

WHAT ARTWORKS MAY COME (TO A MUSEUM NEAR YOU): THE STATE OF FRACTIONAL CHARITABLE GIVING AT THE INTERSECTION OF MUSEOLOGY AND TAX POLICY

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I. INTRODUCTION

Lynda Bunting, acting head librarian at the University of Southern California's Architecture and Fine Arts Library, wanted to donate a piece of art to the Museum of Northwest Art (MONA) in La Conner, Washington.¹ This particular artwork (see Figure 1) stood out as a potential donation even though Ms. Bunting had never before considered donating any of her other thirty pieces of art.² The artwork, a steel-and-glass four-panel piece by glass artist Lisa Zerkowitz, was large, unwieldy, difficult to install, fragile, and altogether hard to maintain.³ Despite these problems, Ms. Bunting wanted to donate the Zerkowitz piece rather than selling it because she knew art museums rely on donations from private collectors.⁴

MONA seemed like a particularly good fit for several reasons. First, Zerkowitz lives and works in Seattle, Washington, where her glass art is widely appreciated.⁵ Second, MONA had previously shown the piece in a group exhibition in 1998.⁶ Finally, Ms. Bunting believed that MONA and its community would best grasp the historic nature of the steel-and-glass work, which was Zerkowitz's breakout piece and a turning point in her career.⁷

Ms. Bunting, however, decided against donating when she learned that the accompanying tax deduction would cover only a small amount of the value of the artwork.⁸ Although Ms. Bunting collects art as a hobby and not

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¹ Interview with Lynda Bunting, Acting Head of the Architecture and Fine Arts Library, Univ. of So. Cal. and former Librarian and Archivist, L.A. Museum of Contemporary Art, in L.A., Cal. (Mar. 3, 2010).

² *Id.*

³ *Id.*

⁴ *See id.*

⁵ *Id.*

⁶ *See id.* Zerkowitz also had a single-person show at MONA in 2005.

⁷ *See id.*

⁸ *Id.* Part II of this Note discusses this quirk in income tax law in depth.

as a means of financial investment, she decided to keep her Zerkowitz piece until she could receive a larger tax deduction.⁹

The story of Ms. Bunting's aborted donation highlights the impact tax law has on charitable donations. Most importantly, it points to the heart of the recent fractional charitable giving debate: the lack of tax incentives can prevent important pieces of art, like Ms. Bunting's steel-and-glass panels, from reaching museums and the public.

Fractional charitable giving is a donation method that allows a donor to make a series of partial donations over an extended period of time.¹⁰ It would, for example, allow a donor to give 10% of a piece of art to a museum each year over ten years. Fractional giving is a particularly useful tool for donors who do not wish to completely part with the donated item. Indeed, due to a quirk permitted after the 1988 *Winokur v. Commissioner* decision, many fractional gifts never left their donor's homes during the course of the donation.¹¹ Fractional giving also allows donors to circumvent deduction caps for large donations and take advantage of any appreciation that may occur over the life of the donation.

Fractional giving, however, became all but obsolete after the enactment of the Pension Protection Act of 2006, which created strict standards designed to prevent donors from keeping art in their own homes during the donation period.¹² After much criticism from the art world, Congress has twice attempted to temper the severity of this new fractional giving rule: first with the Promotion of Artistic Giving Act of 2007,¹³ which was never enacted, and then with Senate Bill 1605, which was introduced in the Senate in August 2009.¹⁴

But is encouraging museum donations a good idea? Tax policy and legal critics routinely overlook the fact that museology itself has begun to question the importance of museums to society. Although museologists point to the museum's role in informal education, preservation, and even urban development, they admit that not all museums are good for their communities, especially those with low resources and little relationship with their communities. Moreover, changes in the field of museology, such as a recent trend toward special exhibits, the emergence of creative museums that are not tied to "great pieces of art," and the understanding that a dependence on elite donors may alienate patrons, may affect the value of art donations in the museum world. It is important that tax policy, especially policy that influences museum donations, responds to these trends.

This Note intends to use museology as a foundation for developing an effective tax policy for fractional charitable giving. Thus, museology is a

⁹ *Id.*

¹⁰ Rachel Emma Silverman, *Wealth Manager: Joint Custody For Your Monet: 'Fractional Giving' Hits The Art World, as Donors Share Works With Museums*, WALL ST. J., July 6, 2005, at D1.

¹¹ *Winokur v. Comm'r*, 90 T.C. 733 (T.C. 1988).

¹² Pension Protection Act of 2006, Pub. L. No. 109-280 § 120 Stat. 780, 1218 (2006).

¹³ Promotion of Artistic Giving Act of 2007, H.R. 3881, 110th Cong. (2007).

¹⁴ S. 1605, 111th Cong. (2009). See discussion *infra* Part VI.

lens through which this Note explores fractional charitable gifts. Part II discusses the basic tax law that affects fractional charitable donations. It begins with an overview of deductions, focusing on the distinctions between itemized and standard deductions, credits, and the Alternate Minimum Tax. Part II then discusses charitable deductions. In particular, this section covers limitations on charitable deductions, “carry-over” deductions, and the difference between inter vivos (during life) and testamentary gifts.

Part III focuses on fractional charitable gifts and deductions. This section provides a historical context for fractional gifts starting with the *Winokur* decision in 1988. Part III outlines the creation of Internal Revenue Code (IRC) § 170(o), which currently governs fractional gifts, and discusses museums’ and legal scholars’ reactions to § 170(o). Finally, Part III analyzes the Promotion of Artistic Giving Act of 2007, the failed first attempt to amend § 170(o).

Part IV evaluates the role of museums in modern society and explores how changes in museum curation and museology should affect tax policy. This section operates under the belief, held by many modern museologists, that museums cannot be considered good simply because they are museums. Thus, Part IV examines the good and the bad of museums: problems within the museum world, the modern goals of museums, and the various functions museums fulfill in society. Finally, this section presents various ways tax policy can and should reflect current trends in museology and museum studies.

Part V provides suggestions for the structure of an effective tax law governing fractional charitable giving. This section outlines four levels of “donative encouragement” that a tax law can provide using various tax incentives. After examining the role and function of fractional gifts in conjunction with the impact of museums on society, Part V argues that fractional giving should be moderately encouraged through tax incentives. Finally, this section provides specific recommendations for amending § 170(o).

Finally, Part VI discusses proposed Senate Bill 1605, which, if enacted, would substantially amend fractional giving. This section analyzes each provision in the Bill, evaluating whether or not it moderately encourages fractional donations.

II. BACKGROUND: TAX DEDUCTIONS AND CHARITABLE DEDUCTIONS

A. TAX DEDUCTIONS IN GENERAL

Deductions can reduce the amount of taxes a taxpayer owes.¹⁵ For income tax purposes, individual taxpayers have two options for deductions: they can deduct either the standard deduction or enumerate any itemized

¹⁵ As a result, they are a particularly useful way for the government to motivate behavior. Deductions serve different and more complicated purposes for gift taxes and estate taxes.

deductions¹⁶ for which they qualify.¹⁷ Itemized deductions include: charitable deductions,¹⁸ deductions for extraordinary medical expenses,¹⁹ and deductions for state and local taxes,²⁰ among others. They vary from year to year and from taxpayer to taxpayer. The standard deduction is a set amount, generally around \$3000 per individual taxpayer.²¹ Thus, taxpayers are better off itemizing their deductions if they qualify for an aggregate of itemized deductions that are worth more than \$3000.²² In general, only higher income taxpayers, who generally are wealthy, itemize their deductions.

Deductions do not reduce the amount of income taxes owed outright; rather, the taxpayer only recovers a percentage of the amount deducted. Moreover, the percentage recovered fluctuates according to the taxpayer's income, or, more specifically, the taxpayer's "Adjusted Gross Income" (AGI), a modified form of the taxpayer's income.²³ The taxpayer's AGI is used to determine the taxpayer's "taxable income," which is the difference between the taxpayer's AGI and either the standard deduction or the eligible itemized deductions.²⁴ The amount of taxes owed is then determined by multiplying the taxable income by a fixed rate, which varies based on the taxpayer's filing status (married or single) and taxable income.²⁵ Thus, the amount of money saved by a deduction is only equal to the value of the deduction multiplied by the taxpayer's fixed tax rate, for example, taxpayer John would only recover \$390 from his \$1000 deduction when he is at a fixed tax rate of 39%. Because of this, taxpayers may save more or less from a deduction because of their adjusted gross incomes.²⁶ Thus, itemizing appeals the most to the wealthiest taxpayers.²⁷

¹⁶ Itemized deductions are defined as all deductions allowed in the Internal Revenue Code that are not personal exemptions and are not used in determining adjusted gross income. I.R.C. § 63(d) (2009). Deductions used to determine adjusted gross income (called "above the line" deductions because of their location on income tax form 1040) include, inter alia, certain trade and business expenses, losses from sale or exchange of property, and rents and royalties. I.R.C. § 62.

¹⁷ I.R.C. § 63. This Note focuses on income tax with respect to individuals and will not discuss the income tax implications for corporations that wish to donate fractionally. The effect of fractional giving on gift and estate tax is more complex and will be discussed only sparingly.

¹⁸ *Id.* § 170(a)(1).

¹⁹ *Id.* § 213(a).

²⁰ *Id.* § 164(a).

²¹ *Id.* § 63(c)(2)(B)-(3). Blind taxpayers and taxpayers filing as heads of households, however, may receive larger standard deductions. The standard deduction acts as a filing threshold and a way to simplify tax returns.

²² Itemized deductions, however, are limited by I.R.C. § 68.

²³ A taxpayer's AGI is determined by taking the taxpayer's gross income and subtracting any "above the line deductions" that the taxpayer may have. *Id.* § 62. For an explanation of "above the line" deductions, see *supra* note 16.

²⁴ I.R.C. § 63(a)-(b).

²⁵ There are, in fact, five separate rate tables, which differ based on the filing status of the taxpayer. Rate tables are used to determine the tax bracket of the taxpayer. *Id.* § 1(a)-(e). A taxpayer's tax bracket refers to the marginal tax rate that applies to the taxpayer given the taxpayer's salary and filing status. Although the lowest tax rate for each filing status is 15% and the highest for each filing status is 39.6%, the AGI cutoff for the marginal tax rate varies between filing statuses. *Id.*

²⁶ For example, take a \$1000 deduction for two single persons, Alex and Sarah. Alex has a salary of \$100,000. Pursuant to I.R.C. § 1(c), Alex's marginal tax rate is 31%. Without a deduction, his taxable income is \$100,000, and he owes \$26,522 in taxes. With a deduction of \$1000, his taxable income is \$99,000, and he owes \$26,212 in taxes. Thus, a \$1000 deduction saves Alex \$310. Sarah, on the other hand, has a salary of \$50,000. Pursuant to I.R.C. § 1(c), Sarah's marginal tax rate is 28%. I.R.C. § 1(c). Without a deduction, her taxable income is \$50,000, and she owes \$11,127 in taxes. With a deduction of

1. Tax Credits

Once a taxpayer's income-tax burden is determined, the taxpayer may finally subtract any tax credits for which the taxpayer is eligible. Credits reduce the amount of tax owed outright. Available tax credits include, inter alia: the child tax credit,²⁸ the foreign taxes credit,²⁹ and the earned income credit.³⁰ Credits are similar to deductions insofar as they reduce the amount of taxes owed; however, while the amount saved by a deduction fluctuates based on the taxpayer's AGI, the effects of credits are static, since taxpayers recover the same amount regardless of their adjusted gross incomes.³¹

2. The Alternate Minimum Tax

One last twist in the tax system is the Alternative Minimum Tax (AMT) rates.³² The policy behind the AMT is simple: the alternate minimum tax kicks in if a wealthy taxpayer's liability becomes too low because of personal exemptions, deductions, and other items.³³ This usually affects taxpayers with adjusted gross incomes above \$100,000 or \$200,000.³⁴ Although tax rates are lower under the AMT (the highest regular tax rate in 2009 was around 39%, whereas the highest AMT rate is 28%),³⁵ the AMT

\$1000, her taxable income is \$49,000, and she owes \$10,847. Thus, a \$1000 deduction saves Sarah \$280.

²⁷ In 2007 and 2006, a substantial number of taxpayers started itemizing their deductions at adjusted gross incomes of \$75,000. *Individual Income Tax Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items*, I.R.S. INDIVIDUAL COMPLETE REP. (PUBLICATION 1304), TABLE 2.1 (2007), available at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96981,00.html#_grp2 [hereinafter *Tax Returns with Itemized Deductions 2007*]; *Individual Income Tax Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items*, I.R.S. INDIVIDUAL COMPLETE REP. (Publication 1304), Table 2.1 (2006), available at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96981,00.html#_grp2 [hereinafter *Tax Returns with Itemized Deductions 2006*]. In 2005, taxpayers started itemizing their deductions at \$60,000. *Individual Income Tax Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items*, I.R.S. INDIVIDUAL COMPLETE REP. (Publication 1304), Table 2.1 (2005), available at http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96981,00.html#_grp2 [hereinafter *Tax Returns with Itemized Deductions 2005*].

²⁸ I.R.C. § 24(a).

²⁹ *Id.* § 27(a).

³⁰ *Id.* § 32(a).

³¹ This puts aside the question of the decreasing marginal utility of money. For a discussion on the decreasing marginal utility of money, see Thomas D. Griffith, *Progressive Taxation and Happiness*, 45 B.C.L. REV. 1363 (2004). For an example of the difference between \$1000 as a credit and as a deduction: Take taxpayers Elmase and Nate, who both have an AGI of \$100,000, a taxable income of \$100,000, and a marginal tax rate of 34%. Elmase has a credit of \$1000, so she will save the entire \$1000. Nate has a deduction of \$1000, so he will save only \$340.

³² The Alternate Minimum Tax is governed by I.R.C. §§ 55–59.

³³ Charles L. Ballard & Paul L. Menchik, *Alternative Minimum Taxpayers: Who They Are and Where They Live*, in PROCEEDINGS: 98TH ANNUAL CONFERENCE ON TAXATION 264 (John Diamond ed., 2005).

³⁴ *Tax Returns with Itemized Deductions 2005*, supra note 27; *Tax Returns with Itemized Deductions 2006*, supra note 27; *Tax Returns with Itemized Deductions 2007*, supra note 27.

³⁵ I.R.C. §§ 1(a)–(e), 55(b)(1)(A)(ii). AMT rates are different for married persons filing separately. *Id.* § 55(b)(1)(A)(iii).

only allows a small number of deductions,³⁶ which include charitable deductions.³⁷

3. Internal Revenue Code Section 170: Charitable Deductions

Taxpayers who itemize or use the AMT may take a deduction for any “charitable contributions” made during the taxable year.³⁸ Between 2005 and 2007, roughly 21% of taxpayers were eligible to take deductions for their charitable contributions.³⁹ Charitable contributions may be made to: (a) the United States government, (b) any nonprofit organization (corporation, trust, or foundation) that operates “exclusively for religious, charitable, scientific, literary or educational purposes,” (c) war veteran organizations, (d) domestic fraternal societies in certain circumstances, and (e) cemetery companies in certain circumstances.⁴⁰ Given this broad definition, it is not surprising that Congress has imposed many limitations on charitable deductions.⁴¹

Generally, the amount of charitable deductions an individual taxpayer may take is capped at 50% of the taxpayer’s AGI.⁴² If a taxpayer makes charitable contributions that add up to more than 50% of the taxpayer’s AGI in a given year, the taxpayer is allowed to “carry-over” any excess amount to deduct in future years.⁴³ These excess deductions will count as part of the taxpayer’s charitable deductions for the next five years.⁴⁴ For example: Anne has an AGI of \$400,000. In year one, she donated a painting worth \$500,000 to a museum. As long as Anne is not eligible for any other deductions, Anne may then deduct \$200,000 in year one, carry over \$200,000 to deduct in year two, and finally carry over the last \$100,000 to deduct in year three.

For the purposes of income taxes and gift taxes, charitable deductions only apply to inter vivos gifts, which are gifts made during the lifetime of the donor. Taxpayers may also make “testamentary dispositions,” which are

³⁶ See *Id.* § 56(b). The AMT eliminates: standard deductions, personal exemptions, and state and local taxes deductions. Medical expenses deductions are simply subject to stricter thresholds. There are also no § 68 limitations restrictions.

³⁷ *Id.* § 170(a).

³⁸ See *Id.* § 170(b). Generally, charitable contributions may not be made in the form of transfers of “future interests.” *Id.* § 170(a)(3). A future interest in property, such as a remainder interest, is not a full interest because there are necessarily some intervening interests between the donor and the object the donor wishes to donate. Moreover, charitable contributions require that donors do not receive a “substantial benefit” from the transfer. Benefits are “substantial” when the benefit the donor receives outweighs the benefit the public receives from the donation. *Ottawa Silica Co. v. United States*, 699 F.2d 1124, 1131–32 (Fed. Cir. 1983). A donor is likely to receive a substantial benefit when a quid pro quo transaction occurs. *Id.* Intangible benefits, like goodwill or publicity, are not considered substantial benefits. Thomas M. Giordano-Lascari & William C. Choi, *A Case for Bifurcating Payments to Avoid Taxes on Prohibited Benefits Under IRC Section 4947*, 18 CAL. TAX LAW. 13 (2009).

³⁹ In 2005, 13% of taxpayers itemized and 8% used AMT. *Tax Returns with Itemized Deductions 2005*, *supra* note 27. In 2006, 14% of taxpayers itemized and 8% AMT. *Tax Returns with Itemized Deductions 2006*, *supra* note 27. In 2007, 14% of taxpayers itemized and 8% used AMT. *Tax Returns with Itemized Deductions 2007*, *supra* note 27.

⁴⁰ I.R.C. § 170(c).

⁴¹ See *id.* § 170.

⁴² *Id.* § 170(b)(1). There is also a 30% cap. *Id.* The different ceilings correspond to the type of organization that is accepting the donation. *Id.*

⁴³ *Id.* § 170(d)(1)(A).

⁴⁴ *Id.*

gifts made upon the death of the donor, pursuant to the donor's will and governed by the estate tax. Generally, testamentary gifts may be subject to estate tax; however, testamentary gifts to charitable organizations are never subject to estate tax.⁴⁵ Given its unlimited nature, this charitable exclusion creates strong incentives for benefactors to wait until death to transfer property to charities.

III. FRACTIONAL CHARITABLE DONATIONS AND DEDUCTIONS

Fractional charitable gifts are charitable contributions in which the donor donates a series of partial interests⁴⁶ until the donee owns a complete, 100% interest in the donation. For example: Charlie owns an original Tiffany lamp worth \$1 million. If Charlie donates a 10% interest in his Tiffany lamp to a local museum, Charlie will have made a fractional charitable gift. The local museum will have full ownership rights to 10% of the Tiffany lamp. Fractional gifts are roughly analogous to dividing up an acre of land among three daughters. Each daughter has full property rights to her portion of the land, even though she only owns a third of the acre.

A. FROM *WINOKUR V. COMMISSIONER* TO 2006

Fractional charitable giving was a useful donation vehicle starting in the late 1970s, but estate and wealth planners did not begin to focus on fractional gifts as a method of tax planning until the early 2000s.⁴⁷ The popularity of fractional donations of art can be traced to the 1988 *Winokur v. Commissioner* decision, which allowed donors to give fractionally without requiring the donee to take physical possession of the work of art until the donation was completed.⁴⁸

In *Winokur*, the Internal Revenue Service (IRS) challenged deductions taken by a donor who gave fractional interests in a collection of art to a museum that only took possession of the art at the completion of the donations. James L. Winokur made two gifts of a 10% interest in a collection of forty-four pieces of art by three Scandinavian artists to the Carnegie Institute.⁴⁹ The deed of gift granted the Carnegie Institute the right to possess the works for the number of days per year that corresponded to the Carnegie Institute's percent interest.⁵⁰ Moreover, the Carnegie Institute had the sole discretion to determine the days it would possess the art.⁵¹ The Carnegie Institute, however, never took physical

⁴⁵ In order to be subject to estate tax, the decedent's estate must exceed certain exemption amounts. In 2009, the applicable exclusion amount was \$3,500,000. I.R.C. § 2010(c). In 2006 through 2008, the applicable exclusion amount was \$2,000,000. *Id.* Estate tax defines "charitable organizations" in almost the same way as § 170(c). I.R.C. § 2055(a).

⁴⁶ The partial interests must be undivided interests. I.R.C. § 170(f).

⁴⁷ Silverman, *supra* note 10. *See also* Samuel G. Wiczorek, *Winokur, Lose or Draw: Art Collectors Lose an Important Tax Break*, 8 HOUS. BUS. & TAX L. J. 90, 97 (2007).

⁴⁸ Wiczorek, *supra* note 47, at 96-97.

⁴⁹ *Winokur v. Comm'r*, 90 T.C. 733, 734 (T.C. 1988).

⁵⁰ *Id.*

⁵¹ *Id.*

possession of the art collection during the donation period.⁵² As Winokur donated his fractional interest, he took deductions that corresponded with the interest he retained.⁵³ The IRS argued that Winokur's gifts were not "charitable contributions" because the Carnegie Institute failed to take physical possession of the art.⁵⁴

The United States Tax Court sided with Winokur.⁵⁵ Citing Income Tax Regulation § 1.170A-7(b)(1), the Tax Court recognized that fractional gifts were a proper form of charitable contribution.⁵⁶ Moreover, the Court determined that it is "the right or entitlement to possession, not actual physical possession, that controls whether a purported present interest will be regarded as a future interest" and ruled that Winokur's fractional gifts were indeed charitable contributions.⁵⁷

Thus, after *Winokur*, fractional giving was ideal for donors who wanted to donate but were not ready to part with their art collections or would just rather keep the art in their homes during the donation period. Indeed, *Winokur* only required that the donee retain the right to take possession of the artwork, a right which could easily be abused.⁵⁸

The *Winokur* decision, therefore, opened the floodgates for donating fractionally.⁵⁹ Although fractional gifts were explained to museums as a type of "gift with a twist" as early as 1999,⁶⁰ it was not until the early 2000s that fractional gifts of artwork really took off.⁶¹ The rise in fractional gifts during this time has been attributed mainly to the "highflying" value of art.⁶² Indeed, in 2005, London's fine art auctions saw a marked increase in prices of contemporary artworks: Christie's sales rose 74% and Sotheby's rose 37%.⁶³ Fractional giving would have been particularly popular during this period of booming art prices because the value of an additional fractional donation reflected the fair market value⁶⁴ of the artwork at the time of the subsequent donation. Thus, the donor would be eligible to take deductions that reflected the artwork's appreciation in value during the donation period.

⁵² *Id.* at 735.

⁵³ *Id.* at 735–36.

⁵⁴ *Id.* at 736. The IRS also argued that the donations are future interests and therefore could not be charitable contributions. For more on future interests, see *supra* note 36.

⁵⁵ *Winokur*, 90 T.C. at 739–40.

⁵⁶ *Id.* at 738.

⁵⁷ *Id.* at 739–40.

⁵⁸ Indeed, this "retained right" almost seems akin to a Crummey Trust. If the museum were to exercise the right of possession, the donor will likely halt the donations. Thus, the museum would never exercise the right of possession.

⁵⁹ Wieczorek, *supra* note 47, at 96–97 (noting that "[s]oon after the *Winokur* case, the IRS recommended acquiescence and then acquiesced in the decision. Following the IRS's apparent approval . . . wealthy donors . . . began using fractional donations of artwork as a planning tool.").

⁶⁰ Marsha S. Shaines & Ildiko P. DeAngelis, *Giving to Museums: Legal Basics of Donations of Cash, Objects, and Other Property*, ALI-ABA (Mar. 1999).

⁶¹ By 2003, estate planners were encouraged to use fractional gifts for clients with collectibles. See, e.g., Ralph E. Lerner, *What to Do with Art and Other Valuable Stuff: Planning for Collectibles*, ALI-ABA (Sept. 2003). See also Wieczorek, *supra* note 47, at 97.

⁶² Silverman, *supra* note 10. Ms. Silverman also noted that fractional gifts mirrored the popularity of fractional ownership of other luxury items like personal airplanes and yachts.

⁶³ *Id.*

⁶⁴ "Fair market value" is the price that a willing and reasonable buyer would pay at that time for the disputed item.

Donations of art and collectibles, in fact, rose steadily in 2003 and 2004 and spiked in 2005.⁶⁵ During that time, many museums were actively encouraging fractional gifts, including the Museum of Modern Art in New York, the Los Angeles County Museum of Art, Boston's Museum of Fine Arts, and the Smithsonian Institution.⁶⁶ Indeed, fractional gifts of artwork were so popular at the San Francisco Museum of Modern Art that the director considered making an exhibition of the fractionally donated art and calling it "Joint Custody."⁶⁷ Even smaller museums, like the Albright-Knox Art Gallery of Buffalo, New York, received fractional gifts of art.⁶⁸

On the one hand, fractional gifts were by no means a dominant donation technique, despite their popularity with museums. Indeed, major museums estimated that even though 80% of their art came from donations, only 10% of those donations were fractional gifts.⁶⁹ Other museums estimated a lower percentage; fractional gifts account for only 0.2% of the Walker Art Center in Minneapolis's collection and 2% of the Los Angeles County Museum of Art's collection.⁷⁰ On the other hand, the pieces of art donated fractionally were often "the most valuable and historically significant pieces," including items like: the Hope Diamond, Paul Cézanne's *Boy with a Red Vest*, and René Magritte's *The Kiss*.⁷¹ Moreover, the "ten percent of total donations" could still add up to a substantial number of donations. Indeed, in 2006 the Museum of Modern Art in New York owned 650 pieces of fractionally donated art in its collection and held fractional interests in another 600 pieces.⁷²

Regardless of their popularity with donors, fractional gifts were only available to those who qualified to take deductions. It is therefore not surprising that "well-known givers" who donated fractionally included Gap, Inc. founder Donald Fisher and his wife, Levi Strauss heir Peter Haas and his wife, and David Rockefeller.⁷³ Fractional gifts, however, could also appeal to moderate income donors who own artwork that greatly exceeds their AGI.⁷⁴ Indeed, fractional gifts may be the only tax-friendly option for

⁶⁵ In 2003, 88,500 taxpayers made 132,000 donations of art and collectibles. Janette Wilson & Michael Strudler, *Individual Noncash Charitable Contributions, 2003*, I.R.S. STATISTICS OF INCOME, 59 (2003), <http://www.irs.gov/pub/irs-soi/03inccart.pdf>. In 2004, 108,500 taxpayers made 143,000 donations of art and collectibles. Janette Wilson & Michael Strudler, *Individual Noncash Charitable Contributions, 2004*, I.R.S. STATISTICS OF INCOME, 78 (2004), <http://www.irs.gov/pub/irs-soi/04innoncash.pdf>. In 2005, 110,500 taxpayers made 178,000 donations of art and collectibles. Janette Wilson, *Individual Noncash Charitable Contributions, 2005*, I.R.S. STATISTICS OF INCOME, 69 (2003), <http://www.irs.gov/pub/irs-soi/05incontribul.pdf>.

⁶⁶ Silverman, *supra* note 10.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ Jeremy Kahn, *Museums Fear Tax Law Changes on Some Donations*, N.Y. TIMES, Sept. 13, 2006, at E1.

⁷⁰ Stephanie Strom, *The Man Museums Love to Hate*, N.Y. TIMES, Dec. 10, 2006 § 2 (Arts and Leisure Desk), 2.

⁷¹ Kahn, *supra* note 69, at E1; Ashlea Ebeling, *Will Democrats Ride To Museums' Rescue?*, FORBES.COM (Nov. 11, 2006), http://www.forbes.com/2006/11/21/beltway-museums-tax-biz-wash-cz_ae_1122beltway.html.

⁷² Kahn, *supra* note 69, at E1.

⁷³ Silverman, *supra* note 10.

⁷⁴ *Tax-Exempt Charitable Organizations 2007: Statement of Ass'n of Am. Museums in Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 110th Cong. 117 (2007) available at <http://www.gpoaccess.gov/wmhearings/110.html> [hereinafter *Statement of Association of American Museums*].

such a donor. For example: take Vivian, who has an AGI of \$50,000 and is eligible for no other deductions. Recently, Vivian's rich uncle bequeathed to her a work of art worth \$500,000. Given her AGI and the value of the artwork, Vivian has no tax incentive to donate the art outright. Indeed, Vivian would only be able to deduct 5% of the artwork's value (\$25,000, which is 50% of her AGI). Moreover, Vivian would run out of carry-over deductions before she could take more than \$125,000 in deductions. In this case, Vivian would be more likely to either sell the work of art or donate the art upon her death. If Vivian, however, fractionally donates 25% of her work of art over a course of five years, Vivian will be able to deduct the full value of the artwork. Thus, fractional donations would make an *inter vivos* donation a viable option for Vivian.

B. THE PENSION PROTECTION ACT OF 2006 AND INTERNAL REVENUE CODE SECTION 170(O)

1. *The Pension Protection Act's Creation of Internal Revenue Code Section 170(o)*

In 2006, Congress drastically altered fractional giving when it enacted the Pension Protection Act of 2006 (PPA).⁷⁵ The changes were introduced by Senator Charles E. Grassley of Iowa, who saw fractional giving as "a subsidy for millionaires to buy art," arguing that "the word 'giving' doesn't mean keeping."⁷⁶ Other proponents of the changes made by the PPA stressed that deductions for fractional giving "raise[] serious questions of tax equity," since the deductions reduced federal tax revenue but failed to offset that loss with the public good of displayed art.⁷⁷

2. *Analysis of Internal Revenue Code Section 170(o)*

Section 1218 of the PPA created I.R.C. § 170(o).⁷⁸ As promised, § 170(o) severely limited a taxpayer's ability to make fractional gifts. Section 170(o)(1) denies a deduction for fractional gifts unless the taxpayer (or the taxpayer and the donee) was the sole owner of the donated item.⁷⁹

⁷⁵ See Pension Protection Act of 2006, Pub. L. No. 109-280 § 120 Stat. 780, 1218 (2006).

⁷⁶ Strom, *supra* note 70, at 1.

⁷⁷ Pablo Eisenberg, *Fractional Giving's Bad Name*, WALL ST. J., Aug. 4, 2008, at A.12. Samuel G. Wieczorek, however, notes that Eisenberg's claim that fractional giving has cost the federal government "billions of dollars in taxes" is not substantiated by any authority. Wieczorek, *supra* note 47, at 99.

⁷⁸ Section 170(o) originally had what scholars referred to as a "technical mismatch problem." See e.g., Wieczorek, *supra* note 47, at 104-05. The mismatch problem involved a quirk in the income tax, gift tax, and estate tax codes that basically forced donors to pay estate taxes on a completed fractional gift. The Tax Technical Corrections Act of 2007, however, eliminated the problem. See Tax Technical Corrections Act of 2007, Pub. L. No. 110-172, § 3, 121 Stat. 2473, § 3 (2007). See also Marsha S. Shaines & Julian F. Saenz, *Tax and Legislative Update*, ALI-ABA 5 (2008); Donn Zaretsky, *Fractional Gift News*, THE ART LAW BLOG (Dec. 19, 2007, 2:49 PM), http://theartlawblog.blogspot.com/2007_12_01_archive.html; Donn Zaretsky, *Fractional Gift Corrections Enacted*, THE ART LAW BLOG (Jan. 10, 2008, 3:15 PM), http://theartlawblog.blogspot.com/2008_01_01_archive.html. This Note will not address the mismatch problem. For more on the original mismatch problem, see Wieczorek, *supra* note 47, at 104-05; Emily J. Follas, Note, "It Belongs in a Museum": *Appropriate Donor Incentives for Fractional Gifts of Art*, 83 NOTRE DAME L. REV. 1779, 1796-798 (2008).

⁷⁹ I.R.C. § 170(o)(1)(A). The Secretary is authorized to make an exception when all persons who together hold an entire interest in the property make proportional contributions. *Id.* § 170(o)(1)(B).

So if four members of a family each own 25% of a painting, none of them would be eligible to take a deduction for fractionally donating their interest in the painting. This provision, therefore, limits the number of donors who can fractionally donate.

Section 170(o)(2) governs the valuation of subsequent fractional gifts. For the purposes of § 170(o)(2), the value of any additional fractional gifts will be the lesser of the fair market value of the property: (a) at the time of the initial transfer or (b) at the time of each subsequent contribution of fractional interest.⁸⁰ This eliminates the problem of taxpayers deducting far more than the donated item was initially worth, a particular danger during periods of growth in the art market. For example: In 2004, Paul owned a painting worth \$200,000. That year, he decided to make a fractional gift of 10% interest to a local museum. Paul was eligible to take a \$20,000 deduction for the donation. In 2005, the artist who made Paul's painting died, so the price of the painting skyrocketed. Paul's painting in 2005 was worth \$4 million. In a pre-PPA world, when Paul donated another 10% interest in the painting, he was eligible to take a deduction of \$360,000 (which is equal to 10% of Paul's 90% interest in the \$4 million). In a post-PPA world, pursuant to § 170(o)(2), Paul would be limited to a deduction of \$20,000, despite the jump in the fair market value of his painting.

This is a powerful deterrent because it shifts the risk-return associated with donating fractionally. Prior to 2006, a donor who chose to donate fractionally was playing the odds that the item donated would increase in value. If the item increased in value, the donor would be eligible for a larger total deduction than the donor would have had with an outright donation. If, however, the item decreased in value, the donor would have been better off donating the entire interest outright. Since the PPA was enacted, a donor who chooses to fractionally donate faces two possible outcomes: (a) if the item increases in value, the donor is stuck at the fair market value of the initial contribution or (b) if the item decreases in value, the total deduction that the donor can take may be lower than if the donor had donated the entire interest outright. Thus, either: (a) the donor will not benefit from donating fractionally or (b) the donor will actually be penalized for donating fractionally.

Section 170(o)(3) creates a recapture provision and an "addition to tax" provision. The Secretary is authorized to provide for a recapture (plus interest) of the value of any deductions taken during the donation period of any fractional gift when: (a) the donor fails to contribute all of the remaining portions of interest on or before ten years after the initial contribution or the death of the donor, whichever is earlier, or, (b) the donee has not had substantial possession of the donated item during the donation period.⁸¹ If there is a recapture, the taxpayer will owe the government an additional 10% of the value of the deductions taken during the fractional deduction.⁸² Thus, the PPA again drastically changed the risk-return of donating fractionally. In this case, donors are required to gamble on

⁸⁰ *Id.* § 170(o)(2).

⁸¹ I.R.C. § 170(o)(3).

⁸² *Id.*

whether they will live longer than ten years, and the donors will be penalized with a recapture, plus interest, plus 10% if they guess incorrectly. Moreover, § 170(o)(3) seems to soundly defeat the holding of *Winokur* by demanding that the donee maintain substantial physical possession of the item during the ten years or less period.⁸³

On one hand, IRC § 170(o) successfully reshaped fractional giving because it leaves no room for wealthy donors to use fractional giving as a tax shelter. By tightening up the valuation requirements, § 170(o) ensures that the donor will not overvalue the artwork or take deductions that exceed the original fair market value of the art. Moreover, by insisting that museums maintain substantial possession of the fractional gift, § 170(o) ensures that the artwork will not be a gift without giving.

On the other hand, IRC § 170(o) failed to successfully reshape fractional giving because it drastically reduced the number of donations to museums. Indeed, the adverse effect of the PPA on art donations was almost immediately apparent: in 2006, the number of art and collectible donations declined by 17%.⁸⁴ Although it is hard to gauge how much of this drop in art and collectible donations may be attributed to the PPA, there is no doubt that the PPA was “a body blow” for some museums.⁸⁵ The San Francisco Museum of Modern Art (SFMOMA), which received the most fractional gifts in the country, was particularly hard hit: its number of donations dropped 80% after the PPA.⁸⁶ Moreover, many donors across the country withdrew large gifts that they had promised to fractionally donate.⁸⁷ Losses from the withdrawal included a collection of forty contemporary works and a tribal folk art collection worth \$2 million.⁸⁸ Still, the PPA did not destroy fractional giving altogether. In 2007, long-time collectors Janice and Henri Lazarof promised to fractionally donate 130 works of art to the Los Angeles County Museum of Art.⁸⁹

Critics of § 170(o) believe that the PPA went too far, effectively “throwing the baby out with the bathwater.”⁹⁰ Although they agree that there is “something unsavory” about art donors taking deductions for art still in their homes, critics argue that an effective fractional giving statute needs to balance competing factors, such as the benefit the public receives in exchange for deductions and the interests of the donors who are making

⁸³ See Donn Zaretsky, *Fractional Gifts Update*, THE ART LAW BLOG (Nov. 2, 2006, 2:34 PM), <http://theartlawblog.blogspot.com/2006/11/fractional-gifts-update.html> (“The new law does many things, but overrule *Winokur* does not appear to be one of them.”).

⁸⁴ In 2006, 108,300 taxpayers made 148,000 donations of art and collectibles. Pearson Liddel & Janette Wilson, *Individual Noncash Contributions, 2006*, I.R.S. STATISTICS OF INCOME, at 68 (2006), <http://www.irs.gov/pub/irs-soi/09sumbulindcontri06.pdf>. Although this decline is significant, it is hard to gauge how much may be imputed to the PPA.

⁸⁵ Kahn, *supra* note 69, at E1.

⁸⁶ Richard Layaco, *More Quick Talk: With SFMOMA's Neal Benezra*, LOOKING AROUND BLOG (Oct. 15, 2007, 5:21 PM), http://lookingaround.blogs.time.com/2007/10/15/more_quick_talk_with_sfmomas_n/#ixzz0hGiblt4T.

⁸⁷ *Statement of Association of American Museums*, *supra* note 74, at 143.

⁸⁸ *Statement of Association of American Museums*, *supra* note 74, at 143.

⁸⁹ Edward Wyatt, *For Los Angeles Museum, A 'Transformative' Gift of Modernists*, N.Y. TIMES, Dec. 13, 2007, at E1.

⁹⁰ Strom, *supra* note 70, at 2.1; Wiczorek, *supra* note 47, at 105, 108.

gifts out of their privately owned art.⁹¹ Whereas the old rules focused too much on the needs of the donors, the new rules look too much to the rights of the public to enjoy the art they “essentially paid for by allowing a charitable deduction in the first place.”⁹²

C. REACTIONS AND RECOMMENDATIONS OF MUSEUMS AND LEGAL SCHOLARS

1. *Reactions to Section 170(o) by Museums and Legal Scholars*

Not surprisingly, museums are the most vocal critics of the § 170(o) restrictions. Fractional giving was a feather in museums’ caps for four reasons. First, museums rely heavily on the “generosity of donors” because they cannot afford to buy celebrated works of art.⁹³ Fractional giving allowed museums to own significant, yet otherwise unobtainable, pieces of art.⁹⁴ Second, the flexible nature of fractional giving encouraged donations from collectors who may not have donated otherwise, generally because outright donation was not a good fit.⁹⁵ Third, in the museum world, “a gift delayed is often a gift denied.”⁹⁶ Delaying a gift may result in incidental damage to the artwork or donors changing their minds.⁹⁷ Because fractional giving transfers some ownership to the donee, a museum could effectually “lock-in” a gift that may have been deferred otherwise.⁹⁸ Fourth, and finally, fractional gifts allowed museums to better focus their acquisition plans and accommodate the artwork well in advance.⁹⁹

⁹¹ Wieczorek, *supra* note 47, at 108.

⁹² *Id.* at 108–10.

⁹³ *Tax Technical Corrections Act of 2006: Written Comments on H.R. 6264 Before the H. Comm. of Ways & Means*, 109th Cong. 21 (2006) (statement of James Cuno, President, The Art Institute of Chicago) [hereinafter *Letter from the Art Institute of Chicago*]; *Tax Technical Corrections Act of 2006: Written Comments on H.R. 6264 Before the H. Comm. of Ways & Means*, 109th Cong. 45, 47 (2006) (statement of Fred Goldstein, General Counsel, Los Angeles County Museum of Art) [hereinafter *Letter from LACMA*].

⁹⁴ *Letter from the Art Institute of Chicago*, *supra* note 93, at 21; *Letter from LACMA*, *supra* note 93, at 45, 47.

⁹⁵ *Letter from the Art Institute of Chicago*, *supra* note 93, at 22; *Letter from LACMA*, *supra* note 93, at 45; *Tax Technical Corrections Act of 2006: Written Comments on H.R. 6264 Before the H. Comm. of Ways & Means*, 109th Cong. 41 (2006) (statement of Millicent Hall Gaudieri, Executive Director, Association of Art Museum Directors) [hereinafter *Letter from the Association of Art Museum Directors*]; *Tax Technical Corrections Act of 2006: Written Comments on H.R. 6264 Before the H. Comm. of Ways & Means*, 109th Cong. 43 (2006) (statement of Sara Geelan, Associate General Counsel, Solomon R. Guggenheim Foundation), [hereinafter *Letter from the Guggenheim Foundation*]. See also *Tax-Exempt Charitable Organizations 2007: Statement of High Museum of Art in Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 110th Cong. 174 (2007), [hereinafter *Statement of High Museum*].

⁹⁶ *Statement of High Museum*, *supra* note 95, at 174; *Letter from LACMA*, *supra* note 93, at 46.

⁹⁷ *Letter from the Art Institute of Chicago*, *supra* note 93, at 22; *Letter from the Guggenheim Foundation*, *supra* note 95, at 43; *Letter from LACMA*, *supra* note 93, at 46.

⁹⁸ *Statement of High Museum*, *supra* note 95, at 174; *Letter from LACMA*, *supra* note 93, at 46; *Letter from the Guggenheim Foundation*, *supra* note 95, at 44.

⁹⁹ *Letter from the Art Institute of Chicago*, *supra* note 93, at 21; *Letter from the Guggenheim Foundation*, *supra* note 95, at 44. The PPA, however, had quite the opposite effect, causing donors to suspend their current fractional gifts and thus upsetting the museums’ focused acquisition plans. *Letter from the Art Institute of Chicago*, *supra* note 93, at 21; *Letter from the Association of Art Museum Directors*, *supra* note 95, at 40–41; *Letter from the Guggenheim Foundation*, *supra* note 95, at 45; *Letter from LACMA*, *supra* note 93, at 46.

Legal scholars offer similar criticisms of § 170(o).¹⁰⁰ First, they note that the ownership limitation of § 170(o)(a) restricts the “pool of works eligible for donation.”¹⁰¹ Second, legal scholars claim that the time limitations on the fractional gifts will discourage donations from young collectors, who would have more than ten years to “spend with their art objects,” and donations of large collections, which may need more than ten years of deductions to make the donations worthwhile.¹⁰² Third, and finally, legal scholars contend that the “substantial physical possession” requirement is cumbersome, not only because the meaning of “substantial” is vague, but also because the provision renders the donor subject to penalty based on the action or inaction of the museum.¹⁰³

2. *Recommendations by Museums and Legal Scholars*

Museums and legal scholars suggest three main amendments to § 170(o). First, they recommend modifying the recapture period so that gifts may take longer than ten years and need only be completed at death.¹⁰⁴ Museums and legal scholars see the ten-year limitation as arbitrary and unduly limiting, especially since the limitation forces donors to wait until they are older to begin gifts.¹⁰⁵ Indeed, some legal scholars recommend extending the time limit to twenty years, which would “give donors sufficient time to plan their charitable donations,” while others recommend allowing the gift to be complete only within six or nine months of the date of the donor’s death.¹⁰⁶ Such an amendment would allow the untimely death of the donor to avoid the recapture penalty but may delay the “full public benefit from the deduction.”¹⁰⁷

Second, museums and legal scholars ask for various exceptions to the possession rule. One such exception would be a waiver for the “substantial possession requirement” whenever frequent changes in possession would be detrimental for a piece of art or a museum.¹⁰⁸ This possession waiver would likely occur when the piece of art is too fragile, large, or rare to move frequently, or when the museum’s space cannot readily accommodate the piece.¹⁰⁹ Some legal scholars advocate for a physical possession

¹⁰⁰ Legal scholarship, in contrast, is surprisingly sparse.

¹⁰¹ Follas, *supra* note 78, at 1793–94. See also Elizabeth Dillinger, Note, *A Not So Starry Night: The Pension Protection Act’s Destruction of Fractional Giving*, 83 U. MO. KAN. CITY L. REV. 1045, 1072 (2008). Whether this “makes a significant practical difference,” however, is not clear. Follas, *supra* note 78, at 1794. In fact, this rule may help fractional giving by eliminating disputes over the ownership of the donated art. *Id.* at 1803–04.

¹⁰² Follas, *supra* note 78, at 1794–95.

¹⁰³ *Id.* at 1795. See also Dillinger, *supra* note 101, at 1066.

¹⁰⁴ *Letter from the Art Institute of Chicago*, *supra* note 93, at 21–22; *Letter from the Association of Art Museum Directors*, *supra* note 95, at 41; *Letter from LACMA*, *supra* note 93, at 46.

¹⁰⁵ *Letter from the Art Institute of Chicago*, *supra* note 93, at 22; *Letter from the Association of Art Museum Directors*, *supra* note 95, at 41; *Letter from LACMA*, *supra* note 93, at 46. The ten-year limitation may also deter donors who need more than ten years to reach their AGI limit. *Letter from the Art Institute of Chicago*, *supra* note 93, at 22.

¹⁰⁶ Wiczorek, *supra* note 47, at 111; Dillinger, *supra* note 101, at 1071; Follas, *supra* note 78, at 1802.

¹⁰⁷ Wiczorek, *supra* note 47, at 111; Dillinger, *supra* note 101, at 1071; Follas, *supra* note 78, at 1802.

¹⁰⁸ *Letter from the Association of Art Museum Directors*, *supra* note 95, at 47; *Letter from LACMA*, *supra* note 93, at 47.

¹⁰⁹ *Letter from the Association of Art Museum Directors*, *supra* note 95, at 42; *Letter from LACMA*, *supra* note 93, at 47.

requirement that would only require physical possession at the end of the time limit.¹¹⁰ Such a provision would also eliminate the problems that arise from frequent shipping and storage of fragile or cumbersome pieces of art.¹¹¹ Others, however, propose that the possession rule simply be eliminated altogether, as it places “undue hardships” on museums.¹¹²

Third, and finally, legal scholars suggest that additional donations be valued in a way that reflects the donations’ actual fair market values. This change would allow donors to benefit from any appreciation in the value of their fractional donations.¹¹³ Some also recommend that the Art Advisory Panel of the Internal Revenue Service more specifically review and supervise all donations that are worth over \$1 million.¹¹⁴

D. THE FIRST ATTEMPT TO AMEND: THE PROMOTION OF ARTISTIC GIVING ACT

The first attempt to amend IRC § 170(o) was the Promotion of Artistic Giving Act (PAGA) of 2007, which was created specifically to elevate the “unnecessarily harsh provisions” of the PPA.¹¹⁵ Although the PAGA notably did not seek to amend the substantial possession requirements of § 170(o), it offered two other major changes.¹¹⁶ First, it sought to extend the donation time limit, requiring that the fractional donation be completed within nine months of the donor’s death.¹¹⁷ This change would have encouraged fractional donations from younger donors and donors with large collections.¹¹⁸ Moreover, because the PAGA eliminated the “fully donated before death” requirement, donors would no longer have to gamble on whether they would outlive the donation period.

Second, the PAGA aimed to amend the valuation procedure for additional partial donations, requiring only that subsequent gifts over \$1 million be subject to certified appraisal from the Internal Revenue Service’s Art Advisory Board.¹¹⁹ This provision was especially well-crafted. It would have encouraged fractional donations since it allowed donors to enjoy the appreciation of their artwork during the donation period, while ensuring less donor gaming, fraud, and abuse of fractional giving.¹²⁰

¹¹⁰ Wiczorek, *supra* note 47, at 111–12.

¹¹¹ *Id.*

¹¹² Dillinger, *supra* note 101, at 1071.

¹¹³ *Id.* at 1070.

¹¹⁴ Follas, *supra* note 78, at 1802–803.

¹¹⁵ *Promotion of Artistic Giving Act of 2007: Hearing on H.R. 3881 Before the H.R.*, 110th Cong. (2007) (introductory remarks by Hon. Tom Udall of N.M.).

¹¹⁶ Donn Zaretsky, *More on the Fractional Gifts Bill*, THE ART LAW BLOG, (Oct. 22, 2007, 12:40 PM), <http://theartlawblog.blogspot.com/2007/10/more-on-fractional-gifts-bill.html>; Follas, *supra* note 78, at 1803. House Bill 3881 also attempted to fix the “mismatch problem.” For more information on the mismatch problem, see *supra* note 78. For more information on the PAGA’s attempts to change the mismatch problem, see Follas, *supra* note 78, at 1803.

¹¹⁷ *Promotion of Artistic Giving Act of 2007*, H.R. 3881, 110th Cong. (2007). See also Follas, *supra* note 78, at 1802.

¹¹⁸ Follas, *supra* note 78, at 1802.

¹¹⁹ *Promotion of Artistic Giving Act of 2007*, H.R. 3881. See also Follas, *supra* note 78, at 1802–03.

¹²⁰ Follas, *supra* note 78, at 1802–03.

Unfortunately, the PAGA was quietly stalled in the House Ways and Means Committee and was never enacted.¹²¹ Two years after the death of the PAGA, however, Senator Schumer sponsored Senate Bill 1605, as discussed below in Part VI.¹²²

IV. TAX POLICY AND MUSEOLOGY

When dealing with a tax statute that affects museums, the first question is whether museums are worth protecting.¹²³ The answer seems obvious: museums are touted as places where the public may “find meaning and value, and delight in exploring the diversity of the human experience.”¹²⁴ Moreover, museums are considered necessary to store, protect, care for, restore, and display special objects.¹²⁵ Museums, however, are not worth protecting simply because they are museums; rather, museologists believe that museums must prove their worth to society.¹²⁶

A. ARE MUSEUMS GOOD FOR SOCIETY?

1. *What are the Goals of Museums?*

Historically, the American museum sought to gather, preserve, and study.¹²⁷ Now, the American museum seeks to improve their visitors and their communities through a variety of public services.¹²⁸ Although some museologists object more to this focus on direct public service—and, therefore, away from the museum’s collection—others encourage the shift because a focus on public service levels the playing field for new museums who may never accrue collections as great as those of the older museums.¹²⁹

While good museums operate to preserve their collections so as to benefit the public (and not simply to benefit themselves), bad museums may seriously lack the physical or managerial resources necessary to do so.¹³⁰ Bad museums, moreover, harm good museums by hoarding resources and diminishing the public’s general respect for museums.¹³¹ Thus, a

¹²¹ Promotion of Artistic Giving Act of 2007, H.R. 3881.

¹²² See Shelley Banjo, *Restoration Work on Gifts of Art*, WALL ST. J., August 8, 2009, at B2.

¹²³ This Note also recognizes that there is a wide variety of art and a wide variety of museums, both public and private. For the purposes of this note, however, “art” generally refers to tangible pieces of fine art and “a museum” generally refers to fine art museums, with some exceptions.

¹²⁴ STEPHEN E. WEIL, MAKING MUSEUMS MATTER 210 (2002).

¹²⁵ STEPHEN E. WEIL, BEAUTY AND THE BEASTS 30 (1983).

¹²⁶ See WEIL, *supra* note 124, at 56, 59. See also Selma Holo, *A Crisis is a Terrible Thing to Waste*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES (Selma Holo & Mari-Tere Álvarez eds., 2009).

¹²⁷ WEIL, *supra* note 124, at 28.

¹²⁸ *Id.* at 29.

¹²⁹ *Id.* at 29, 35.

¹³⁰ *Id.* at 62–63.

¹³¹ *Id.* at 73. Indeed, the public’s trust in museums has reportedly diminished due to the number of corporate, governmental, and nonprofit scandals. Selma Holo & Mari-Tere Álvarez, *Introduction to Chapter 1: Public Trust*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES, *supra* note 126, at 3.

museum must strive to provide more direct public service than mere existence, and obtain necessary resources to be successful.¹³²

2. *What are the Problems with Museums?*

Although museums strive for public service, they may be both physically and psychologically inaccessible to the general public.¹³³ Museums can intimidate, numb, and bore their visitors, while also fostering a sense of inferiority.¹³⁴ Moreover, museums may implicitly communicate the “authority, power, and values of the dominant culture.”¹³⁵

This alienation of the general public is partially a result of the dependence of museums on their donors.¹³⁶ Museums rely heavily on donors to fill out their collections and their visitors are generally from the upper- and middle-class.¹³⁷ This “elite subordination of the museum” simply affirms the class status of the rich and educated while alienating all others.¹³⁸ Indeed, museums have had little success at closing the gap, despite mailings and special events targeted at minority groups and lower income patrons.¹³⁹ Thus, many see museums as “by the elite for the elite.”¹⁴⁰

3. *What are the Functions of Museums?*

Museums fulfill a myriad of roles in society including: informal education, preservation, art display, and entertainment. Museums also act as temples of contemplation, as journalists, as connoisseurs, as symbols of power, as centers for scholarship, as forms of bureaucracy, as agents of social change, as cornerstones for urban development, and as monasteries.¹⁴¹

a. *Education*

The education of visitors is unquestionably one of the primary “goods” offered by museums.¹⁴² Museums are considered self-learning sites that present visitors with an “informal” education.¹⁴³ Indeed, museums are encouraged to view themselves as assistants in the learning process rather

¹³² WEIL, *supra* note 124, at 4, 63. *See also* JOHN H. FALK & LYNN D. DIERKING, *LEARNING FROM MUSEUMS: VISITOR EXPERIENCES AND THE MAKING OF MEANING* 233 (2000).

¹³³ *See* FIONA MCLEAN, *MARKETING THE MUSEUM* 75 (1997).

¹³⁴ *Id.* at 23.

¹³⁵ FALK & DIERKING, *supra* note 132, at 206.

¹³⁶ WEIL, *supra* note 124, at 161.

¹³⁷ MCLEAN, *supra* note 133, at 24, 75. *See also* Cherise Smith & Gary Matthews Jr., *What is the Relevance of Museums? Can You Imagine a World Without Them?*, in *BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES*, *supra* note 126, at 44.

¹³⁸ MCLEAN, *supra* note 133, at 76.

¹³⁹ *Letter from LACMA*, *supra* note 93, at 47; Claudine K. Brown, *The Museum's Role in a Multicultural Society*, in *REINVENTING THE MUSEUM* 143, 144 (Gail Anderson ed., 2004). *See also* Holo & Alvarez, *supra* note 131, at 55. Despite the poor results, museum audiences are still more diverse than before. Vanda Vitali, *Grappling with Limits: Museums and Social Inclusion*, in *BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES*, *supra* note 126, at 72, 73.

¹⁴⁰ MCLEAN, *supra* note 133, at 24.

¹⁴¹ *See generally* WEIL, *supra* note 125.

¹⁴² FALK & DIERKING, *supra* note 132, at 2.

¹⁴³ WEIL, *supra* note 124, at 64. *See also* GEORGE E. HEIN., *LEARNING IN THE MUSEUM* 7 (1998). “Formal” education is the type of education that comes from schools. *Id.*

than purely as educators.¹⁴⁴ Determining whether or what people, in fact, learn from museums can be very difficult.¹⁴⁵ This is because, unlike other types of learning, learning that takes place in museums is a “whole-body, whole-experience, whole-brain activity.”¹⁴⁶ In fact, it may be that museums are prime learning sites simply because humans are highly motivated to learn when they are in supporting environments that do not create anxiety or fear.¹⁴⁷

b. *Preservation*

Like education, preservation of objects is one of the main services provided by museums. Simply put: museums are stewards of the objects they collect, which have been entrusted to them so that museums may carry out a public purpose.¹⁴⁸ Although preservation is a traditional function of museums, it has only recently become valued in its own right and viewed as more than just a means to an end.¹⁴⁹

c. *Art Display*

When discussing fractional gifts, legal scholars often argue that art should be in a museum, rather than in private collections or on the art market, so that as many people as possible may see the art.¹⁵⁰ Museums, on the other hand, are acutely aware that “the idea that people are morally ennobled by contact with works of art is a pious fiction.”¹⁵¹ Museologists concede, however, that a museum visitor’s response to the live object of art differs from a response to a photograph, video, or visual representation of that art.¹⁵²

d. *Entertainment and Cornerstones in Recent “Mixed-Use” Urban Developments*

Museums in and of themselves can benefit the cultural, economic, and social well-being of a community simply because they are spaces where all members of a community can gather.¹⁵³ Indeed, as a form of entertainment, museum-going is considered a prime leisure activity, on par with shopping and sports.¹⁵⁴ Unlike shopping or sports, however, museums provide

¹⁴⁴ MCLEAN, *supra* note 133, at 80.

¹⁴⁵ FALK & DIERKING, *supra* note 132, at 9. This determination may be difficult because our model for determining how someone learns is arguably flawed. *Id.*

¹⁴⁶ *Id.* at 9–10. This determination may be difficult because our model for determining how someone learns is flawed. *Id.* at 9.

¹⁴⁷ *Id.* at 32. See also HEIN, *supra* note 143, at 136–37.

¹⁴⁸ WEIL, *supra* note 124, at 5, 19.

¹⁴⁹ *Id.* at 28–29.

¹⁵⁰ Follas, *supra* note 78, at 1792, 1810. See Dillinger, *supra* note 101, at 1074; Wiczorek, *supra* note 47, at 112. See also Kahn, *supra* note 69 (quoting Senator Grassley, “a painting in a private living room doesn’t benefit the public.”). For a particularly moving counter-argument, watch the 2009 documentary THE ART OF THE STEAL (9.14 Pictures 2009) directed by Don Argott.

¹⁵¹ WEIL, *supra* note 124, at 203–04 (internal quotation marks omitted) (quoting Robert Hughes).

¹⁵² *Id.* at 206.

¹⁵³ *Id.* at 207; Marcia Trotta & Roger L. Kemp, *Introduction*, in MUSEUMS, LIBRARIES AND URBAN VITALITY 3–4 (Roger L. Kemp & Marcia Trotta eds., 2008).

¹⁵⁴ FALK & DIERKING, *supra* note 132, at 2; WEIL, *supra* note 124, at 66.

visitors with an educational, “experience-rich environment” in a “distinctive public space.”¹⁵⁵

Because museums create both peaceful public spaces and experience-rich environments, cities and urban developers in the United States have begun to use museums as cornerstones of their community renovations.¹⁵⁶ Indeed, urban developers are using museums to restore the “traditional town centers” of their communities.¹⁵⁷ In these developments, the focus is simply on the presence of the museum in the community, rather than the specific offerings found within the museum, which is sometimes referred to as the “Bilbao effect.”¹⁵⁸ Urban planners believe that these cultural attractions will stimulate business development and allow communities to profit from the growing market of cultural tourism.¹⁵⁹ Moreover, cities hope these cultural attractions will attract to the newly revitalized downtown areas young professionals, empty-nesters, and members of the “creative class,” defined as “those who work in ‘knowledge-based’ professions like research or arts,” who see their time as too valuable to waste on commuting.¹⁶⁰

Notable frontrunners in this new use of museums are Cincinnati and Denver.¹⁶¹ Cincinnati’s recent simultaneous rejuvenation of its urban core and its overall arts and culture offering is considered a sign that Cincinnati is “working its way up the food chain of U.S. cities”¹⁶² Indeed, Cincinnati has reopened five museums in its downtown and developed lofts and condominiums aimed at young professionals, empty nesters, “urbanists,” and entrepreneurs.¹⁶³ As hoped, this development has created a high demand for downtown living, especially among these groups.¹⁶⁴ Like Cincinnati, Denver used museum buildings as “anchors” for two major mixed-use developments, with the intention of creating a thriving environment to rejuvenate parts of the city.¹⁶⁵

Thus, despite their faults, museums may offer many beneficial functions to their communities in general and society as whole.

¹⁵⁵ WEIL, *supra* note 124, at 68, 71, 207.

¹⁵⁶ Trotta & Kemp, *supra* note 153, at 3.

¹⁵⁷ *Id.* at 3–4. Libraries are also being used as new “traditional” town centers.

¹⁵⁸ Guillermo Barrios, *The Revitalization of the Urban Environment: A Measure of the Museum’s Social Value*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES (Francisca González Arias, trans.), *supra* note 126, at 38–40. Bilbao was a relatively unknown town in Spain until the Guggenheim Foundation decided to open a Guggenheim Museum there. *Id.* at 38.

¹⁵⁹ Nancy Moses, *Have a Plan and Make the Most of Arts and Culture*, PUB. MGMT, December 2001, at 18, *reprinted in* MUSEUMS, LIBRARIES AND URBAN VITALITY, *supra* note 153, at 12–13.

¹⁶⁰ Susan Breitkopf, *Cultural Assets Turn to Mixed Uses*, URB. LAND, September 2006, at 140, *reprinted in* MUSEUMS, LIBRARIES AND URBAN VITALITY, *supra* note 153, at 125, 125–126; Raymond L. Buse III, *Renaissance on the River*, URB. LAND, Apr. 2007, at 98, *reprinted in* MUSEUMS, LIBRARIES AND URBAN VITALITY, *supra* note 153, at 54.

¹⁶¹ Other cities like Louisville, Kentucky; Charlotte, North Carolina; Raleigh, North Carolina; and Philadelphia, Pennsylvania have also had success with these mixed-use communities. Breitkopf, *supra* note 160, at 125.

¹⁶² Buse III, *supra* note 160, at 54.

¹⁶³ *Id.*

¹⁶⁴ *Id.* at 56.

¹⁶⁵ Breitkopf, *supra* note 160, at 125–26; Cynthia L. Kemper, *Art on View*, URB. LAND, May 2007, *reprinted in* MUSEUMS, LIBRARIES AND URBAN VITALITY, *supra* note 153, at 58, 59.

B. HOW SHOULD TAX POLICY REFLECT MUSEOLOGY?

Given the importance of museums to society, tax policy should continue to favor tangible donations of art to museums. When determining how to ensure that these statutes best favor museums, tax policy must also reflect both the surprisingly dynamic goals of museums and current movements in the field of museology. This is especially true with respect to tax statutes like § 170(o) that are likely to affect donations.

On the most basic level, the success of a museum can be measured in two ways. First, good museums strive to provide direct public services.¹⁶⁶ Second, good museums have the necessary resources to serve their missions.¹⁶⁷ Thus, on the one hand, it is important for tax statutes to encourage donations of fine art so that museums can obtain necessary resources. This is especially true because museums depend on donors to help them obtain “great pieces of art.”¹⁶⁸ This reliance on the elite,

however, may alienate members of the public, especially visitors with lower incomes. Thus, museums that depend too much on the elite for donations may fail to provide effective public service. So, on the other hand, tax statutes that encourage too many donations of fine art risk enabling a reliance on the elite that could actually harm museums. Tax policy, therefore, must tread lightly when providing incentives to donate to museums; tax statutes should encourage donations of fine art but not encourage so many donations that museums alienate their public.

Tax policy must also keep in mind the recent tension between museums’ permanent collections and the special exhibits. Some museologists argue that a museum is great only if it has a key collection, “un nucleo duro,” of the famous pieces of art the public expects to see.¹⁶⁹ Recently though, museums have shifted their focus from the permanent collection to the special exhibit in what has been termed a “special exhibit ‘frenzy.’”¹⁷⁰ This new trend weakens the importance of the permanent collection to museums. Thus, donations of fine art, which generally become part of the permanent collections, may not be as significant to museums as they once were. Tax policy, therefore, ought to consider the effect of the special exhibit on the value of fine art donations when providing incentives to donate to museums. Since museums place less value on donations of fine art, tax statutes may provide fewer incentives to donate.

¹⁶⁶ WEIL, *supra* note 124, at 4, 63. See also FALK & DIERKING, *supra* note 132, at 233.

¹⁶⁷ WEIL, *supra* note 124, at 4, 63. See also FALK & DIERKING, *supra* note 132, at 233.

¹⁶⁸ Letter from the Art Institute of Chicago, *supra* note 93, at 21; Letter from LACMA, *supra* note 93, at 45, 47.

¹⁶⁹ Leticia Azcue Brea, *Bringing Our Permanent Collections to Life*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES (Francisca González Arias, trans.), *supra* note 126, at 25, 27.

¹⁷⁰ Alan Shestack, *When I was a Youngster*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES, *supra* note 126, at 139. See also Holo & Álvarez, *supra* note 131, at 19. Some believe, however, that the costs of special exhibits have caused museums to return their focus to their permanent collections. *Id.* at 20.

Finally, a museum's goal to collect the best pieces of art may hinder its ability to assemble collections that are creative and responsive to its community's interests.¹⁷¹ Indeed, museums seem to be shifting away from striving to obtain the best artwork. Museologist Stephen Weil, in particular, predicts that the current "era of heroic collecting," during which museums have focused on collecting "great art," will end soon for three reasons: (1) the majority of the "Old Master" art has already been acquired by museums, (2) recent moral and ethical codes prohibit new museums from collecting many cultural artifacts, and (3) new museums are unlikely to inherit private collections.¹⁷² Others believe that the era of collecting is waning because of the current "gradual shift in emphasis . . . from what [museums] have (collections) to what they do (create public value)."¹⁷³

The end of heroic collecting may be beneficial to museums because new museums that cannot amass "great collections" can focus instead on public programming.¹⁷⁴ For example, the William King Regional Art Museum in Abingdon, Virginia lacks "a single work of art that a major New York City museum would consider fit to hang in its galleries."¹⁷⁵ Museologists, however, argue that the William King Regional Art Museum's public programming provides far more community value "pound for pound" than any New York City museum.¹⁷⁶ Likewise, the Strong Museum in Rochester, New York, which was established in the 1960s and devoted to the history of the northeastern United States, was failing until it asked its community what changes they recommended.¹⁷⁷ As a result, the Strong Museum experienced great success when it abandoned its original focus on issues prior to the 1950s in favor of contemporary exhibits exploring the Cold War, AIDS, and even the characters from Sesame Street.¹⁷⁸ Thus, the value of museums to their communities may no longer be the museums' collections of great pieces of art, but rather their ability to adapt to their communities' needs and reach out to their communities through public programming. Tax policy should reflect, and indeed aid, this movement away from an obsession with collecting "the best" pieces of art. Tax statutes, therefore, should provide only a moderate amount of incentives to donate fine art.

Thus, tax statutes affecting museums, especially those affecting charitable contributions to museums, will be most effective if they reflect

¹⁷¹ Indeed, some argue that this creativity, albeit forced, is what sustains museums in the long-run. Holo & Alvarez, *supra* note 131, at 99–100.

¹⁷² WEIL, *supra* note 124, at 211.

¹⁷³ Gary Vikan, *Communication: One Mission, One Blog*, in BEYOND THE TURNSTILE: MAKING THE CASE FOR MUSEUMS AND SUSTAINABLE VALUES, *supra* note 126, at 176.

¹⁷⁴ WEIL, *supra* note 124, at 211. New museums that cannot amass great collections may also turn to niche collecting, for example, the Museum of Jurassic Technology in Los Angeles, California.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 209.

¹⁷⁸ *Id.* at 209–10.

the changing landscape in the field of museology by providing a moderate amount of incentives to donate fine art.

V. SUGGESTIONS FOR FRACTIONAL CHARITABLE GIVING

A. LEVELS OF DONATIVE ENCOURAGEMENT AND FRACTIONAL CHARITABLE GIFTS

Congress can use tax incentives to create what are essentially four different levels of donative encouragement. The highest level of donative encouragement would allow tax credits for donations. As discussed in Part II, tax credits reduce a taxpayer's tax burden outright, unlike tax deductions, which reduce only a portion of the taxable income. Thus, the most effective way to encourage donations is to allow donors to take tax credits worth at least a fraction of their charitable donation.¹⁷⁹ Tax credits for donations would highly benefit donors, who could use the credits to offset their tax burdens outright. Credits, however, come at a high cost to the public, who either will shoulder more of the country's tax burden to

make up for the tax revenue lost because of the credit or will not be able to benefit as much from federal government programs funded by tax revenues. Thus, a "donation tax credit" would be effective only if the public gains so much from the donations that the credit offsets their much increased tax burden or forgone tax revenue.

A high level of donative encouragement would allow donors to take tax deductions whose requirements are easily met and heavily favor the donor. The easier it is for a taxpayer to qualify for a deduction, the more likely the taxpayer will try to take the deduction. Thus, the easier the requirements are to fulfill, the more favorable the deduction is for a donor. Although such deductions will favor donors, the deductions will still come at a cost to the public, albeit not to the same extent as a donation tax credit. Unlike tax credits, the government's forgone tax revenue will retain a portion of the deductions; however, the federal government's tax revenue will be lower. For example, take taxpayer Harry, who is single and has an AGI of \$100,000. Harry donated \$50,000 to charity, and qualifies for no other deductions. Without his charitable deductions, Harry would have owed \$26,522 in taxes. With his charitable deductions, he will owe \$11,127 in taxes. The government, therefore, lost about \$14,000 in tax revenue from Harry, but still retained about \$11,000. Thus, the "heavily favorable deduction" would be effective only if the public gains enough from the donation to offset its increased tax burden.

A moderate level of donative encouragement would allow donors to take tax deductions whose requirements can be met, but do not heavily favor the donor. Intuitively, the more requirements for which a taxpayer has

¹⁷⁹ Such tax credits would only be feasible if they were limited to a fairly low amount.

to qualify, the less likely the taxpayer will be to try to take the deduction. Thus, fewer donors will comply with the requirements, so fewer donations will be made. Deductions with more requirements, such as valuation requirements for gifts over \$1 million, will not favor donors as heavily. Such deductions, however, will come at a lower cost direct to the public: fewer donors would take the deduction, so less tax revenue will be lost. Thus, the “moderately favorable donation deduction” would be effective only if the public gains enough from the donation to offset their somewhat increased tax burden.

Finally, a low level of donative encouragement would allow donors to take tax deductions whose requirements are difficult to meet and do not favor the donor. Imposing harsh requirements on donors, such as a recapture provision plus interest plus an additional fine for failed deductions, would intuitively reduce the number of donors who attempt to take the deduction. Such deductions will barely favor donors, but the public will receive more tax revenue. Thus, the unfavorable donation deduction would be effective only if the public gains enough from the donation to offset its slightly increased tax burden.

Prior to the PPA, fractional gifts were at a high level of donative encouragement. Donors received extremely beneficial tax deductions that allowed them to take into account any appreciation of their art during the donation period and even keep the art that they were ostensibly giving.¹⁸⁰ Pre-PPA fractional giving arguably did not achieve the correct social gain-burden balance, even though the public eventually gained from these deductions when the art was displayed by the museums.

Section 170(o) is currently at a low level of donative encouragement. Donors must overcome many hurdles, some of which are so unfavorable that they have effectively destroyed fractional giving.¹⁸¹ Section 170(o) may unfairly tip the scale away from encouraging donors because both the public and museums no longer gain donations of great art. Since neither a low level of donative encouragement nor a high level of donative encouragement works, it is suggested that fractional giving will be most effective at a moderate level of donative encouragement.

B. ARE FRACTIONAL CHARITABLE DEDUCTIONS IMPORTANT ENOUGH TO REVIVE?

As Senator Grassley pointed out, fractional gifts were, to some extent, giving without giving.¹⁸² Moreover, only a small percentage of taxpayers and, indeed, donors were affected by the change in fractional giving. To even be eligible for a charitable deduction, the taxpayer must be itemizing or using the AMT. In 2005, this would only account for about one quarter

¹⁸⁰ Only a small percent of donors, however, used fractional giving—this may be due in part to its nascent popularity.

¹⁸¹ The hurdles did not discourage all donors, as evidenced by the Lazarofs' recent fractional donation. See Wyatt, *supra* note 89.

¹⁸² Strom, *supra* note 70, at 1. In that sense, they toe the line between future interests and gifts. For more information on future interests, see *supra* note 38.

of the population.¹⁸³ Of those eligible, about 1.6% took deductions for donated art and other collectibles.¹⁸⁴ Of those deductions, no more than 10% of those art donations were donated fractionally. Thus, the change in fractional charitable giving only directly affected about 0.04% of taxpayers. On the one hand, if so few taxpayers are fractionally donating, then why discourage those donors with unduly stringent requirements? On the other hand, if so few taxpayers are affected, then why change § 170(o)?

Another argument against revising § 170(o) is that there are a myriad of other measures in place to encourage donations of art. For one, income tax law has already established many incentives to encourage inter vivos gifts. The current 50% AGI limitation is generous enough to encourage charitable donations by and large. Moreover, if the value of a donation is larger than the AGI limitation, the excess amount can be carried over for the next five years. Thus, donors must exceed their AGI limitations by five times before outright donations are financially impractical.¹⁸⁵

Along with inter vivos gifts, donors have the option of making a testamentary donation. Wealthy taxpayers are usually encouraged to give gifts to their friends and family during their lifetime, as opposed to waiting until death, because gift taxes are generally more favorable than estate taxes.¹⁸⁶ Charitable gifts, however, are the opposite: an unlimited amount of charitable gifts may be excluded from the decedent's taxable estate, unlike inter vivos charitable gifts, which are capped at 50% of AGI.¹⁸⁷ Therefore, taxpayers may be better off, transfer tax-wise at least, to wait until their death to donate.

Donors also may use more complex donation vehicles like charitable-remainder trusts or donor-advised funds.¹⁸⁸ In charitable-remainder trusts, the taxpayer donates a piece of art to the trust.¹⁸⁹ The trust then sells the art, and, since the trust is income tax exempt, the taxpayer avoids taxation and takes a deduction.¹⁹⁰ Upon the death of the taxpayer, what is left in the trust is donated to a predetermined charity.¹⁹¹ In donor-advised funds, the taxpayer donates a piece of art to a donor-advised fund, which then sells the art.¹⁹² The donor then advises the fund to create a charitable foundation.¹⁹³ Because the fund has a charitable purpose, the donor can avoid paying income taxes.¹⁹⁴ These vehicles are less favorable than fractional giving

¹⁸³ See *supra* note 39.

¹⁸⁴ See *supra* note 39.

¹⁸⁵ This assumes that the taxpayer's AGI remains constant during the five-year period and that the donor is not eligible for any other deductions.

¹⁸⁶ This difference is due to how gift taxes and estate taxes are paid. For more information see BORRIS BITTKER, ELIAS CLARK & GRAYSON M.P. MCCOUCH, FEDERAL ESTATE AND GIFT TAXATION 22 (9th ed. 2005).

¹⁸⁷ I.R.C. § 2055(a).

¹⁸⁸ Mike Spector, *A Portrait of Art as a Tax Deduction*, WALL ST. J., July 22, 2008, at D1.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

because they are very complex; however, they still allow donors to escape taxation on gains of sale.¹⁹⁵

A final option for the taxpayer is to donate without taking a deduction. Like collectors Janice and Henri Lazarof, if donors wish to donate fractionally on their own terms, they may. They just may not be eligible for any itemized deductions. Taking a deduction, however, is not the only benefit of donating. Donating to museums comes with many nonmonetary rewards: donors feel good about themselves and donors get invitations to galas and other social events, social acclaim for themselves and their families, publicity for their companies, a gallery or wing named after themselves. Indeed, some countries, like the United Kingdom, do not even offer tax deductions for art donations.¹⁹⁶ Collectors like Ms. Bunting, who do not view art collecting as merely a financial investment, may be better poised to respond to the intangible benefits of donating to museums.

On the other hand, as Part IV articulated, tax statutes that affect museums should be attuned to the trends of museology, taking into account issues like the problem of overreliance on donors, the trend toward special exhibits, and the museum's new role in urban development. Indeed, a tax policy that encourages only a moderate amount of donations may help museums move away from their dependency on donors, persuading museums to focus on their public programming, while still allowing museums access to good resources for their permanent collections. Thus, regardless of the other incentives available, if fractional giving can be adjusted to properly fit the needs of museums, then it should be revived.

C. SUGGESTIONS FOR FRACTIONAL GIVING

As mentioned above, § 170(o) generally fails to balance the needs of donors with the needs of the public; however, there are some provisions that are respectable. For one, future amendments to § 170(o) should continue to require that donors have a full interest in the donated item before they are eligible for the deduction. Although this limits the number of taxpayers eligible to take deductions for fractional donations, it ensures that fractional donations avoid certain problems with ownership.¹⁹⁷ The extra recapture penalty should also be retained. The penalty is necessary, even though it seems harsh, because taxpayers generally cannot take a deduction until the charitable gift is completed.¹⁹⁸ The extra recapture penalties, therefore, should be in place to thwart abuse.

Moreover, the effects of § 170(o)(2)'s nonstandard valuation method may be mitigated when the art market is in decline.¹⁹⁹ In a booming art

¹⁹⁵ *Id.*

¹⁹⁶ Stephen Adams, *Lack of Tax Incentives on Art Donations Is 'Disgraceful,'* THE DAILY TELEGRAPH, Jan. 12, 2010, available at <http://www.telegraph.co.uk/culture/art/art-news/6973926/Lack-of-tax-incentives-on-art-donations-is-disgraceful.html>. Indeed, Britain has been criticized for being one of the few remaining European countries that lacks deductions for art donations. *Id.*

¹⁹⁷ Follas, *supra* note 78, at 1793. See also Dillinger, *supra* note 101, at 1072.

¹⁹⁸ Otherwise, the gift looks too much like a future interest. See I.R.C. § 170(a)(3).

¹⁹⁹ Currently, the art market is in decline. Banjo, *supra* note 122 ("Critics point out that the proposed bill comes at a time when, overall, artwork is declining in value. The art market has dropped 30% so far this year . . .").

market, the § 170(o) valuation is a problem because it caps the value of the donation at the original fair market value of the initial donation. In a declining art market, the § 170(o) valuation would not be as harmful since the lower valuation each year would reflect the actual fair market value of the art. Regardless, the current cap on donations may be an unduly harsh response to abuse and overvaluation. If Congress must find a way to curb overvaluation, it should enact something akin to the PAGA's valuation procedure in which any donation above \$1 million must be appraised by the IRS. Moreover, Congress should allow donors to track the fair market value of their subsequent donations.

On the other hand, there are several aspects to § 170(o) that should be fixed. First, the time limit on the duration of the gift should not be so short as to undermine the purpose of fractional giving. A ten-year time limit may be too short, even though the potential to carry over donations basically adds an extra five years to a donation period. The Bill's twenty-year limit is preferable because it would place limits on the donation period, but would not be so harsh as to deter donations.

Second, any future iterations of § 170(o) must remove the "before death" clause since it is unduly harsh to punish someone because of his or her unexpected death. Instead, donors should be allowed to complete the donation with an at-death gift. If the before death clause is not removed, then there should be an exception to the recapture provision when a donor dies before the museum can take possession.

Third, and finally, to avoid the "giving is not keeping" problem, there must be incentives for the museums to take possession of the artwork during the fractional giving. Although the substantial possession requirement is less likely to affect the number of fractional donations, it places a large burden on the donee and affects the safety of the donated artwork. In that regard, an exception for fragile or unwieldy art would improve fractional donations even if it would not increase them. Conversely, allowing museums to waive the possession requirement in the case of fragile, cumbersome, or hard-to-store pieces of art could reopen the door to abuse. Indeed, any piece of art could be at risk when moved simply because most, if not all, artwork could be damaged in transit. Museums, however, should not be forced to take possession if they genuinely lack the space or resources to care for a piece during the donation. In light of this dilemma, Congress should either: (1) require large initial donations so that the museum's right to possess the art is substantial enough to warrant taking possession of the art or (2) create incentives for museums to house the art for extended periods.

Thus, any future iteration of § 170(o) must moderately encourage donations by retaining the extra penalty for recapture provision, removing the "before death" requirement, and including a fair market valuation of subsequent donations, appraisal by the IRS for deductions worth more than \$1 million, and proper incentives for museums to take possession of the fractional gift.

VI. A NEW HOPE: SENATE BILL 1605

On August 6, 2009, Senate Bill 1605 was introduced to the Senate by Senator Charles E. Schumer of New York.²⁰⁰ The Bill was referred to the Committee on Finance and never progressed further.²⁰¹

A. ANALYSIS OF THE BILL

Senate Bill 1605 heavily amends § 170(o).²⁰² Although the Bill retains § 170(o)(1)'s requirement that the donor has a full interest in the donated item, Senate Bill 1605 explicitly allows eligible donors to make initial fractional contributions with certain limitations.²⁰³ First, the initial fractional contribution must be at least 10% of a donor's entire interest.²⁰⁴ Second, the contribution must be pursuant to a written, binding contract.²⁰⁵ Third, no less than 20% of all interests must be donated within eleven years of the initial fractional contribution.²⁰⁶ Fourth, all of the interests must be donated either within twenty years of the initial fractional contribution or before the death of the donor, whichever is earlier.²⁰⁷

Thus, Senate Bill 1605's amendments to § 170(o)(1) reopen the door to fractional contributions. But are the requirements reasonable? The 10% initial contribution seems reasonable but may deter donations of large collections of art. Indeed, under this requirement, a donor with a large and valuable collection of sixty Ancient Greek vases, for example, may not be able to fractionally donate all sixty vases in the same year. There is no question that the written contract requirement and the 20%-interest-by-eleven-years requirement are reasonable because they are not unduly prohibitive. Indeed, the 20%-interest-by-eleven-years requirement places only moderate limitations on a donor's risk-return options: a donor whose item has declined in value can no longer wait for more than eleven years to see whether the market will bounce back. The "twenty years or before death" time limit remains prohibitive. Although the twenty-year period is more lenient than the ten-year period, Senate Bill 1605's amendments still ask donors to gamble on the date of their death and risk harsh recapture penalties if they guess incorrectly.

Senate Bill 1605 revamps the § 170(o)(2) valuation, making it more donor-friendly. The value of any additional fractional contribution is determined by multiplying the fair market value of the property with the donor's interest in the property and then multiplying that with the percent interest being contributed.²⁰⁸ For example, Margaret owns 60% of a

²⁰⁰ S. 1605, 111th Cong. (2009). Senate Bill 1605 had three co-sponsors: Senator Johnny Isakson of Georgia, Senator John Kerry of Massachusetts, and Senator Tom Udall of New Mexico. S. 1605.

²⁰¹ *All Congressional Actions for S. 1605*, 111th Cong. (2009), available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN01605:@@X>.

²⁰² S. 1605 also avoids the previous "mismatch problem" by amending estate tax § 2055(g) and gift tax § 2522(e). For more information on the mismatch problem, see *supra* note 78.

²⁰³ S. 1605.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.*

painting, having donated 40% of the painting to a museum in year one. In year two, the fair market value of the painting is \$100,000, and Margaret donates an additional 10% interest to the museum. The value of this 10% interest will be equal to the fair market value of the property in year two (\$100,000) multiplied by Margaret's percent interest before the additional contribution (60%), multiplied by the additional donated interest (10%). Thus, Margaret will be able to claim a deduction of \$6000.

This is a fairer valuation policy. It tracks the real fair market value of the donated item, and allows donors to take deductions that reflect their actual interest in the property. Moreover, this valuation method returns the donor's risk-return analysis to what it was before the PPA. Donors may freely gamble on whether the donated item will appreciate in value during the donation period. Donors, therefore, will be able to profit from any appreciation in the value of the donated item without fear of being penalized by the § 170(o) for guessing incorrectly.

Senate Bill 1605 also amends § 170(o)(3)'s recapture policy. The Bill also leaves the additional tax penalty intact.²⁰⁹ Moreover, recapture (plus interest) is still the penalty for taxpayers who fail to contribute 20% of the interest in eleven years and all of the interest before twenty years or their death.²¹⁰ Senate Bill 1605, however, changes the physical possession requirement. Although the donor is subject to recapture (plus interest) if the donee did not properly possess the donated item, the amendments are more lenient.²¹¹ Instead of requiring the donee to have substantial physical possession for the entire donation period, Senate Bill 1605 sets up a ratio that affords the donor two choices.²¹² During an "applicable period of time" the donor may either: (1) split the physical possession of the donated item with the donee in a manner that reflects the percent ownership²¹³ or (2) hand over the item completely to the physical possession of the donee.²¹⁴

The recapture provision for taxpayers who fail to adhere to the § 170(o)(1) requirements is reasonable. The recapture provision for taxpayers who fail to transfer properly the donated item to the donee is also reasonable. The first option, in which the donor may split the physical possession of the artwork with the donee, allows the donor to keep the fractionally donated artwork in the donor's home during the donation period as long as the donor is willing to physically share the artwork with the museum. If a piece of artwork is too difficult, costly, or fragile to be moved frequently, the donor has the option of permanently leaving the artwork with the museum. These two choices are particularly appealing because they both acknowledge the donor's interest in physical possession and eliminate the aspects of the *Winokur* decision that led to abuse.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.*

²¹³ If Mark donates 10% of his interest in a Klimt painting to a local museum, the museum must physically possess the painting for at least 10% of the year, or thirty-seven days.

²¹⁴ S. 1605. Senate Bill 1605 defines an "applicable period" as: (1) a five-year period that begins after the initial fractional contribution or (2) each subsequent five-year period during the total twenty-year donation period. *Id.*

B. HOW DOES SENATE BILL 1605 COMPARE?

Senate Bill 1605 takes four good steps toward moderately encouraging donations. First, the Bill explicitly allows fractional contributions. Second, it correctly left untouched the donor limitation and the extra recapture penalties. Third, the new 20%-interest-by-eleven years requirement is a restraint on the fractional donor, but a restraint that is easily fulfilled. Fourth, and finally, the Bill's possession requirements and proposed valuation methods are lenient and fair, yet neither provision overly favors the donor. The possession requirement resolves many of the problems that arise from forced and frequent transportation between the donor and the museum, while ensuring that no gift is given yet kept at the same time. Although Senate Bill 1605 lacks a method for curbing overvaluation, the proposed valuation standards track both the actual fair market value of the donated item and the donor's true interest in the item.

The Bill, however, falls short of medium donative encouragement in three respects. First, the Bill fails to amend the highly restrictive before death requirement. Second, the 10% initial contribution may deter donations of large collections of art. Third, and finally, Senate Bill 1605 is unnecessarily broad. Indeed, arguments that favor fractional giving rely heavily on the public good created by encouraging donations to museums. If, however, an art collector decided to fractionally donate artwork to a university, which in turn displayed the art in a building that only students could access, little of the usual direct public benefit arguments could be made in favor of the donation. Thus, unless fractional giving is limited to museums,²¹⁵ Congress should employ a low level of encouragement.

In sum, Senate Bill 1605 generally repairs § 170(o) to encourage a moderate amount of donations by explicitly allowing fractional gifts, retaining the donor limitation and extra recapture penalties, and correcting the possession and valuation methods. The Bill, however, leaves some room for improvement, especially with regards to the before death requirement and the 10% initial contribution requirement. Moreover, Senate Bill 1605 must explicitly narrow its focus to apply only to donations to museums, for otherwise, the policy arguments supporting a medium level of donative encouragement, and indeed, fractional giving itself, lose their relevance.

VII. CONCLUSION

In an economic downturn, tax breaks for wealthy individuals become increasingly difficult to justify. Fractional giving, however, does not benefit wealthy taxpayers alone; rather, fractional giving mainly serves museums and their patrons. Indeed, fractional giving shifts the assets of the rich (as donors) to the public (as the patrons of museums). Given the importance of museums to society as places that foster learning, preservation,

²¹⁵ Fractional giving is clearly meant to be limited to gifts to museums because the debate over fractional giving has only concerned gifts of art. Moreover, the prior attempt to amend § 170(o) was titled the Promotion of Artistic Giving Act.

entertainment, and even urban development, fractional giving must be reinstated as a legitimate method of donation.

Thus, art collectors must be encouraged to donate fractionally, regardless of the economy. To achieve this, Congress must strive to reach a balance amongst the needs of the museum, the needs of the donor, and the needs of the public. Senate Bill 1605 is a first step in the right direction, but it falls short of finding the right level of donative encouragement. Indeed, even if Senate Bill 1605 is enacted, fractional giving will still need restoration.