respects and more intended to give food for thought and inquiry rather than to constitute any sort of do-it-yourself manual. It is intended primarily for collectors, not dealers, although in many respects the new 1986 tax code has narrowed the differences in the treatment of the two. A "dealer," incidentally, is defined in the tax law as one who holds objects primarily for sale to customers in the ordinary course of business. Conversely, a collector is one who is not a dealer. The distinction is sometimes fuzzy: a person can be both a collector and a dealer, as many of us are. Without going into detail, the two functions can be separated by keeping two sets of genuine books — legally, one for a collection, one for dealer's inventory.

The elimination of lower rates on capital gains has put non-incorporated dealers and individual collectors on an equal basis so far as tax rates are concerned, but the distinction still exists insofar as deductibility of certain expenses is concerned. More on this later.

A few basic comments on income tax deductions for theft and fire losses and the attendant necessity of keeping good records and carrying insurance are in order.

You may take solace in the belief that theft or fire losses are fully tax deductible if not covered by insurance. This is far from true. In the first place, theft or fire losses are deductible under the new tax laws only to the extent they exceed 10% of your basic income. Also, your deduction is limited to your tax "cost" or current value, whichever is *less.* If you paid $200 for a piece that is worth $2,000 when it is stolen or destroyed by fire, you get a deduction of only $200, which, if you are in a 28% bracket, saves you $50 in taxes. In other words, Uncle Sam is your co-insurer only to a very limited extent. Thus, insurance is a real must for the collector.

It should be noted that if your theft or fire loss, even on the basis of cost, is so large as to reduce your taxable income to below the 28% bracket, then the government bears even less of the loss under the example above.

As for insurance, at least some homeowner's policies cover tangible property up to 50% of the insurance on your house but there are all softs of fine arts limitations, jewelry limitations, etc. Furthermore, 50% of the value of your house may not be enough for some of you. A number of collector acquaintances have told me from time to time that they have no separate insurance on their collections "because it is too expensive." However, after searching around I discovered that an itemized all-risk policy can be had from a highly reputable company at the remarkably low annual premium of 25¢ per hundred dollars — or less than a fourth of one percent of the value of my collection which is, I believe, conservatively appreciating at 6% per annum or many times the annual premium.

Turning next to valuations and record keeping. For tax and insurance purposes you should have workmanlike current appraisals which will be acceptable to your insurer. These should be filed with the company and the valuations should be agreed upon by them so that once a loss has been established there can be no argument as to the amount of each piece you have. This should be updated periodically, both as to valuation and the items added and deleted. You will most likely not be covered for items not actually listed under this type of policy, but these may be covered under your homeowner's policy or under a general floater. Furthermore, if your items travel with you to shows and the like, you should be sure they are covered while outside your home.

For all purposes, not only with respect to theft and fire loss deductions but for others discussed a little later, precise cost records should be kept, and these should include a buildup of costs where items have been traded for others. In other words, if you buy a gun for $100 and later give it, plus another $100, for another, your records should show your cash cost for the newly acquired gun as $200 and should be cross-referenced to your records on the first gun. Photographic documentation is extremely helpful in substantiating losses for both tax and insurance purposes, as well as for identifying stolen items that may turn up on the market.

I had television tapes made of my entire collection some years ago. These consist of numerous closeup views of each piece, and they vividly show every serial number, proofs, and even pits and dents. In the event of loss, very sharp prints can be made from the tapes for use in sustaining tax deductions or insurance claims. These tapes are superior to photographs, because they provide any number of angle shots of each piece and you can see on the TV screen exactly what the tapes will show while the tapes are being made. Today fairly inexpensive camcorders are available so that you can make your gun tapes. An advantage here is that you can promptly and inexpensively catalogue new acquisitions.

I will turn now to several other areas of tax law of general interest to arms collectors.

Ordinarily, as most of you know, if a firearm is *sold* (as opposed to traded) by a collector for a price in excess of cost, the gain is subject to tax at a top rate of 28%, or 33% if your income falls in certain ranges. However, the tax law provides that if a property is held *"for investment"* and is traded for another property of *"like kind,"* no gain is recognized. The two requirements here are that the property exchanged is held "for investment" and that it be "of like kind" for that received. Theoretically, it might be argued that property owned as a hobby is not held for investment, but it is my understanding that for purposes of this particular provision, the Treasury in at least one situation has not taken this position, although

this position seems somewhat inconsistent with that of the Court of Claims in the *Wrightsman* case discussed below. As for what constitutes "like kind," antique firearms should be, and I understand have on audit in at least one case, in fact been considered to be "of like kind." Query as to firearms on the one hand and swords or armor on the other. There are no published or private rulings on this that I know of. If you exchange an item for a combination of "like kind" items and cash, the gain will be taxable to the extent of the cash. For example, assume that you have an item originally bought for $500 which you exchange for another item having a value of $600 plus $200 in cash paid to you. The actual gain is $300 but it is my understanding that the taxable gain is only $200 (i.e. the amount of the cash).

As a result of this rule, if it stands up, a collector could go through life without ever selling anything and thus never have to pay any capital gains tax. If he held the property until death, his estate's basis for computing gains in the event of a sale would be the date-of-death value. Hence, capital gains tax on appreciation of all items that he owned during his lifetime would be eliminated. However, this whole area graphically shows the need for good records. If something you have obtained from a series of exchanges through the years is sold, the burden of showing your tax base cost is on you. If you can't show it, it may be considered zero which perhaps in many cases might not in fact be too far off the mark.

Next, suppose you have a fire or theft and you are fully insured. What are the tax consequences of your recovery?

If you are fully insured, the excess of the insurance proceeds over your base cost is treated as a gain and taxed as such, with a maximum tax of 28%. However, because the gain is "involuntary" you are given two years to buy replacement property (antique guns in our case) without paying the tax on the gain, and this period may be extended upon application to the Internal Revenue Service at its discretion (which I am led to believe is freely granted).

And what if you recover stolen property after having recovered insurance or taken a tax deduction? If you have recovered property for which you were insured, there should be no tax consequences since you have had no deduction, but under the policy you will probably have to return the insurance proceeds. This will depend on the terms of the policy. If you recover property for which you have taken a tax deduction in an earlier year, you have to add back into taxable income in the year of recovering the amount previously deducted.

Expenses of Collecting

Let us turn next to the tax treatment of expenses incurred in connection with collecting, such as insurance premiums, security alarms, subscriptions to publications, membership dues, etc. and, more importantly, expenses of travel and lodging in connection with auctions, shows, looking for acquisitions and, in particular, the expense of attending this meeting. I personally have never considered these expenses — from the collector's point of view — to be deductible for income tax purposes. In doing some research for this article, however, I found a United States Court of Claims case in which these issues were raised and in which the court held that such expenses were indeed held not deductible for income tax purposes. However, the court was divided. The fact finding commissioner who heard the case according to that court's procedural rules recommended that the deduction be allowed, and subtle changes in the statutory law since that decision in 1971 indicate that this question may still be open. The facts in the case were interesting; it involved *Charles and Jayne Wrightsman,* whose family have been benefactors of well-known museums. In middle age, Charles sold out his interest in a family business and he and his wife became avid collectors and students of the arts. They travelled extensively in pursuit of acquisitions and instruction and kept careful records of their acquisitions. Their collection catalogues were themselves considered valuable material. The Wrightsmans' social life centered around persons interested in the arts and most of their collection was displayed in a New York City apartment where they spent very little time. The *Wrightsman* case was decided on the theory that collecting for them was a hobby and not an investment, although the court conceded it was a close question. The test was what stood as their *primary* reason for collecting. I think that in today's climate where investing in antiques and the art has gained increasing investor interest, where even bank trust departments have been setting up common trust funds to permit clients to invest in the arts, the decision might well go the other way if the collector acted in a businesslike way. Therefore, he should keep complete records, have insurance, indicate in every way possible that he considered his acquisitions as investments, provide in his Will for orderly disposition of his collection, and so forth. The mere fact that a collection happens to be a source of pleasure should not necessarily mean that the *primary* motive is not an investment motive.

In this area, the distinction between "collector" and "dealer" becomes important. To the extent that you are a dealer, these expenses should certainly be deductible. To the extent that you are a collector, they may not be. What if you are *both* a dealer and a collector? Have any of you had any experience with the Internal Revenue Service in this regard? In any event, I would suggest to your accountant the possibility of taking a deduction for part

of your expenses.

Federal, Gift and Estate Taxes

Let us take a look at the gift and estate tax structure, how it affects your estate planning, what it costs to "come clean" and what it can cost to try to "cut tax corners," how you can get caught, what happens if you get caught, and how your estate can benefit greatly particularly under the recent amendments by playing without the rules and how to make certain your heirs realize the most from your collection, if it is to be sold.

First, under the present gift and estate tax structure, anyone can give or bequeath an unlimited amount free of federal gift or estate tax to his wife. In addition, under present law one can leave a total of $600,000 to others, such as children, free of tax. It should be noted that if your spouse survives you and dies with amounts in excess of those set forth, her estate will be subject to estate tax on her death and therefore it may not make sense to leave your entire estate to her outright. For example, you could leave $600,000 in trust with the income to her and thereby shelter that amount from tax in her estate as well as in your own and leave any balance outright to her. In this way, you and your wife could give up to $1,200,000 free of federal estate tax to your children. In addition, if your estate sells tangible items (such as arms) for their estate tax valuation, there is no gains tax because under the law the tax base cost for inherited property is generally the estate tax valuation even though your estate is not subject to any estate tax. If your estate sells at prices in excess of the estate tax valuation, the gains tax is imposed at 28% of such excess. Thus, if your collection is to be sold, it may, depending on the size of your estate and on whether you leave all or part to your wife or others, be better to have your collection appraised higher rather than lower for tax purposes. Of course the appraisal must in any event be within reasonable limits. It is always subject to review by the Internal Revenue Service but there is a presumption that the value determined in estate tax proceedings is binding for income tax purposes.

Within certain limits, estate taxes can be saved by making gifts of items from your collection to members of your family during their lifetimes. You can make gifts to any number of individuals of items having a value of up to $10,000 each year without any tax consequences whatsoever. In other words, if you have three children, you can give them each items worth up to $10,000 ($20,000 if you are married) in every calendar year until you die without ever having to file a gift tax return and without having any of these amounts subject to estate tax at your death. Furthermore, this method will result in additional savings if the items given appreciate in value during your life because the appreciation occurring after the date of the gift is removed from your estate.

When it comes to making gifts, it is possible to retain the enjoyment of these items during your lifetime and yet to have the value of these items excluded from your estate for tax purposes if the donees consent to your keeping possession of them. However, if there is any *agreement* either express or implied permitting you to keep possession, the items that are the subject of the gift will be treated in the same manner as if you had made no gift at all. Hence, any such gifts should be accompanied by a *deed* which clearly entitles the donee to immediate possession. The mere fact that you have deeded a number of items to others without any ever having been removed from your gun room could give the Internal Revenue Service ammunition for an argument to the effect that there has been an implied agreement by the donee not to remove such items.

Gifts to Charities

This is an area that I will not discuss in any detail here except to point out that there can be substantial tax advantages to those who wish to donate their collections to charitable organizations. The rules are complex but in my experience few arms collectors have any interest in giving their collections to museums or other charities.

Estate Disposal

Now suppose you die and your executor must decide how to dispose of your collection. Suppose he (or your wife if she is executor) decided not to come clean. What can happen? All kinds of things, none of them good.

First, how can your estate get caught?

(a) In one case, an individual (a client of mine) inherited a lot of "junk" in a barn. He sold it at auction — a small overlooked portion of an estate he inherited — for about $30,000. His lawyer (me) never knew about it, his accountant never knew about it and the individual never gave it a thought. Eventually he got a call from the Internal Revenue Service to set a date for an audit conference. On that unforgettable occasion he was asked why the $30,000 sales were not reported on his tax return. It developed that the Internal Revenue was making a routine check of auctioneers' records to uncover frauds. As it turned out, the individual had losses in other transactions that wiped out the gains, so he had no problem. But otherwise he could have been in big trouble via penalties and interest, or if fraud could be proven, even worse.

(b) Informers. Another taxpayer was involved many years ago in a situation having nothing to do with a collection. He had an accountant who fired an assistant. The assistant turned informer on the taxpayer in the hope of getting a reward from the IRS, as well as to get even with his former boss. The taxpayer won his case on appeal (the court held that the law was on his side), but the legal, accounting and expert witness and other fees were large and the heirs couldn't take possession of their

inheritance for about five years.

All of you may think you have no enemies but we have heard enough not so complimentary comments about other collectors and dealers to believe that some outsiders may feel the same way about some of us. Thus a "disappearing collection" may not be an answer to Uncle Sam's call for taxes, which in any event may not be as steep as you may think.

(c) There is a question on the estate tax return form which reads "did the decedent at the time of death own any articles or collections having either artistic or intrinsic value such as jewelry, furs, paintings, antiques, rare books, coins, or stamps?" The return must be signed under penalties of perjury. Never expect your wife, or anyone else who may be your executor, to answer this any way other than candidly.

(d) On an estate tax audit you can be sure the IRS will review all of your checkbooks, savings bank books, income tax returns, and other records for at least three years prior to death. Any large deposits or withdrawals will have to be explained. So you deal in nothing but cash — okay — but you are still vulnerable to informers, IRS general information learned from audits and subpoenas from dealers, auctioneers and others: concealment is no answer. Furthermore, at death, how is your estate going to dispose of your collection? If your wife attempts to back it out and sell on the sly, how is she going to do so? No doubt she will have plenty of friends offering to help her get rid of it at a "fair price" or "top dollars." Every time I hear these words, I laugh.

To re-cap:

(a) Keep complete and accurate collection records: description of each item, where you got it, who owned it before you, every article, book or catalogue where it may have appeared, every letter or what not on it, including, when and what you paid for it and current (at least every two years) appraisals of values, and tell your wife or family what you have. Do not tell them it's "'junk" to justify the understated price you paid for it; and do not claim it is worth ten times what you paid for it to make it appear that your purchase was a great bargain. Avoid keeping valuations and records in your gun room. To do so will just assist careful thieves in doing a diligent job.

(b) Don't try to chisel on taxes. If your collection is to be sold, concealment or disposal in a clandestine way could cost far more than honestly declared estate tax values. Your collection should be advertised; previous ownership, display in magazines, publicity in auction catalogues and similar promotion could bring far more than any estate tax savings you might achieve by selling on a clandestine basis through friends, second-rate dealers, and others who do not know what or where the market is. All of this is particularly relevant under the present tax law under which, as mentioned above, you may well find you have no such taxes to worry about.

(c) Name in your Will and/or instructions to family or executor those advisers whom you wish to have assist in evaluating and disposing of your collection. Authorize them to pay such advisers reasonable compensation or commissions for their services.

(d) If your intent is that the collection be sold, say so in your Will. Failing to do so may prevent the expenses of sale, such as commissions and advisory fees, from being deductible administration expenses for tax purposes. Such expenses are deductible only "if necessary in connection with the administration of your estate."

(e) If in doubt as to how your estate can dispose of the collection, your best bet may be auction by a well-known house: Christie's, Sotheby's, Bourne, etc., are all honest and reputable — but I would still be inclined to name a trusted adviser to help. "High art" and very rare guns are probably better sold at auctions than run-of-the-mill military guns, but the definite trend in my opinion seems to be the auction route. But the auction should, to attract serious buyers, have many high quality items, and should be well advertised. The economic advantages of auction are obvious; they are:

(1) You sell and get paid quickly and can invest the proceeds promptly — as opposed to having your money idle on a dealer's shelf for long periods;

(2) Your selling costs are known — typically 10% of the price paid by you and 10% by the seller;

(3) Prime auctions are well and widely advertised and attended; and

(4) You can protect yourself against low prices by setting a "reserve" or a minimum price, although some auctioneers do not favor this procedure.

Summary

To capsulize this rather rambling series of comments, several points should be emphasized:

(a) Let your family know what your collection is and what it is worth.

(b) Tell them what you want done with it when you pass on.

(c) Choose your advisers with care, but do choose them and tell your executor who they are.

(d) Keep in mind the disadvantages of consignments to a dealer: he may die, disappear or what not and whatever is in his hands may be difficult to identify and to reclaim. This happened to me, albeit in a very minor way.

(e) Do not advise disposing of the collection on the sly; your estate will realize more even after taxes (if any) if sold openly.