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Private Museums Under Scrutiny: Is Tax-Exempt Status Justified?

Investors have long seen art as an investment opportunity, resulting in a growing number of collectors who have been pouring money into the art market. In recent years, many wealthy individuals have sought to convert their personal art collections into private museums as a way of reducing taxes while retaining control of the property. By donating the art to an organization that will use it for a charitable purpose, founders can deduct both the full fair market value of the donated art and the value of cash and stocks they donate to the entity. In addition, the payment of the ongoing carrying costs of insuring, conserving and warehousing the art is tax-free.

Tax experts and, most recently, the Senate Finance Committee chaired by Senator Orrin G. Hatch, R-Utah, have questioned whether the tax-exempt status of a number of these private museums is justified by sufficient public benefit, and specifically, whether some of the smaller museums that are on or close to a donor's property, and are accessible to the public during limited times and in some cases by appointment only, meet the guidelines set forth by the Internal Revenue Service.

The controversy arises because the IRS guidelines are vague about the amount of public benefit that is sufficient to justify preferable tax treatment; however, public access is often critical. Many times, offering educational programs to the public is the basis for a private museum being tax-exempt, and the question then becomes: How much public access is necessary? The IRS has issued rulings requiring adequate signage and advertisements for visitors and has refused tax-exempt status when the private museum is not separate and apart from the owner's home or office. It is important to note, however, that public benefit can be achieved without broad access by the general public, such as where the entity lends works to other organizations for public viewing, engages in grant-making or makes its collections available to researchers.

Because the standards are vague and ill-defined, it becomes important to focus on the details of operation that establish sufficient public benefit. At the beginning of each year, administrators should establish a plan for operation that is designed to achieve the desired public benefit. Such a plan might include adequate signage and advertising of the programs offered by the organization, to generate interest and attendance. At the end of the year, the accomplishments can then be easily reported on the entity's annual information return (Form 990PF) as a statement of the entity's work to achieve its public benefit. Focusing on planned programs and activities at the beginning of each year allows administrators to think critically about how to best serve the public benefit for which the organization was originally formed.