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27. *Id.* at § 103(b), 104 Stat. at 1963 (to be codified at 20 U.S.C. 954(d)(2) (1990)).

28. *Id.* at § 103(b), 104 Stat. at 1963 (to be codified at 20 U.S.C. 954(d)(1) (1990)).

29. *Id.* at § 109(1), 104 Stat. at 1971 (to be codified at 959(c)(1) (1990)).

30. *Id.* at § 109(9), 104 Stat. at 1971 (to be codified at 959(c)(6) (1990)).

31. *Id.* at § 109(1), 104 Stat. at 1971 (to be codified at 959(c)(1) (1990)).

32. G. Biddle, Memorandum on the Reorganization of the Departmental Agencies of the Federal Government Dealing with the Visual Arts, reprinted in, *National Arts Legislation: Hearings Before The Special Subcomm. On The Arts of The Senate Comm. On Labor And Public Welfare On S. 165 And S. 1316*, 88th Cong., 1st Sess. 143, 144 (1963).

33. Rothstein, *Arts Organizations In New York Fear Planned Cuts*, *New York Times*, January 14, 1991, § C, at 11, col. 5.

34. 121 Cong. Rec. 15,595 (1975) (statement of Senator Pell).

Charitable Contributions of Artwork and Federal Tax Law

Introduction

The art community should see an increase in the number of donations from private collections as a result of a recent change in the federal tax code. The change, part of the Omnibus Budget Reconciliation Act of 1990 (1990 OBRA), relates to valuing charitable donations of tangible personal property.¹ It abolishes the requirement that the value of such deductions be calculated one way for purposes of regular income tax and a less favorable way for alternative minimum tax purposes.

Prior to the change, for regular tax purposes, the value of a deduction for a charitable contribution of property was equal to the property's fair market value at the time of the donation. However, for alternative minimum tax purposes, the value of the deduction was decreased by the amount the property had appreciated since acquisition. This reduced the attractiveness of making donations of appreciated property as a way of decreasing the donor's federal income tax liability. With the recently enacted change to the Internal Revenue Code, effective in tax year 1991, this dual valuation requirement is canceled in some circumstances. The value of appreciated tangible personal property is the same for alternative minimum tax purposes as it is for regular tax purposes. This can be a tremendous windfall for the taxpayer who wishes to donate valuable appreciated objects to the art community.

This update will first discuss the treatment of charitable contributions of personal property, both for regular tax purposes and alternative minimum tax purposes, prior to the passing of 1990 OBRA. Addi-

tionally, the incentive that 1990 OBRA has created for increased charitable contributions of artwork will be addressed. Finally, the conclusion will set forth the overall affect that this legislation will have on the art community.

Treatment of Charitable Contributions of Property Prior to Change

Treatment for Regular Tax Purposes

A taxpayer² may generally deduct contributions to charity from his or her adjusted gross income (AGI) to determine the taxable income (TI) on which the taxpayer pays income tax.³ When the taxpayer contributes property, the value of the property, and hence, the amount the taxpayer may deduct, is equal to the fair market value of the property at the time the taxpayer contributes it. The taxpayer may deduct this full amount provided the donation is made to a charity recognized by the I.R.S. and the charity puts the property to a use related to its status as a charity.⁴ However, the sum of the taxpayer's charitable deductions is limited; the total may not reduce the taxpayer's AGI by more than a set percentage in the tax year the deduction is claimed.⁵

For example, assume Donor bought Painting in 1980 for \$10,000. In 1990, Painting had a fair market value of \$25,000. Donor then contributed Painting to a tax exempt art museum. The art museum put the Painting on display (rather than selling it). Donor could deduct \$25,000 from his or her adjusted gross income when figuring the taxable income provided it would not reduce taxpayer's AGI by more than the percentage the Code allows. However, if the Donor contributed Painting to the local little league which hung Painting in its snack bar, the donation would be put to an unrelated use and the taxpayer could not deduct the full \$25,000.

Deductions for charitable contributions are allowed because Congress has determined that it is good public policy to encourage donations to charities by giving the donations favorable tax status. To promote donations of non-cash property, Congress allows such property to be valued at its fair market value at the time of contribution, rather than the value at the time the taxpayer acquired it. This valuation method is especially beneficial to the art community because donations frequently are in the

form of paintings or similar cultural properties that have appreciated since acquisition.

Treatment for Alternative Minimum Tax Purposes

Taxpayers who use itemized deductions to lower their TI below amounts set by the Code must make a computation to determine whether they must pay an alternative minimum tax (AMT).⁶ The level that triggers this additional computation varies based on the status of the taxpayer. For instance, a single taxpayer must make the computation if his or her taxable income is less than \$30,000. However, a corporation need not make this computation unless its taxable income is less than \$40,000.⁷

To determine whether they must pay an AMT, these taxpayers must calculate a new taxable income figure. In calculating this new figure, some of the deductions allowed for regular tax purposes are not allowed, and the value of others is reduced.⁸ The deductions which are not fully allowed for AMT purposes are those taken for items deemed by the Code to be items of tax preference.⁹ The taxpayer must add the disallowed deduction, or portion thereof, to the original TI to arrive at a new TI figure known as the AMTI.¹⁰ Nevertheless, determining this new figure for most taxpayers is very easy because they have not taken any of the rather exotic deductions that the Code labels as items of tax preference.

Once all the items of tax preference are added, taxpayers are allowed to take a limited number of deductions and exemptions from the AMTI.¹¹ The amount remaining is multiplied by the alternative minimum tax rate to arrive at the taxpayer's alternative minimum tax.¹² If this total exceeds the taxpayer's federal tax paid on TI, the taxpayer is liable for the difference.¹³

From 1986 until the recent change, deductions for charitable contributions of appreciated property were deemed to be items of tax preference. AMT rules did not allow the full fair market value to be deducted when calculating AMTI. For AMT purposes, the value of the deduction was equal to the donor's adjusted basis in the property. As such, the taxpayer had to add to his or her TI the difference between the fair market value and the adjusted basis of property deducted as charitable contributions.¹⁴ The adjusted basis of the property was generally the amount the taxpayer paid for it, plus

any amount spent to improve it, minus depreciation deductions already taken.

For instance, in the previously mentioned example, Donor's basis in Painting is \$10,000. If Donor would have had to use this amount to assign a value to the charitable contribution, Donor's deduction would have been reduced by \$15,000. Donor would therefore have to add this \$15,000 to the TI to determine the AMTI figure.

Congress created the Alternative Minimum Tax to help maintain taxpayer confidence in the tax code. The confidence of taxpayers is linked to their belief that the system is basically fair. Congress' recognized faith in the system's fairness suffers when many taxpayers earning high incomes drastically reduce their taxable income through the use of deductions unavailable to the average taxpayer. Congress enacted the alternative minimum tax rules to ensure that these higher income taxpayers pay at least a minimum amount of taxes.¹⁵

Impact of the Legislation

The 1990 OBRA modified how certain deductions for charitable contribution of property are treated for AMT purposes.¹⁶ Effective in tax year 1991, donations of otherwise qualifying tangible personal property are no longer treated as items of tax preference.¹⁷ They therefore are not subject to dual valuation requirements.¹⁸ Thus, in the previously cited example, if Donor made a charitable contribution in 1991, the donor could deduct \$25,000 from the adjusted gross income to arrive at the TI.

Congress did not exempt all donations of appreciated property from special treatment under AMT rules. Real and personal property interests, such as land and trusts, are still items of tax preference for AMT purposes.¹⁹ Also, the contribution still must be used by the donee in a manner consistent with its tax exempt status, and the total amount by which charitable contributions may reduce AGI remains the same.

Congress enacted the change because it concluded that there was a special need to encourage donations of tangible items with unique cultural or educational value such as works of art and manuscripts.²⁰ The change was designed to provide an additional incentive for taxpayers to make such contributions. It is clear that Congress wanted to increase specific kinds of donations, not just donations in general, because the change is limited to items of tangible personal property.

Congress has also created an incentive for taxpayers taking many deductions to make a qualifying charitable contribution of property under the new tax code. As noted above, by taking a deduction that is not considered an item of tax preference, taxpayers may keep the full value of their deduction when figuring their AMTI. This is good news for all types of museums, libraries, and archives because the donation must be in the form of tangible personal property in order to keep its full value under AMT rules. This change should also increase the donation of items these institutions need such as coin collections, paintings, manuscripts, sculptures, and artifacts.

Additionally, this modification will affect how some taxpayers plan their tax strategy, because many taxpayers will continue to prefer deductions that will be valued the same way for regular and alternative minimum tax purposes. Since a donation of tangible personal property is now one of these deductions, they will prefer it to other AGI reducing deductions. For instance, in the example previously mentioned, Donor would opt to use Painting to reduce the AGI rather than more common tax shelters deductions which are still considered items of tax preference for AMT purposes. The 1990 OBRA should also benefit patrons of art institutions because the donee must still put the contribution to a use related to its tax exempt status in order for the contribution to be fully deductible. Therefore, donors are likely to make contributions contingent on being put to a related use and therefore enjoyed by the donee's patrons.

Conclusion

Taxpayers with appreciable personal property once again have a tax incentive to donate that property to charities that can put it to good use. By exempting tangible personal property from the list of tax preference items, Congress created a means by which some taxpayers may use that property to

obtain a tax break not subject to any alternative minimum tax. This change should increase personal property contributions to the art community, therefore benefitting museums around the country and preventing foreign investors from relocating valuable works of art. Ω

John T. Longo

1. Omnibus Budget Reconciliation Act, Pub. L. No. 101-508, § 11344, 101 Stat. 508 (1990) (codified at I.R.C. § 57(a)(6)(b) (1990)).

2. Unless otherwise noted, the term "taxpayer" is used to mean either an individual or a corporation subject to federal income taxes. Likewise, the term "donor" means either an individual or a corporation making a donation.

3. To figure regular income tax liability, taxpayer multiplies his or her TI by his or her tax rate.

4. I.R.C. § 170(e)(1)(B). The I.R.S. has taken the position that an unrelated use would include selling the object donated to generate revenue even if the revenue is then used by the donee for a purpose consistent with its status as a charity. The regulations do recognize that because some of the property donated may be sold does not mean the contribution is for an unrelated use. Treas. Reg. § 1.170A-4(b)(3).

5. I.R.C. § 170(b). Presently this percentage is 30%-50% for an individual whose contribution is in the form of property, depending on the type of property and recipient of the contribution. I.R.C. §§ 170(b)(1)(B), (C).

6. I.R.C. §§ 55-59.

7. I.R.C. §§ 55(d)(1)(A)-(C).

8. 1 Stand. Fed. Tax Rep. (CCH) ¶ 570 (1991).

9. *Id.*

10. Alternative minimum taxable income. *Id.*

11. I.R.C. §§ 55-59. The present exempt amount varies from \$20,000 to \$40,000 depending on the taxpayer. I.R.C. §§ 55(d)(1)(A)-(C).

12. AMT rate is 24% for a corporation and 21% for a taxpayer other than a corporation. I.R.C. § 55(b)(1)(A).

13. I.R.C. § 55(a).

14. I.R.C. § 57(a)(6).

15. 1 Fed. Tax. 2d (P-H) 1680 (1990).

16. Omnibus Budget Reconciliation Act, 101 Stat. 508 (1990).

17. *Id.*

18. This is a return to the way all property contributions were treated prior to 1986. See I.R.C. § 57, *reprinted in*, 11 Fed. Tax. Serv. (Bender) 11-2782 (1991).

19. I.R.C. § 57(e).

20. 1 Fed. Tax. 2d (P-H) 1680 (1990).

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