

# COLLECTORS' ANGST: WHAT DO I DO WITH MY COLLECTION?

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## CONUNDRUM: (a Noun):

A confusing and difficult problem or question;

A question or problem having only a conjectural answer.

Perhaps the more accurate question posed in the title of this written discourse should be “what does my spouse and/or family do with my collection if I continue to procrastinate and do nothing except talk about the collection. . . and then die?” I am one of those enthusiastic arms collectors that gets excited each day as a military or arms show date approaches. It really does not matter to me what the primary theme of the show might be. The focus could be on the U.S. Civil War, early American history and battles for our country’s independence, or it could be the Spanish American War, Word War One or World War Two. All of these significant events are important to me. The show could have a more international focus which would feed my fix for seeing and handling European armor, medieval weapons, pre-Culloden Scottish weapons, early Viking and Roman weapons such as a Gladius sword, a spatha, the large two-handed swords which I find very cool, and then there are the crossbows. I love it all . . . which creates all sorts of issues for my wife should I perish without any well thought out plan on what happens to these treasurers upon my demise.

I find that when gathering with my fellow collecting friends at these military or gun shows the topic of our informal discussions frequently turns to one theme. Do our beloved collections become a burden to our families. As I look around the antique weapons show room or at the line of collectors waiting to get into the show, I opine the median age of the group is around 70 years old (half were older and half younger). You might even say it is older than 70 years as we look at the age of our members of the American Society of Arms Collectors.

Our membership typically owns the larger collections that are of the best quality, most rarity, and the highest monetary value. Yet, our preparation for what should happen to our treasures tends to be lacking, thus exacerbating the situation as we get on in our years.

- **Inheritances bring out the best in some families and the worst in others.**
- **It may be hard to predict how the prospect of an inheritance will work out with any given family.**
- **You need to plan everything you possibly can in advance to minimize the potential for wranglers.**
- **Good communication between family members often avoids the pitfalls of estate planning and eases the transfer of assets.**

We all know thinking and pondering on what to do with our beloved antique arms should be more than a passing concern. Objects in our collection tend to have great meaning to us, and parting with them many times entails a very real loss, grief, and nostalgia for happier times. Any thoughts or discussions on deaccessioning firearms, swords, accoutrements, and other key items from our collection tends to put us in touch with our mortality and confronts us with end-of-life or nearing the end-of-life issues that typically makes us uncomfortable. However, we all know that the path of doing nothing and letting our heirs simply divvy up the hoard is not the correct answer. The remainder of this essay will address the questions or issues we need to face and take action on while we are among the living, and have full control over our mental and physical capacities.

### ISSUE ONE: COMMUNICATION

- **Many collectors keep their families in the dark as to the scale, nature, and cost to assemble their collection.**
- **What happens if you (the collector) have a sudden death or become incapacitated by a medical emergency?**
- **What are your spouse, family members, and heirs’ expectations?**
- **Many prodigious collectors are coy with their families about how much money they are investing in their collections.**
- **If you are one of those collectors who keeps their purchase prices close to the vest...what happens to your knowledge when you die?**

Many collectors keep their families in the dark as to the scale and nature of their collecting. Have you thought about the effect that your sudden death or incapacitation might have on your collection? What would your heirs’ expectations be? What should be done with your collection? Should it be sold? Distributed among family members? Some combination between sales and distribution among the family? What will remain after income and estate taxes?

When your collector spouse spends \$50,000 or \$100,000 on rare antique pistols or swords, you generally have some knowledge of those purchases, but not always. Often the most prodigious collectors are coy with their family about just how much they are “investing”. The result may lead to all sorts of problems when the collector dies or is incapacitated due to a serious health event

\*DISCLAIMER. This article is not designed to provide specific legal advice to a client, but rather represents relevant areas of knowledge and experience gained on the topics covered by this paper during my 40-plus years as a tax lawyer who regularly represents taxpayers before the IRS, IRS Office of Independent Appeals, the U.S. Tax Court, and before other federal and state trial and appellate courts on tax disputes. My tax law expertise is typically on issues involving the valuation of all genres of property, including real, tangible, and intangible property, the values of which claimed by a client have been challenged by the taxing authorities. I am also a credentialed appraiser with the International Society of Appraisers. My appraisal experience focuses primarily on antique or classic firearms, swords and other edged weapons, armor, accoutrements, and militaria.

and liquidity becomes an issue for the family to pay income or estate taxes, health care costs, mortgages; all further complicating a cashflow problem or unanticipated tax situation.

### **The Big Question: Does your family want your collection?**

What is my intention as to the “Big Question”? I am not referring to the value of your collection. I mean the collection itself. Does your family like the collection or do they like the value of the collection?

When I use the word “family” in the context of your collection, I am using the term collectively and broadly. It could be that some family members love the collection as much as you do as the collector, while others do not. That is okay, and needs to be addressed as part of the larger wealth-transfer process. Usually there are ways to deal with it. It is similar to owning a family business where some members of the next generation will be involved in the business and others will not. Most people want some sort of equality of distribution, and that can most often be dealt with by using other assets or life insurance (if reasonably available).

So, the question boils down to this, “Does the family care about the collection?” If not, then that will likely lead to a sale, or a donation to a charity or museum. If the family does care about the collection, then it will likely call for a wealth-transfer solution, either during your life or at death. And here is where collectors often receive a big surprise. Collectors have an incredible passion for their collections and assume that everyone else, especially their family members, share that same passion and appreciation. In my experience as a serious collector and a tax lawyer, one who has been advising clients for over 40 years, I am here to tell you that is usually not the case. More often than not, the family does not share your passion for the collection. In fact, my experience in talking with other collectors is that quite often family members resent the time, attention, and financial resources that have been lavished upon the collection instead of them.

It is also possible that the family members do not yet know if they have the same passion for the collection. Consider the following fact pattern that most families may find themselves in.

A collector of antique firearms started his collection in earnest just a few years ago. He had always had an interest in weapons used in the American Revolution that he now collects, but he was not able to pursue it fully until a liquidity event (i.e., sale of a family business or a significant inheritance of marketable securities) occurred several years earlier. The firearms collection has since grown by some order of magnitude, both in number and quality of pieces, and in value of the collection.

The collector’s children, and their spouses, all appreciate the history and uniqueness of the firearms collection, but they are busy raising young children and building careers. They honestly do not know yet how all of this may fit into their lives. So, for the time being, no permanent plans are being made for the collection, beyond a general disposition in the will.

By making no drastic decisions, has the collector deferred taking any meaningful action to the detriment of his or her spouse or family? The collector is able to maintain options with respect to where the collection might ultimately go, depending on how the family’s interest progresses. Baked into

this deferral or non-decision are the assumptions of continued good health and failure to take into consideration any tragic catastrophes, such as an unforeseen health-changing event.

Is the foregoing a real decision? Is it realistic given your family situation or is it more a thinking that you do not want to address the situation in any meaningful way?

In summary on the need to communicate with your family, the Big Question must be asked. Do not be surprised by the answer. But do understand that the answer to the Big Question is the driver behind the rest of the collector’s planning process.

### **ISSUE TWO: INCOME, GIFT, AND ESTATE TAX PLANNING**

- Tax considerations are always important; whether selling, exchanging, donating or gifting – during lifetime and upon your death.
- You cannot take the collection with you.
- However, after your death, the IRS might indeed take your collection.
- If you have a non-liquid estate (i.e., cash poor or real estate rich) plus a valuable collection... you can see the complications may increase.

Tax considerations are always important for collectors, whether they are selling, exchanging, donating or gifting during their lifetime or at their death. Like other taxpayers, collectors cannot take it with them. But after death, the tax authorities might indeed take it.

### **Income Tax Planning**

Individuals often start their collections without any consideration of their tax implications. However, tax matters are a critical aspect of collecting. Keeping financial records is important even for collectors who see their activity as a hobby. The tax collector views a collection from a financial standpoint from its very beginning.

### **Classification for Income Tax Purposes**

The first issue regarding income tax planning relates to whether an individual is classified as a dealer, investor, or collector. This classification is critical to determining how the individual is taxed, what rate the individual is taxed at, the extent to which expenses may be deducted, and the applicability of other tax provisions. It is important that the individual choose a classification and structure his or her activities are consistent with, in case the classification is challenged by the Internal Revenue Service.

### **Classification as a Dealer**

A dealer is someone who carries on a trade or business selling art, and in the context of this article, collectibles such as firearms, edged weapons, armor, accoutrements and similar items or artifacts. The United States Supreme Court stated that, to be considered carrying on a trade or business, the taxpayer must be involved in the activity with continuity and regularity, and the primary purpose for the activity must be income or profit. If a person is classified as a dealer, collectibles are considered inventory. A dealer

generally holds a valid sales tax resale certificate issued by the state where the dealer operates from and does not pay sales tax on purchases but does collect sales taxes from his or her purchasers to the extent required by state sales and use tax laws. One tax advantage to being classified as a dealer is that the dealer may deduct all ordinary and necessary expenses, even if they result in a loss.

Because the artifacts or collectibles held by a dealer are considered inventory, the disadvantage of being classified as a dealer is that operational income, including gains on the sale of the artifacts and collectibles, is taxed at ordinary income tax rates (which currently are up to a maximum rate of 37 percent for federal income tax purposes). Another disadvantage is that the gain on the sale of artifacts or collectibles held by a dealer may not be deferred under the like-kind exchange provisions of Internal Revenue Code section 1031. In addition, a dealer who makes a charitable deduction of an artifact or collectible is entitled to deduct only an amount equal to the dealer's basis in the donated item (i.e., cost of purchase plus any capital expenses for restoration), not the objects' fair market value. Furthermore, a dealer is generally subject to self-employment tax on the net income earned by his or her business.

#### ***Classification as an Investor***

An investor buys and sells collectibles (i.e., firearms, swords, armor, etc.) primarily for investment as opposed to merely for personal use. The primary inquiry in determining whether an individual is an investor is whether that individual is engaged in the investment activity with the primary objective of making a profit. If questioned by the Internal Revenue Service ("IRS"), an investor must prove that the artifacts or collectibles are held primarily for investment purposes. An investor typically does not hold a sales and use tax resale certificate and pays applicable sales taxes on purchases for his or her collection.

The advantage of being classified as an investor is that any gain on the sale of the artifacts or collectibles held more than one year is taxed at capital gains rates. For collectibles that rate is 28 percent. It is important to note that an investor is no longer permitted to defer any gain by structuring artifact or collectible sales in accordance with the like-kind exchange provisions of Internal Revenue Code section 1031.

The disadvantage of being classified as an investor is that the individual's ordinary and necessary expenses related to the collection (i.e., the investment) are no longer deductible as a miscellaneous itemized deduction (formerly subject to the two-percent floor) as all miscellaneous deductions subject to the two percent of your Adjusted Gross Income are eliminated and no longer deductible for Tax Years 2018 through 2025.

#### ***Classification as a Collector***

A collector is engaged in a hobby, buying and selling artifacts or collectibles primarily for personal pleasure. If the hobby activity generates a profit for three or more of the last five years, the presumption is that such activity is not a hobby. However, even if that test is not satisfied, it is possible for an individual to establish that the activity is not a hobby but rather a profit-motivated venture. The IRS has developed a set of nine factors it considers when determining if a collector is engaged in a profit-motivated venture. These factors to be considered include:

- The manner in which the taxpayer carries on the activity;
- The expertise of the taxpayer or the taxpayer's advisors;
- The time and effort expended by the taxpayer in carrying on the activity;
- The expectation that assets used in the activity may appreciate in value;
- The success of the taxpayer in carrying on other similar or dissimilar activities;
- The taxpayer's history of income or losses with respect to the activity;
- The amount of occasional profits, if any, that are earned;
- The financial status of the taxpayer; and
- The elements of personal pleasure or recreation.

All facts and circumstances must be taken into account, and no single factor or group of factors is determinative.

The advantage of being classified as a collector is that any gain the collector realizes on the sale of artifacts or collectibles held more than one year is taxed at a maximum capital gains rate for collectibles of 28 percent. No gain may be deferred using the like-kind provisions of Internal Revenue Code section 1031. The disadvantage of being classified as a collector is that the collector's ordinary and necessary expenses are deductible as miscellaneous itemized deductions, but only to the extent of income earned by the sale of artifacts and collectibles pursuant to Internal Revenue Code section 212 for ordinary and necessary expenses paid or incurred (1) for the production or collection of income; or (2) for the management, conservation or maintenance of income-producing property; but only for tax years beginning after 2025.

#### **Estate and Gift Tax Issues**

- Collections must be reported at FMV.
- Valuable collections may create estate tax liability up to 40% of value.
- Collections are not liquid assets, yet estate taxes must be paid when due, regardless of when a collection is sold.
- Use of gift tax annual/exclusion and lifetime gift tax exemption plus unified gift and estate tax credit needs to be planned before death.
- Estate tax applies to the FMV of all of a person's assets, both probate and non-probate assets.
- Unified gift and estate tax credit is reduced by 50% on January 1, 2026.

The owners of a substantial collection of antique weapons or collectibles may be pleased with their collecting acumen but are often concerned that a high estate tax value will be placed on these objects, perhaps so high that their estates will have insufficient liquid assets to pay the estate tax. When planning an estate that consists of a collection with a substantial fair market value, therefore, collectors and their advisors should pay special attention to the disposition of the collection on or before the collector's death. Sophisticated estate planning lawyers can use a number of planning techniques that can effectively limit the amount of gift and estate tax payable on lifetime and post-mortem transfers of property, including the collection. Many of these techniques seek to take advantage of the lifetime gift tax exemption, the annual gift

tax exclusion, and the unified gift and estate tax credit.

Several of the most commonly used planned giving strategies include the following:

- Lifetime gifts to family members;
- Maximizing the Annual Gift exclusion which is currently \$18,000 per recipient for 2024;
- Utilizing the collector's lifetime gift and estate tax exemption, which are linked so that the use of one's gift tax exemption will reduce the amount one may leave at death estate-tax free;
- The lifetime gift tax exemption is \$13.61 million in 2024, however, under current law, that amount will be decreased by half on January 1, 2026.
- Installment Sale of the Collection;
- Lifetime Gifts to Charities;
- Transfers to Charity upon Death.

The estate tax applies to the fair market value of all of a person's assets, both probate assets and non-probate assets such as life insurance policy payouts, IRAs, 401(k) plans, and similar defined contribution retirement account distributions that occur upon the owner's death minus a decedent's liabilities such as loans and mortgages to the extent of the decedent's liability on the debt or mortgage (i.e., 50% if debt liability includes a co-borrower such as a surviving spouse, business partner, etc.).

While a discussion of the giving strategies listed above, and a number of other techniques is beyond the scope of this article, an experienced and competent estate planning lawyer can go through each of these strategies with you to determine if any of them would be feasible and advisable to the collector and his or her family. Keep in mind the current estate tax rate is 40 percent. Come 2026, the unified gift and estate tax credit is cut in half which has the effect of putting the decedent-collector at a higher estate tax rate that will be imposed at a lower net taxable estate value.

### **Estate Administration – A Lack of Knowledge?**

Selling a collection at the death of a collector is likely the most common scenario. This may be by design or simply because the collector could not or would not part with the collection while alive, or even engage in the planning process while alive. From a purely tax planning point of view, the biggest advantage to selling artifacts, antique weapons, etc., at the collector's death is that the cost basis in the collection will be stepped up (or down) to its fair market value. As a result, the 28 percent long-term capital gains rate for collectibles, and the additional 3.8 percent healthcare surtax, is not relevant or even applicable, except for the post-death, presale appreciation that may occur if there is an extended time period from the date of the collector's death and the date on the eventual sale of their collection.

The biggest drawback to selling at death is not tax related, but the fact that the person who knew the most about the collection is no longer around. This can lead to major issues – inventory of the collection items, provenance, network of dealers and galleries familiar with the collection – if meticulous records have not been maintained. Furthermore, it will be necessary that the personal representative of the estate is either knowledgeable about the collection or is able to retain someone who is. Otherwise, the collec-

tion may be sold for much less than its actual worth. Also, while detailed records are always extremely helpful, make sure someone knows where they are and can actually understand them.

If a recent appraisal is not available, it will be necessary for the collection to be appraised if a Form 706, Federal Estate Tax Return, will be filed with the IRS. This is required by the IRS. Even if an appraisal is not required, it is still good practice to have an appraisal prepared to give the personal representative an idea of what the collection items should be sold for. Keep in mind, if the collection is being sold at death and has been subjected to the federal estate tax system and a 40 percent federal estate tax rate (plus any applicable state estate taxes), this can give rise to liquidity issues. Depending on the makeup of the decedent collector's entire estate, some or all of the collection may need to be sold to provide liquidity to pay estate taxes and other costs of maintaining the collection during estate administration (i.e., insurance, storage), or to make cash bequests or other distributions contained in the Last Will and Testament.

It is important that the collector's estate documents (will and/or revocable trust) have appropriate language to support a deduction for any expenses incurred to sell the collection, in whole or in part. Expenses of the estate to sell the collection are deductible on the federal estate tax return or estate's fiduciary income tax return if the sale is necessary to pay debts, expenses, or taxes; to preserve the estate; or to effect distribution. A provision should be included in the estate planning documents that directs that any artifacts and items in the collection which are not bequeathed or selected by beneficiaries be sold and proceeds distributed. This provision should be sufficient to establish that the sale was necessary to effect a distribution of estate assets, thereby ensuring the availability of the deduction under Internal Revenue Code section 2053. In any case, the executor or personal representative will need to elect whether to deduct these expenses on the federal estate tax return or on the estate's fiduciary income tax return.

### **ISSUE THREE: RECORDKEEPING AND INVENTORIES**

- What should you be doing now while you are here in the present?
- Inventory is critical for collector, family, estate planning attorney.
- Inventory provides a road map to the eventual estate fiduciary/executor and preparer of IRS Form 706, Federal Estate Tax Return.

A collector, without even knowing it, has an inventory of sorts if he or she has maintained bills of sale and catalogs of sales where antique weapons were purchased. Is this enough to help a collector if he or she is no longer able to effectively communicate with his or her family due to death or a significant health or medical event? What should you be doing now while you are here in the present? Beyond this, the company writing insurance to cover the collection will require an inventory, and may even assist the collector in building a form of inventory if they do not already have one.

For the collector, his or her family, and their estate planning attorney, the inventory becomes a crucial document, helping the collector to express the "four W's" – What goes Where, to Who, and When. The inventory will also provide a roadmap to the eventual estate fiduciary (i.e., executor or personal representative) and the preparer of IRS Form 706, Federal Estate Tax Return.

## Case Study – How One Family Prepared an Inventory

A collector had a massive collection – not so much in terms of dollar value, but in terms of number of pieces. The collector hired a professional videographer, who walked through the house filming as the collector described each piece or part of the collection – what it was, where he obtained it, an approximate price and value, and where he thought the piece should eventually go, be it a particular family member, a particular museum or other charity, or just sold in an estate sale. Copies of the video (now on disk) are with the insurance company, the lawyer, and the trust department that will serve as his executor.

That oral inventory has also been reduced to writing, in the form of a spreadsheet. This helps greatly in the planning process. It is, of course, up to the lawyer to make sure those wishes are properly documented and incorporated into the overall wealth-transfer plan.

An additional benefit is the recorded oral inventory provided the family with memories and a record of the collector's shear enjoyment regarding his or her collection, the details and intricacies about several of the more significant items in the collection, to include the provenance of the items, any restoration or repairs made and by whom, and similar information that will be extremely helpful to the family and executor when it becomes time to dispose of the collection.

### What Does the Inventory Need to Include?

- **Description of each item, to include:**
  - Dimensions
  - Description of the key components (i.e., type of woods, type of hardware, etc.)
  - Identity of maker
  - Country of origin
  - Date or estimate of object's age
  - Description of distinguishing characteristics
  - Provenance
  - Exhibition history
  - Restoration/repairs (type, done by, date, cost)
  - Maintenance requirements, where stored/displayed
  - Any research or reference materials
- **Photograph each item/multiple photographs:**
  - Need to adequately depict the physical condition of the item.
  - Show areas of repair and restoration.
- **Use ID tags or disks to help identify and authenticate each item in the collection.**
- **The inventory will assist you in the risk-management and insurance of the collection.**
- **Greatly helps if any item is stolen or questions of provenance.**
- **Inventory is of critical importance in the event of the collector's death for the Executor who may not be knowledgeable on many items of the collection yet must step in under state law to take control of the collection until its distribution occurs.**
- **Inventory will greatly assist the appraiser for purposes of valuation and insurance.**

An inventory can take many forms, and the value and scope of the collection will dictate what is appropriate in any given situation. It should, at a minimum, include a description of each piece, to include dimensions, description of the key components (i.e., type of wood, iron or brass hardware, edged weapon grip materials and type of wire used to retain the grip's wrapping if appropriate), identity of the maker or makers, inspector's marks, if appropriate, country of origin, and date of manufacture or estimate of age. You will also want to indicate or describe any distinguishing characteristics, provenance, exhibition history, restoration/repairs (type, done by, date, cost), maintenance requirements, where stored/displayed, etc. This inventory can be expanded as appropriate, including listing any research materials that reference an artifact and any externally maintained registries or publications that include this artifact.

I also recommend that the collector photograph each item in the collection, probably several photographs to adequately depict the physical condition of the item and show areas of restoration and repair. With larger collections that many of our ASAC members own, the use of identification numbers or tags (preferable metal or plastic) should be assigned to each piece, which will allow for better organization of the collection inventory. All of the foregoing helps to identify and authenticate each item of the collection, as well as assist in the risk-management and insurance of the collection. For example, the foregoing inventory and history greatly assists if a theft takes place or any questions of provenance. The inventory is of critical importance in the event of the collector's death and an executor or personal representative, who may not be knowledgeable on many items of the collection, must step in to take control of the collection until its disposition occurs. Also, the detailed inventory will greatly assist the appraiser of the collection for purposes of insurance and subsequent valuation frequently required for the preparation of the IRS Form 706, Federal Estate Tax Return. Lastly, the inventory will assist the family to preserve his or her legacy as represented by the items in the collection.

While it is possible to maintain meticulous paper records, it would be more prudent to use a computer program that is properly backed-up. There are a number of options available, such as an Excel spreadsheet, a Quicken list, a personal website, as well as some private software options like Collectify Collectors' Edition and Collectify Home Inventory (see [www.collectify.com](http://www.collectify.com)) permitting the creation and storage of a comprehensive collectors' database software to manage everything relating to your collection. You are also able to store and access your collections database through a private Collectify Cloud service, avoiding the malware that tends to be common with most public Cloud services. Another alternative collector database service is called CatalogIt ([www.razorleaf.com/products/clover/collectIt](http://www.razorleaf.com/products/clover/collectIt)). These collection database systems provide you with the ability to use precise document fields, save digitalized records, photographs, and similar data at a level of your choosing. You can record your collection items' full valuation histories, attach formal appraisals, organize and track insurance documents, receipts, provenance histories, create reports and similar useful information. The cost of these collection management systems is reasonable, usually between \$100 to \$150 annually for most sized collections.

#### **ISSUE FOUR: The Importance of Valuation Appraisals**

- Appraisals are required for estate, gift, and income tax reporting.
- Appraisals are needed on integrated estate planning.
- Appraisals are needed for state tax purposes.
- Appraisals are needed for equitable distributions for insurance, divorce proceedings, etc.
- Appraisals are important for insurance companies to provide insurance coverage.

The appraisal of a collection, as well as other tangible personal property is an integral part of estate planning. Appraisals are required for state income or ad valorem taxes, charitable contributions for income and gift tax purposes, estate tax purposes, as well as for divorce settlements and proceedings and for most insurance policies. When the collection reflects a significant component of the collector's assets in value, an appraisal may be required by the executor, personal representative, or presiding family member, to aid in the fair and equitable distribution of a collection to various members of the family; and to ensure the executor makes knowledgeable and proper decisions as required by a state's estate administration laws which govern transfers of property, upon the death of the collector.

In addition to an appraisal being required by federal tax law to support valuation for income, estate, and gift tax purposes, it is likely that anyone providing insurance coverage will require an initial appraisal and periodic updates. Lenders who make loans secured by the collection will also require an initial and periodic updates to appraisals.

#### **Appraiser's Qualifications and Experience**

A key element when seeking an appraisal, is the selection of an appraiser. The appraiser must be familiar with trends in the relevant market that pertains to your collection, as well as the individual specialization area they may have in order to provide accurate appraisals that can be submitted to the IRS. For example, an appraiser who is knowledgeable and experienced in appraising antique firearms, edged weapons, and similar items may not be experienced in appraising rare coins or uncertified coins. A similar point can be made when appraising gemstones where the appraiser should be credentialed by the Gemological Institute of America ("GIA") or a similar appraisal credentialing organization.

Appraisals are frequently required to support the federal income tax charitable deduction for contributions of tangible personal property, including firearms, swords, and similar collectibles. The appraisal requirement is triggered to support a deduction for a contribution of an antique weapon or a collectible when the claimed value for which exceeds \$5,000. That \$5,000 amount applies to any single item, or to an aggregate of similar items donated during the same calendar year. Once reached, the collector-taxpayer must:

1. Obtain a qualified appraisal for the contributed property;
2. Attach a fully completed appraisal summary to the federal income tax return on which the taxpayer first claims the deduction for the contributions; and
3. Maintain certain records about the contribution.

This is in addition to the general substantiation requirement of obtaining a contemporaneous written acknowledgement of the contribution from the charitable nonprofit organization stating that no goods or services were received as part of the donation.

The term "qualified appraisal" means an appraisal prepared by a "qualified appraiser" no more than 60 days before the date of contribution. The appraisal must be signed and dated by a qualified appraiser, who must also state that the appraisal fee is not based on a percentage of the value of the appraised property. The appraisal must include:

1. A detailed description of the property;
2. The physical condition of the property;
3. The date or expected date of contribution;
4. The terms of any agreement or understanding entered into or expected to be entered into by or on behalf of the donor that relates to the use, sale, or other disposition of the property contributed;
5. The name, address, and taxpayer identification number of the appraiser;
6. A detailed description of the appraiser's background and qualifications;
7. A statement that the appraisal was prepared for income tax purposes;
8. The date on which the property was valued;
9. The appraised fair market value of the property;
10. The method of valuation used to determine the fair market value;
11. The specific basis for the valuation, such as comparable sales transactions; and
12. A description of the fee arrangement between the donor and the appraiser.

The appraisal must also be received by the donor before actually filing the tax return. The appraiser is required to include in the appraisal an acknowledgement that he or she understands that a substantial or gross valuation misstatement resulting from the appraisal could subject the appraiser to civil penalties under certain circumstances. This is in addition to the requirement that an intentionally false or fraudulent overstatement of value in the appraisal could lead to civil penalties and aiding and abetting penalties.

The IRS also requires that an appraiser must demonstrate verifiable education and experience in valuing the property type being appraised, and must not have been prohibited from practicing before the IRS at any time over a three-year period ending on the appraisal date. These heightened requirements make it imperative that the collector, or the collector's representatives (i.e., Executor or Personal Representative), examine the appraiser's qualifications.

Also note that just because someone is an expert in one area does not mean that he or she is an expert in all areas. The collector, collector's family, and/or the personal representative must exercise care when selecting the appraiser. You must examine the expertise of the appraiser as well as the experience of the appraiser with a particular type of collection items to be appraised.

If you are not filing a tax return (i.e., income, gift or estate), donating non-cash assets (i.e., collectibles) to a non-profit, or obtaining insurance for collectibles, a qualified appraisal report may not be needed. The expense and time required to develop a formal appraisal may be avoided in certain circumstances. Many collectors mistakenly seek an appraisal when only general guidance as to value is required. If your objective is to sell your collection, and you are interested in determining the amount a dealer would pay for it, most dealers will be pleased to make an offer or provide you with their best estimates of value without the labor and expense of creating a formal appraisal report. Similarly, an auction house usually will provide you with an auction estimate free of charge based upon the possibility of being selected to auction the contents of the collection. Independent appraisers also can evaluate property and provide a verbal appraisal of the property for less than a formal written appraisal because less of the appraiser's time is utilized.

#### **Who is Not a Qualified Appraiser?**

- Donor of property (Mohamed v. Comm, TC Memo 2012-152).
- Donee of property.
- Appraiser who sold, exchanged or gave the property to donor unless appraised value does not exceed acquisition price and donated within two months of acquisition IRS Art Advisory Panel.
- Individual related to employee of any of the above.
- Individual regularly used as appraiser for any of the above and doesn't do a majority of appraisal work for other clients.
- Individual who receives fee based on appraised value of property.
- Appraiser disqualified under 31 USC §330(c) within 3 years of appraisal.

The IRS Art Appraisal Services is a team of professionally trained appraisers who provide advice and assistance to the IRS and taxpayers on valuation questions arising in connection with personal property and works of art. Each of the appraisers in the IRS Art Appraisal Services has specific training in appraisal methodology, the Uniform Standards of Professional Appraisal Practice ("USPAP"), and education and experience in fine art, decorative arts, and collectibles, including paintings, drawings, prints, sculptures, antiques, ceramics, textiles, carpets, silver, rare manuscripts, antiquities, ethnic art, coins and sports, entertainment, and historical memorabilia. Although organized under the IRS Independent Office of Appeals, the Art Appraisal Services team typically assists the IRS examination function, lawyers from the IRS Office of Chief Counsel and the U.S. Department of Justice, as well as IRS Appeals Officers, on the valuation of personal property, collectibles and works of art.

On occasion, the IRS Art Appraisal Service also has the ability to seek review on art and collectibles from the Art Advisory Panel of the Commissioner of Internal Revenue. Created in 1968, the IRS Commissioner's Art Advisory Panel (the "Panel") provides advice and makes recommendations to the Art Appraisal Services. The Panel assists by providing value recommendations regarding the acceptability of tangible personal property appraisals taxpayers submit to support the fair market value claimed on the wide range of art and collectibles involved in income, estate, and gift tax returns. In certain circumstances, the Panel may also assist in determining the value of personal property for collection or seizure

actions, in the investigation of financial crimes, or other matters, where the fair market value of personal property may be at issue.

When a tax return selected for audit includes an appraisal of a single work of art or cultural property (i.e., historic firearm, sword, etc.) valued at \$50,000 or more, the IRS examining agent or appeals officer must refer the case to the Art Appraisal Services unit who then determines whether to also seek the review of the Panel. While the Art Appraisal Services unit researches publicly available information, the Panel provides additional knowledge of private sales based on their personal experiences as dealers, scholars, and museum curators, and from information obtained from other members of their relatively small industry. The Panelist's knowledge is particularly beneficial when questions exist about the authenticity or condition of works of art and the collectibles.

The Panel is not provided with any taxpayer information including the taxpayer's name, the type of tax, the tax consequences of any adjustments to the value, or to who did the appraisal. The foregoing is designed to ensure objectivity and safeguard taxpayer privacy. To minimize the possibility that panelists recognize a taxpayer's entire collection, the art works or collectibles are usually discussed in alphabetical order by artist or by object type. During the Panel meetings, the Panelists review the information provided, along with the research and findings of both the Panelists and the Art Advisory Service appraisers. After discussing each item individually, the Panel reaches consensus on the value of the object and provides an oral recommendation to the Art Advisor Services appraisers.

#### **Closing Thoughts for the Collector and Their Families**

- Valuation of the Collection is Critical
- For insurance purposes/risk-management.
- To minimize family conflict if you must distribute to family member.
- FMV appraisals so family members or executor may distribute collection equitably if required by the Last Will and Testament.
- Do you want to sell or distribute collection during lifetime or after death?
- Prepare an action plan.
- Locate advisors who are essential to the implementation of your plan.
- Prepare directions for non-experts.

A critical component of collecting antique weapons or any collectibles for that matter is deciding when and how to part with an item or pieces from a collection. After all, our collections represent a significant part of who we are, and the collection may go through many iterations according to the goals and wishes of their collectors. Collectors, their heirs and donees, and their advisors must understand the tax, legal and personal issues involved in the process.

A collector may need to consider whether to sell during his or her lifetime. Heirs may not have knowledge about or familiarity with the collection or its value. In both cases, the methodology and timing of disposition are of the utmost importance, especially when a high value is at stake.

Once a decision is made to sell, strategies to consider include whether to sell at auction, through a private sale by means of a

dealer, or through a combination of the two. In every case, a careful analysis of the costs, timing, and the collector's goals must be carried out. Does the sale of the collection as a whole make the most sense? Are certain objects to be retained for sentimental or monetary reasons? Consideration of the collection's value and an estimation of the complexity, speed and certainty of disposition will help in the development of an overall strategy.

There are advantages and disadvantages to selling through a dealer or at auction. The best choice depends on the collector's or collector's family situation. A large collection may sell best at auction, or maybe one piece out of the entire collection will do better if it is placed with a dealer, while the rest of the collection is sold together at auction. There is no absolute answer. Most collectors need an advisor who understands the market and can recognize where the best interest lies for the collector and his or her family.

If you would like more detailed information on a comparison of baseline differences between selling your collection through a dealer and selling by auction, please see my earlier article entitled "How Should I (Or My Heirs) Go About Selling My Collection By Auction?", published in the American Society of Arms Collectors Bulletin at 112:57-66 (September 2015). The article is reproduced on the ASAC website and can be printed off the digital version if you want to share it with your family (<http://americansociety-ofarmscollectors.org/resources/articles>). The article contains a helpful three-page due diligence checklist in the Appendix, including questions to ask the auction company if you are considering the use of an auction company. I include a copy of the due diligence checklist at the conclusion of this paper. The checklist will provide you with some structure about how you might seek to evaluate your options.

Instructions about collections, from the collector, are particularly important because they generally involve a large number of pieces with valuations that are not obvious based on appearance alone. This scenario often leads to conflict.

The values of items in a collection should not be based on insurance appraisals. When this mistake is made, the heir who receives the collection can come out far behind heirs who receive cash or real estate. Insurance appraisals usually represent a "retail replacement" valuation that can be very different from the "fair market" valuation that would be used for financial planning or estate tax purposes. "Fair market valuations" represent, by definition, a value closer to what a collection might be expected to bring in an orderly sale.

In the event you decide to divide your collection among multiple family members, you have to then designate which specific items are to be distributed to which family members, then define and specify the location of each recipient's inheritance. If you, in

the alternative, decree your collection will be distributed in "equal shares" you really must obtain a detailed and comprehensive appraisal. Note, this approach may cause problems if two heirs want the exact same item or items from the collection. The same problem may arise when some heirs want to keep certain collection items and others want to sell. It is up to you, as the collector, to objectively analyze your family dynamics and the financial situation of each family member in making this decision. A simpler alternative is to establish an estate plan directing the collection to be sold, with the proceeds shared equally among the heirs rather than enduring the cumbersome process of equitably dividing the physical artifacts and objects from your collection to your family members or beneficiaries.

What about the question of whether the collection should be disposed of in your lifetime, versus directing your estate to handle the sale? Typically, the sale is best handled during the collector's lifetime. Who would oversee the sale as knowledgeably as the collector? Are your heirs situated and knowledgeable to manage the collection sale? Then there are the tax issues, which differ relating to lifetime gifts or sales versus bequeathing the collection items at the time of your death. The tax issues, in my opinion, should only be a part of your determination, not the sole consideration.

If you plan to dispose of your collection after your death, you need to prepare a written disposition plan for your heirs and maintain it with your collection inventory. You need to prepare now as if you will not be available to provide guidance in the future.

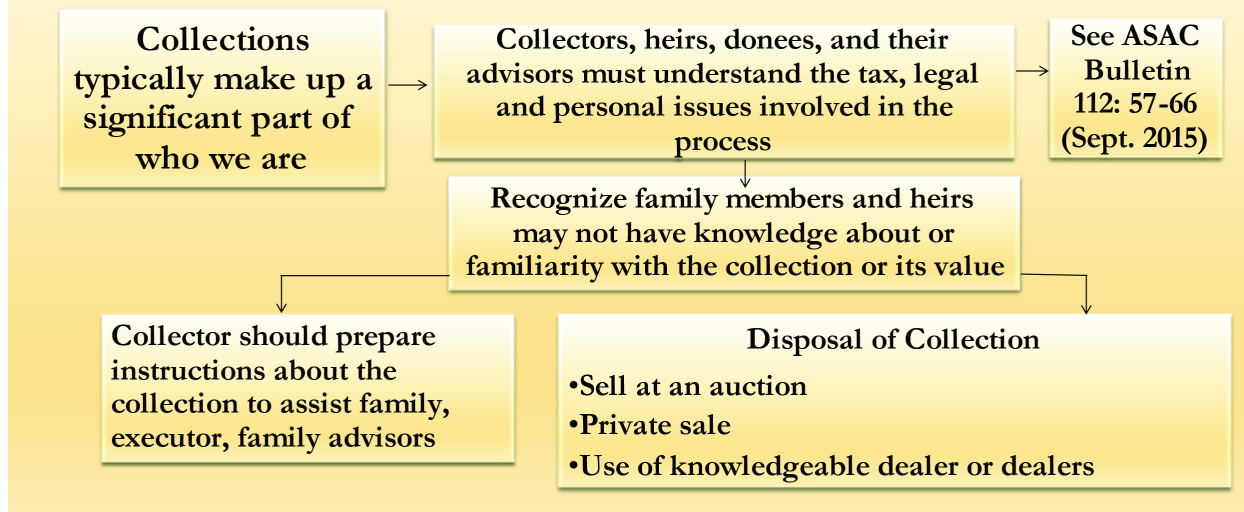
Make an action plan for your collection, even if you anticipate many more decades of collecting. You can and should continually revise and update your plan. Postmortem planning is not an option, so speak with your advisors now.

If the timing is immediate, find the advisor or advisors who are essential to the implementation of the plan and proceed accordingly. Otherwise, prepare detailed written instructions and leave copies with both your collection and your estate plan. If you prefer that your collectibles be distributed among family members, provide specific instructions in writing as to how distribution is to be accomplished. If you wish to distribute the proceeds, make certain that you provide directions for non-experts to contact a firm or dealer who is trustworthy, experienced, and reputable. Your instructions should be as detailed as possible.

Inheritances bring out the best in some families and the worst in others. The problem is that it's difficult to predict exactly how the prospect of an inheritance will work out with any given family, so it's best to plan everything you possibly can in advance to minimize the potential for wrangling. Good communication between family members often avoids the pitfalls of estate planning and eases the transfer of assets.



# CLOSING THOUGHTS FOR THE COLLECTOR AND THEIR FAMILIES



## APPENDIX

### Due diligence checklist from the perspective of the consignor-seller

The collector or other seller who desires to sell part or all of a collection needs to identify which auction house to use. The options range from internationally known auction houses to more regional and local auction houses. When it comes to deciding how to dispose of an Arms and Armor collection composed of muskets, rifles, carbines, pistols, swords and other edged weapons, cannons, and similar items from around the world there is also a need to explore auction houses that have the experience and reputation for handling similar specialized collections. The amount of due diligence required by a seller should be commensurate with the value of the consignment. The question then becomes, how do you undertake this important task? The checklist below attempts to provide you with some structure about how you might seek to evaluate your options.

### CHECKLIST

#### A. How do you go about identifying the proper auctioneer for your sale?

1. Seek first person recommendations from someone you trust who has or had a similar collection and a successful auction. It is important for the seller to be part of the interviewing process of auctioneer candidates. Possible sources may include people from the following backgrounds:

- Antique Dealers
- Lawyers who do "Estate or Estate Administration" work
- Trust Officers from Trust Companies or Banks
- Other knowledgeable collectors who have participated in auctions as sellers or who may be able to identify additional collectors by means of first-hand knowledge
- Internet research on auction houses and similar sources that document auction results of comparable collection items

After you complete your initial background research, you are then ready to schedule a meeting with the auctioneers or firm representative from the auction house to begin the interview process.

#### B. The Interview Process of the Auctioneers/Auction Houses

The goal of the auctioneer interview process is to determine whether the auctioneer/auction house candidate actually wants your business. It is very important for you to prepare for this meeting and listen carefully to the auctioneer's answers to your questions. You should be looking and examining the auctioneer candidate in the following manner and areas:

1. Personal Observation
  - personality/trustworthiness
  - demeanor
  - body language

- analysis
- reasoning
- communication skills
- credibility

## 2. Depth and Breadth of Experience

- How long have you been an auctioneer?
- Are you a part-time or full-time auctioneer?
- Where are you licensed?
- How many auctions do you conduct annually?
- How often have you auctioned items like mine?
- What were the best results you realized and to what do you attribute these results?
- What were the worst results you realized and to what do you attribute these results?

## 3. Marketing Approach• What is the buyer profile for my goods?

- What is the best strategy to market my goods?
- What are the details and cost for the marketing plan you recommend?
- Why should you not do more marketing?
- Why should you not do less marketing?
- Is the marketing campaign you recommend comparable in scope and cost to what you normally do?
- Do I receive progress reports?
  - If so, when and how often?

## 4. Market Conditions

- Is the market currently a good one for my type of goods and financial objectives?
- When was the peak of the market?
- Where does the market stand now in relation to the market peak?
- What are the primary challenges you see for the sale of my goods at this time?
- Is the market improving or declining, and how fast?
- Should I go to auction now or wait?
  - Why?

## 5. Consignment Process

- What are your practices and procedures in handling consignments?
- What do you think of my goods?
- Where would my goods be stored and under what conditions?
- What types and amounts of insurance would cover my consignment and against what risks?
- Who has risk of loss after a sale is made and when does it pass?
- Do you have a surety bond or do you participate in a statutory recovery fund?
- If so, how much protection is afforded to me for a loss?

## 6. Consignor Goals

- How do you view my financial goals for an auction?
- What do you see as the likely results I will realize at auction?
- Describe your view of my worst-case scenario?

## 7. The Auction

- What is the venue?
- What is your proposed staffing for my auction?
- What types of auction do you conduct?
- Do you recommend an auction with and/or without a reserve?
  - Why/explain in relation to my goods.
  - What are the advantages and disadvantages of each?
- What type of auction do you recommend for my goods and why?
- What are the advantages and disadvantages of each?
- What kind of bidder turnout do you expect?
- What are the procedures and charges, if any, if I decide to cancel or postpone the auction?
- What would you do about the auction if there is bad weather, an emergency situation, etc.?
- What is your view on shills and phantom bids and do you use them, or would you use them for me?
  - (If answer is yes, leave promptly.)

## 8. Charges/Expenses

- What will be the cost to market my goods for auction?
- How much is the selling commission?
- How much is the buyer's premium and who keeps it?
- Is there a no-sale fee for lots that do not sell?
- What other costs would I incur?

## 9. Settlement

- Who collects bad funds from buyers, how, and is there any charge to me?
- Who holds the auction proceeds and in what kind of account? (bank escrow or trust account should be required).
- What if I want to use a commercial escrow agent or attorney escrow account to hold the sales proceeds in escrow?
- When and how do you handle settlement?
- Show me a sample statement depicting the settlement format of what I would receive from you at settlement.

## 10. Dispute Resolution

- If we have a dispute, how and where will it be resolved? NOTE: Disputes with out-of-state auctioneers carry significant disadvantages.

## 11. References

- Do you have reference lists of recent individuals and commercial sellers whom I may contact? NOTE: You need to contact those references to learn how well the seller knows the auctioneer, whether the seller liked/disliked the auctioneer, whether seller's goals were met, whether seller was paid on time, and ask if you would sell again, would you use the auctioneer again?
- Do you have a letter of reference from your bank regarding your accounts and dealings there? (This is not an improper request.)
- Contact the state regulatory board to determine if any complaints have been filed against them or any of their licensees.

**NOTE: Auctioneers should possess the financial controls, responsibility, and strength to properly conduct the auction business and protect their clients. You should be looking to determine if the auctioneer is under or thinly capitalized. An auctioneer's debt can expose an auction business to creditors' claims. Consulting the auctioneer's bank references and obtaining a Dun & Bradstreet financial report will assist you to make this determination.**

In closing on this due diligence checklist, it is important that you measure all aspects of the interview meeting responses, together with checking out references, prior consignor sales customers, auctioneer's bank references, and similar third-party sources of information. Overall, you will need to include an examination of your own "gut feel" now that you are more fully informed about all of the salient issues pertaining to your particular consignment with each auctioneer/auction house. In closing, ask yourself after completing your due diligence investigation as to whether your auctioneer is just doing the job or is he or she performing the job at the highest level of competence, skill and accountability.

## ENDNOTES

- <sup>1</sup> See Richard M. Horwood, “The Art Collector Meets the Tax Collector”, 29(4) *Journal of Taxation of Investments* 33 (Summer 2013).
- <sup>2</sup> *Commissioner v. Groetzinger*, 480 U.S. 23 (1987).
- <sup>3</sup> Internal Revenue Code Section 162. Unless specifically stated otherwise, all references to the Internal Revenue Code are to the Internal Revenue Code of 1986, as amended (the “IRC”).
- <sup>4</sup> IRC § 165(c)(1).
- <sup>5</sup> IRC § 1031(a)(2)(A).
- <sup>6</sup> IRC § 170(e)(1).
- <sup>7</sup> *Wrightsmen v. U.S.*, 428 F.2d 1316(Ct. Cl. 1970).
- <sup>8</sup> Depending on the frequency that an investor sells artifacts or collectibles to their parties, he or she may not be required to collect sales taxes on such sales since many states provide for an exemption for occasional sales. However, the definition of what constitutes occasional sales varies widely among the states, requiring further research into an applicable state’s statutes, regulations, and other administrative guidance.
- <sup>9</sup> IRC § 1031(a)(1) (effective on and after January 1, 2018)
- <sup>10</sup> The Tax Cuts and Jobs Act of 2017, Pub. Law 115-97, 131 Stat. 2054, suspended the miscellaneous deductions. Subject to the 2% of adjusted gross income limitation for tax years 2018 through 2025.
- <sup>11</sup> See IRC § 183(d).
- <sup>12</sup> Treas. Reg. § 1.183-2(b).
- <sup>13</sup> IRC § 1014.
- <sup>14</sup> Treas. Reg. § 20.2053-3(d)(2).
- <sup>15</sup> Internal Revenue Code § 170(f)(11)(E) and Treasury Regulation § 1.170A-17.
- <sup>16</sup> Treasury Regulation § 1.170A-13(c).
- <sup>17</sup> Treasury Regulation § 1.170A-13(c)(3)(iv)(B).
- <sup>18</sup> IRS Notice 2006-96, 2006-4 I.R.B. 902 § 3.04(2).
- <sup>19</sup> Internal Revenue Code § 170(f)(11)(E)(ii), (iii).

