

The Hidden Cost of Failing to Plan

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The Top 10 Mistakes Made When Planning for Art and Other Collectibles: A Guide for Professionals and Their Clients

Mistake #3: The Hidden Cost of Failing to Plan

Art and collectibles, while beautiful and culturally significant, can pose significant estate planning challenges. At the time of death, these assets are subject to estate taxes based on their fair market value. Without proper planning, federal and state estate taxes—combined with the costs of selling the assets—could erode over 50% of a collection's value.

Art, as an alternative investment, began emerging in the 1970's and has only boomed as a result of digitalization. Art as a profitable investment now consistently outperforms other asset classes such as the FTSE 100 and S&P 100. According to 12 *Wall Street Journal* article, "The Art of Passing Along Art," highlights an unexpected problem faced by many collectors, particularly those who acquired their art in the 1950s and 1960s. These octogenarian collectors are discovering that their art collections have appreciated significantly more than their liquid assets. As a result, their estates often lack sufficient liquidity to cover estate tax obligations.

For example, consider a New York estate with \$40 million in liquid assets and \$100 million in art. That New York estate will potentially incur a \$63.5 million tax bill, forcing the executor to sell some or all of the art within nine months to satisfy the obligation. Such rushed sales often lead to undervalued transactions, significantly reducing the collection's realized value. In extreme cases, the entire collection might be sold for a fraction of its worth simply to meet the estate's federal and state tax liabilities.

Strategic Solutions for Collectors

Fortunately, there are various strategies to reduce the estate tax burden on art and collectibles. These include:

- **Charitable Contributions:** Using art to fulfill philanthropic goals can provide both estate tax relief and personal fulfillment.
- **Lifetime Gifting:** Strategic gifting of art during the collector's lifetime can shift value outside the taxable estate.
- **Estate-Freezing Techniques:** These methods help move highly appreciated (or soon-to-appreciate) assets out of the taxable estate.
- **Moving the Collection out of state:** Using limited liability companies and other entities can eliminate the potential for state estate taxes by changing the location of the assets.

When considering these options, it's essential to evaluate whether the collection holds more value as a cohesive whole or as individual pieces. Each strategy should be tailored to the collector's goals, ensuring that both financial and sentimental value are preserved for future generations. Make sure you speak with a trusted estate planner who specializes in planning for large collections of art and other intangible assets.