduction without the museum receiving the ultimate benefit of a work of art. We support the concept in the legislation that a fractional gift should be coupled with a commitment to transfer the entirety of the work, ultimately, to the museum. Nevertheless, the legislation as drafted (even with the corrections to the unintended consequences identified above) would continue to discourage generous donors from supporting museums by transferring their private wealth to the common good. In order to encourage donors in their philanthropy and at the same time increase enforcement we recommend the following corrections.

4. **Eliminate the mandatory 10-year period for recapture purposes**. There does not appear to be any specific policy advanced by requiring recapture of deductions and penalties if the remaining interests in the property are not transferred prior to the earlier of 10 years from the initial transfer or death. Donors, who willingly give partial interests in a valuable museum quality work of art, should be able to avail themselves of the flexibility of giving their gift over their lifetimes if that best suits their financial and personal needs and desires. So long as the possession requirements are met, taxpayers should be permitted to make fractional interest gifts over any period of time without risking recapture of the deductions.

   In place of a limited time period, we suggest that a donor be required to pledge at the time of the initial fractional contribution that the balance of the interest will be transferred either during lifetime or at death. In addition, if the donor failed to complete the gift of the entire interest or failed to provide physical possession as suggested below, the donee would provide an information return to the Internal Revenue Service and, in such event, all prior income and gift tax deductions would be recaptured. A binding contract with reporting provisions would help ensure that any work for which a deduction was taken will ultimately go to the donee museum.

5. **Provide limited exceptions to recapture where required possession and use is not practical**. The new statute requires recapture where the donee does not take

physical possession of the property. We support the concept that substantial physical possession should occur during each 10-year period until the gift is completed (this assumes that the mandatory 10-year gifting period is eliminated). As a practical reality, however, very fragile, very large, or very rare works often should not be subject to travel or frequently moved. We suggest that physical possession can be waived if: (a) the donee museum certifies that physical possession would not be in the best interest of the work of art, the museum or the public because (i) the museum's construction commitments would prevent possession of the work during the period, or (ii) packing and transporting the work may damage the work because of its fragility; or cause serious financial hardship to the museum because of the cost of transporting and assembling a large work of art, or (b) the donor dies before the donee has an opportunity to possess the work.

6. **Restore the fair market value deduction**. With the addition of enhanced protections to the appraisal process in Section 170(f)(11)(E) of the Code and the recently issued guidance in Notice 2006-96, 2006-46 IRB, the possibility for abusive appraisals is significantly reduced. Furthermore, we recommend that appraisals of works with a total value (not just the proposed gifted interest) exceeding $1,000,000 be subject to automatic review by the IRS Art Advisory Panel. With these changes, the donors should be allowed to use the actual value of a donated interest rather than the historic and potentially unrealistic value as now required by the Act. Furthermore, there seems little logic or policy justification to continuing to allow a fair market deduction for gifts of fractional interests in real estate to charities and yet disallow such a deduction for gifts of works of art.

The suggested changes will ensure that one of the most significant sources for great works of art will continue to come into the public domain. We appreciate your willingness to consider these changes.

Very truly yours,

Millicent Hall Gaudieri
Executive Director

Anita M. Difanis
Director of Government Affairs