

A Knowledge Checklist for Art and Collectible Owners

The fundamentals of buying, selling and maintaining valuables.

Owners of art and collectibles are typically driven towards their purchases by a deep appreciation for their objects of choice. Oftentimes this knowledge of the art market leads to a collection of significant value. While most collectors take great care in selecting their acquisitions, often the pragmatic side of possessing rare and valuable objects is overlooked. The checklist below serves as a primer for those beginning to acquire art and other valuable objects and outlines a number of practical, logistical and planning concerns for owning art.

The following checklist was compiled to be comprehensive and informative, however if one is considering any of the following actions it is always best to consult your advisor for an individualized conversation.

Know how art is valued.

Art collectors are not expected to be experts or historians, however knowing how art is valued is important. As a collection reaches a significant aggregate value, a knowledge of the process and the types of valuations are especially helpful for navigating the art market and planning for the eventual sale or transfer of the objects. Art and collectibles – comprised of fine art, decorative art, furniture,

ethnographic art, jewelry, watches, automobiles and ephemera – have three distinct valuation purposes, which drive the assigned value:

- Fair Market Value (FMV): This is the most used value that represents the price at which an object would exchange between a willing buyer and a willing seller, each having access to all available information about the object and its sale. The FMV is supported by comparable works selling in relevant markets and similar conditions and is used for formal requirements, such as estate planning, charitable donations, and tax filing for estate and gift purposes. Owners seeking these types of valuations should ensure that their appraiser is Uniform Standards of Professional Appraisal Practice (USPAP) certified.
- Retail Replacement Value: This value is also known as an “insurance” value. It is typically higher than FMV or even a multiple of it and theoretically represents an immediate replacement of a lost item from the most immediate marketplace in retail as opposed to an auction. The retail nature of the value implies that the selling price comprises not only the intrinsic value of the item but also retail mark-ups

and the retailer's profit margin. Appraisers for this purpose should also be certified by the USPAP.

- Auction Estimates: Generally, these estimates are provided gratis when an owner is considering a sale. Like FMV and Retail Replacement Value, estimates are well-researched and supported by comparable works. However, instead of issuing a single assigned value, a range is provided. While appraisers and auction houses do not subscribe to specific formulas for valuations, the median of the auction estimates tends to be aligned with the FMV, while the high estimate (or a multiple of the FMV) is the retail replacement value.

For the types of valuations, where USPAP standards should be followed, there are a multitude of options for selecting an appraiser, ranging from auction houses to art advisors to appraisal-only companies. When seeking an appraisal, owners should look for an appraiser with experience in viewing and valuing relevant objects, as well as someone who has knowledge of the market in which the objects trade. Selecting the most relevant and qualified appraiser can be of utmost importance in the event of an audit, contested values or loss dispute.

Learn how to protect and care for art.

When owning valuable objects, handling and securing them is the collector's priority.

However, the act of doing so properly can be complex as maintenance, storage and risk management can vary broadly based on object type. Safes make sense for jewelry but typically not for paintings; marble sculpture may be installed on a lawn, but pastels should be installed away from natural and bright lights. If a vintage Patek Philippe or Ferrari 250 stops running, where does one go to replace the parts – or should one even replace the parts at all?

To these and other similar questions, collectors should consult a reputable specialist within the specific field of collectibles to ensure the proper means of displaying, maintaining and restoring the valuable objects. However, no level of care or maintenance can avert all losses, and owners should also engage a risk management advisor to insure the art or collectibles. Typically, policies that protect valuable objects and collections are itemized and include schedules of highly detailed appraisals with photographs and condition reports and may also have specific riders and terms depending on the object type.

Lastly, many valuable objects are meant to be lived with and enjoyed, which implies a certain amount of handling and movement. In the event the objects do require handling, mounting or transportation, owners should engage professional art handlers experienced in crating, securing and transporting similar objects.

Establish the purpose of the art or collection.

Each individual art owner is classified by the IRS as either a dealer, investor or collector. Each has unique tax benefits and liabilities, and one's identity is determined by how each of the works are owned, such as:

- Inventory within a business (a dealer)
- Holdings within a portfolio (an investor)
- Objects for enjoyment (a collector)

The IRS makes clear distinctions among the three identities with regards to the process of acquisition, intent at acquisition, where the art is stored after purchase and to whom or how the art is transferred. One's identity as an art owner drives tax treatment for owning and transacting in art, determining which deductions may be taken and at what capital gains rate art is taxed upon selling.

Distinguish how and where to buy and sell art.

Art trades in a largely unregulated market via both primary (dealer) and secondary (auction) venues as well as through private sales directly between owners and sellers or brokered by a dealer or auction house. Art is sold around the world, and while some objects are globally marketable, such as Impressionist paintings and fancy colored diamonds, other art may find its best market closer to home, such as American art (e.g. John Singer Sargent and Winslow Homer).

Professional art owners, such as dealers, are usually well-versed at where geographically to buy or sell a work of art and which type of venue might offer the most beneficial pricing. For example, works by a living artist may achieve their highest price via the dealer who represents the artist; whereas should a work by the same artist find its way to auction, a potential buyer might be able to purchase the work at a lower price in the secondary market where previously the artist's works have been untested.

Fiduciary owners of art, such as museums, foundations, and estate executors are often best served selling works at auction. This serves as public evidence that a "fair market value" was achieved in an as-transparent-as-possible venue.

For those considering buying or selling art, auction and dealer venues present a range of considerations. Auction purchasers will usually pay a hefty "buyer's premium" in addition to the "hammer price" of the work, and auction sellers usually will have a "vendor's commission" as well as sales expenses netted from their proceeds when selling a work. While buying and selling privately typically is a simpler "all-in" price structure, when buying through a dealer, prospective purchasers should be aware of any post-sale terms the dealer may impose, such as a right of first refusal that would require any resale of the work first be presented to the dealer before any other offers are entertained.

Know how to give art away.

Objects of beauty do have a life cycle, and with proper handling, care and maintenance, they can last multiple generations. However, taste change – buying objets d’art with the intention of passing them on as family heirlooms doesn’t guarantee it a spot on your great-granddaughter’s mantelpiece.

Owners of valuable objects should consult with their eventual heirs to determine the trajectory of the art collection, as well as their wealth, legal and tax advisors, to develop a strategy for transferring ownership of the collection. Many times an entity will be created, in which to own the works, such as a Limited Liability Company (LLC) for art investors or a Family Limited Partnership (FLP) for collectors; these entities may then play a useful role in the efficient and potentially tax advantageous transfer of the valuable objects.

If an owner has charitable intent, it may be advisable to transfer the works directly to the benefiting organization while living, or perhaps more advantageous to transfer the works within the estate. This type of charitable transfer can lead to meaningful tax deductions, provided that the owner abides by the IRS’s “related use” rule and can prove the donation is related to the purpose of the organization. For example, a nonprofit foundation will not necessarily have use for a rare coin collection; however, the proceeds from the sale of the coins would most likely be accepted. No matter the method of charitable transfer, a prospective donor should always confer with the receiving organization to

confirm that the donation conforms to the charity’s gift acceptance policy.

Owning valuable objects necessitates special attention and care. The markets, in which they trade, should be observed and engaged in carefully, and conscientious and well-advised plans should be made for the eventual transfer of the objects.

Even when the first rule of art collecting is “buy what you love,” a sensible approach to owning and living with the collection can add its enjoyment over the years and, perhaps, generations.

For further insight on transfer planning and strategy, contact one of our experienced wealth advisors or explore our content library [here](#).

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Hypothetical cash flow analysis: Stocks are proxied by the S&P 500 Index

The S&P 500 Index is a stock market index tracking the performance of approximately 500 of the largest companies listed on stock exchanges in the United States.

Bonds are proxied by the Bloomberg Barclays U.S. Aggregate Bond Index

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS, and CMBS (agency and non-agency).

The Hypothetical Cash Flow Analysis is based on Monte Carlo analysis.

Monte Carlo simulation is a stochastic modeling technique which leverages Chilton Trust's proprietary Capital Market Assumptions (CMAs) as inputs and, assuming the returns are approximately normally distributed, performs thousands of simulated iterations which result in wide variety of potential portfolio performance outcomes.

Capital Market Assumptions (CMAs) consist of historical asset class returns, standard deviations, correlations, and yields but also take into account Chilton's forward-looking views on the markets. Actual investment results experienced may be higher or lower than forecast due to market uncertainty.

Correlation is a statistical measure of the strength of the relationship between the relative movements of two variables. More specifically in our case, the Pearson correlation coefficient measures the linear relationship between 2 sets of asset class returns. It is the ratio between the covariance of the asset class returns and the product of their standard deviations.

Standard deviation is a measure of volatility expressed as a standardized deviation from the mean. Essentially it is a measure of the dispersion or variation of a set of values. Assuming the set of values is normally distributed, 95% of the values will fall approximately within plus or minus 2 standard deviations from the mean.

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