



# Art Law Clinic Client Newsletter

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In September, Harvard Law School launched a new clinical offering at The Hale and Dorr Legal Services Center in connection with Professor Terry Martin’s seminar on Art Law. This clinical program provides legal assistance to museums and other nonprofit arts organizations on a broad range of issues, including charitable giving, collections management, corporate governance, cultural property, intellectual property, and tax-exemption issues. Through Harvard’s clinical teaching program, students are assigned to work with clients under the direct supervision of an attorney.

This newsletter is a result of student research on issues of interest to the museum and nonprofit arts community. Laura Damerville’s article on Disaster Planning is unfortunately especially timely given the recent natural disasters both in the United States and abroad. In time for year-end giving, this edition also includes a charitable giving focus, including articles by Effie Barton on in-kind gifts; Arabella Yip on bargain sales and appraisal rules; and Lindsay Bleier on corporate sponsorship. Since the holiday season also means bustling business in museum stores, there is an article on UBIT: “Museum Store Products” by Laura Damerville.

We hope that you find the inaugural issue of our client newsletter informative and interesting. We welcome suggestions for future newsletter topics. Feel free to contact us with your requests or for more information about our program. Happy holidays!

— Polly Clark, Editor  
Senior Fellow, Art Law Clinic

## Disaster Planning: Is Your Museum Prepared?

By Laura Damerville '07

In the aftermath of Hurricane Katrina, emergency preparedness has become a topic of much discussion in the museum community. While the catastrophic damage caused by Katrina has been extraordinary, natural disasters that can cause significant harm to people and cultural heritage regularly occur. In the last few years, numerous museums and collections have suffered extensive damage, especially from flooding. By thoroughly preparing for such emergencies, many institutions have been able to minimize the loss of life and property.

Creating detailed emergency procedures specific to your institution can save a lot of trouble during crises. By having a plan in place, valuable time can be spent assuring the safety of individuals and collections, instead of panicking over what is to be done. In creating your emergency procedures, consider the following:

### Establishing Priorities

In creating your emergency procedures, make sure that you initially ensure the safety of any visitors and museum staff. Consider how people are to be evacuated or protected, and be sure to make accommodations for individuals with dis-

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abilities. Next, look to which pieces of the collection are most valuable or most likely to suffer damage in different crises. You should also consider what key documents would be important to have on hand and maintain hard copies off-site. By knowing your museum's priorities, you can help prevent confusion and chaos that might keep museum staff from using precious time and energy most effectively during a crisis.

### Maintaining Communications

The total collapse of communications that occurred in New Orleans when Hurricane Katrina hit has highlighted the importance of having alternative communications plans. Your communication plan should identify a site as an alternative base of operations in case museum facilities become unsafe, create an emergency chain of command, and provide that the key staff maintain walkie-talkies in the event that phone communications are down. It is important to maintain current emergency off-site contact information for your staff and board.

### Institution-Specific Planning

In addition to preventing harm, emergency procedures may actually constitute an important part of the duty of care that trustees owe to their institution. As part of their duty of care, those who govern a museum are responsible for protecting against reasonably foreseeable dangers, which given recent events, would include natural disasters.\*

It is thus important to create an institution-specific plan. Procedures that take into account the nature of your museum and its collections, physical facilities, and the nature of likely disasters are more likely to be effective. You should consider a number of different possible scenarios and make sure to have procedures easily tailored to particular situations.

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\* Marie C. Malaro. *A Legal Primer on Managing Museum Collections*, 406-17 (2nd ed. 1998).

## Creating Your Own Emergency Procedures

**F**orm guidelines to help you in creating your own emergency procedures are available at the International Council of Museums website at: [http://icom.museum/disaster\\_preparedness](http://icom.museum/disaster_preparedness).

*When developing your plan, keep records of the process for future reference. Set an institutional timeline for regular review and update of the procedures to make sure that the plan stays relevant and that staff members, including new employees, are familiar with the procedures. Taking these steps now can save a great deal of trouble in the future.*

## Charitable Giving Focus: In-Kind Gifts

By Effie Barton '07

**M**useums are able to build interesting and rich collections through the generosity of donors. Charitable donations come in many forms, but perhaps the most important to a collecting museum is the in-kind gift. The character of a unique object, whether a painting, a rare butterfly or a historic artifact, makes an in-kind donation priceless; however, we know that for tax purposes there always needs to be a valuation. Because assessing the value of artwork can be so subjective, Congress is concerned about inflated appraisals. A recent proposal has suggested limiting, or even eliminating, the amount a donor can deduct for in-kind gifts. (see "Concerns of Congress," opposite).

Since in-kind gifts are now such a hot-button topic and continue to be so vital to the growth of collections, museums should understand the current law in this area.

### Related or Unrelated Use

One of the first things a museum must do when offered an in-kind gift is determine whether the proposed gift would be used to further the charitable purposes of the museum.

Whether or not the proposed gift is related to the museum's purposes or will be sold shortly after acquisition will affect how much a donor is able to deduct for tax purposes. If the in-kind gift will be used to further the purposes of the charitable organization, the donor is allowed to deduct full fair market value. The IRS will treat a gift as having a related use if it is "reasonable to anticipate" that the donation will be used to further the museum's exempt purposes. Such related uses for a museum might include displaying a painting in a gallery or studying the painting for educational or research purposes. If the painting is sold and the proceeds are used for museum purposes, then the IRS would not consider the gift to be put to a related use. However, if a donor contributes an entire collection to a museum, she may still take a full fair market value deduction even if the charitable organization sells an insubstantial portion of the donation, so long as the bulk of the collection is put to a related use.

If the artwork is not going to be used for the purposes of the museum, the donor can only deduct the basis of the ob-

ject; that is, the price that the donor originally paid for the artwork. As artwork can substantially appreciate in value over the years, a tax deduction limited to the original price would be much less attractive to a donor.

### Gifts from Artists

If an artist donates his own artwork to the museum, the artist can only take a basis deduction, i.e., the cost of producing the artwork and the materials. The artist is not allowed to deduct the full fair market value of his work.

### Loans

If a donor loans an object to a museum, she is not allowed to take any tax deduction whatsoever, regardless of whether it is a temporary or permanent loan. Even if the donor has promised to give the object to the museum, so long as the donor has the right to reclaim the property and the museum does not actually own the work of art, there is no deduction.

### Substantiation Rules

If the donor contributes an in-kind gift valued at \$250 or more, a museum must write an acknowledgment describing the gift and any return benefits given to the donor. This written acknowledgement is necessary in order to allow the donor to deduct the gift for tax purposes.

If the in-kind gift is valued at more than \$500, the donor must file a Form 8283 with the IRS. The donor must include additional information, such as when, how, and for what price the object was acquired by the donor.

If the in-kind gift is valued at over \$5,000, then the donor must hire a qualified appraiser to assess the value of the work and include an appraisal summary on Form 8283. (See “The Appraisal Rules: To Appraise or Not to Appraise?”) The museum also must sign and complete a part of the donor’s Form 8283 stating when the property was received and whether the property is intended for an unrelated use.

If the total deduction for the donated art is \$20,000 or more, then the donor must attach to Form 8283 a complete copy of the signed appraisal. If there is an individual work of art that is valued at more than \$20,000, a photograph must be provided upon request.

If a museum disposes of the object within two years of receipt, the museum must file Form 8282 with the IRS and send a copy to the donor.

In-kind donations are indispensable to a museum. A museum should openly discuss its intentions on how the donation will be used with a donor as the museum will be required to disclose the information on Form 8283, and if the object is sold, on Form 8282. If the museum can help the donor understand what standards are necessary in order to receive a full fair market value tax deduction, then the museum will be in a better position to obtain more varied and valuable gifts.

## Concerns of Congress

**C**ongress is concerned about misstated and inflated valuations of in-kind gifts. In a recent report, the Joint Committee on Taxation examined the issue and made proposals to change the current law. The leading proposal would allow only a basis deduction for all in-kind property donated to a charity. A more drastic suggestion considers eliminating any deduction for donated property. More restrained proposals, such as raising the appraisal standards, could address the concerns of Congress without discouraging donors from contributing in-kind gifts. To learn more, the American Association of Museums has prepared an issue brief on the matter that can be viewed at: <http://www.aam-us.org/getinvolved/advocate/issues/tax/index.cfm>.

## Bargain Sales: Too Good to be True?

By Arabella Yip '06

### What is a Bargain Sale?

**T**he IRS defines a bargain sale as “a transfer of property that is in part a sale or exchange and in part a contribution.” For example, a donor wants to donate a work of art to her favorite museum. However, she would like to generate income from the donation on top of claiming a charitable deduction. A bargain sale would permit her to do both. She donates a portion of the artwork to the museum and the museum purchases the remaining part. This is called a “bargain sale,” because the museum buys the rest of the work for less than the fair market value.

## How Does a Bargain Sale Work?

The amount of the deduction a donor may take is the difference between the fair market value and the sales price of the object. In order to take the deduction, the donor must be able to establish donative intent prior to the transfer. The basis (i.e. original purchase price) must be allocated between the gift portion and the sale portion of the bargain sale.

For example, suppose our hypothetical artwork is a painting that was originally purchased for \$10,000. It is later appraised at \$100,000. The donor would like to sell a partial interest to the museum at \$50,000 and donate the remaining interest to the museum. While the donor is essentially giving \$50,000 in value to the museum, she is also profiting \$40,000 from the original purchase price. However, to calculate the amount of income that the donor must report, the \$10,000 basis is divided proportionately between the gift price and the sales price. The donor will report income based on the difference between the sales price and the divided basis, i.e. \$50,000-\$5,000. Thus, the donor will report income of \$45,000 for the sale portion and can claim a \$50,000 charitable deduction as the value of the gift.

The arrangement sounds good for everybody, doesn't it? The donor makes some money, the museum saves some money, and the public gets access to a masterpiece that would otherwise be seen only in the privacy of the donor's home.

## Controversy

The problem is this: the IRS is afraid that donors will declare the artwork to be worth much more than its actual value and claim an inflated charitable deduction come tax time. Since valuation of a unique object like a work of art or a historic document is very subjective, the IRS does not have uniform appraisal standards. Without uniform standards, it is easier to inflate the value of such objects with little risk of detection. It does not help matters that appraisers and institutions are pressured to support excessive valuations. For more on the issue of appraisals, see "The Appraisal Rules: To Appraise or Not to Appraise?"

Over the years, there have been a number of high-profile accusations of taxpayer abuse of the bargain sale rules. Recipient museums are often dragged into the fray and accused of allowing donors to manipulate the system. The costs of being drawn into any public controversy are high.

Bad publicity can result in damage to an institution's public reputation, which in turn may discourage attendance and future contributions.

## Recommendations

So, how should a museum that would like to accept bargain sales respond?

- Set a clear internal policy for review and approval of bargain sale offers.
- Develop a system to maintain evidence that an informed judgment was made as to the fairness and reasonableness of the purchase price with respect to the fair market value.
- Be prepared to acknowledge in writing to the donor that the purchase price is less than fair market value. Important: the museum should in no way endorse or give the appearance of endorsing the donor's statement of fair market value.
- Have written evidence that the donor has donative intent and is setting a low price for the purpose of making a partial donation.
- Seek the advice of counsel if the donor's appraisal is inflated. The museum must be prepared to discuss an inflated valuation with the donor, and even to consider refusing the gift if the donor insists on using an excessive appraisal value.

For more on bargain sales, see Marie Malaro's *A Legal Primer on Managing Museum Collections*.

## The Appraisal Rules: To Appraise or Not to Appraise?

By Arabella Yip '06

In light of increasing governmental concern about possible overvaluation of non-cash gifts, it is imperative for museums to fully understand current law and consider their role in the effort to remedy tax abuse.

### The Rules

Claims for charitable deductions of donated property exceeding \$5000 in value must be supported by an appraisal from a "qualified appraiser." It is the donor's responsibility

to procure an appraisal. Donee organizations and other interested parties are expressly disqualified from providing appraisals for a donor's tax deduction. They are disqualified because of the inherent conflict of interest. The desire to please a donor, who would benefit from a larger charitable deduction, may compromise their objectivity and lead them to overvalue the object.

However, recipient museums are required to acknowledge receipt of an in-kind "gift" by filling out a section of the donor's IRS Form 8283, "Noncash Charitable Contributions." Although appraised values are listed on the form, the museum is required only to acknowledge the receipt of the items described, the date the items were received and indicate whether the items will be used to support the museum's mission. The regulations specifically note that the museum's signature does not indicate concurrence in the appraised value claimed.

The appraisal is subject to review by the IRS, which may refer the matter to its own panel of experts when the valuation seems high. The Art Advisory Panel was established in the 1960s to review valuations on artwork in estate, gift and charitable contribution cases. All taxpayer audits that include a work of art or cultural property valued at \$20,000 or more are referred to this twenty-five-member panel.

Professional codes of ethics also prohibit museums from participating in appraisal practices. The Association of Art Museum Directors prohibits museum directors from providing "any statement of the monetary value of a work of art." Similarly, the American Association of Museums limits appraisals by curators to only "internal use at their institution, and with the approval of the curator's museum, for other nonprofit institutions." See the "Code of Ethics for Art Museum Directors" at [www.aamd.org/about/#code](http://www.aamd.org/about/#code) and the American Association of Museums' "Code of Ethics for Curators" at [www.aam-us.org](http://www.aam-us.org).

### The Donor's Expectations

Despite the impartiality required for museums in gift valuations, donors sometimes still look to museums to help maximize the value of their deduction. They often think that they are entitled to this help, because of the donation. A donor may look to a curator to provide an appraisal or request help to select or otherwise arrange appraisals of their gifts.

### The Museum's Response

Under no circumstances should a museum give appraisals for tax purposes or contract for appraisal services on behalf of the donor. Many museum policies provide that the museum will not pay for donor appraisals. It is important that museums set a clear internal policy with regard to appraisal requests so that museum staff will know how to respond. If a donor insists on recommendations, museums should emphasize that they are both legally and ethically prohibited from aiding in appraisals and should direct donors to professional appraisal organizations, such as the American Society of Appraisers (ASA), the Appraisal Association of America (AAA), or the International Society of Appraisers (ISA).

Lastly, if the museum has knowledge that the donor intends to submit an appraisal value that appears excessive, it should seek the advice of counsel before proceeding with the acceptance of the gift.

## 'Tis the Season for Corporate Sponsorship

By Lindsay Bleier

As we approach the holiday season, museums hoping to boost their resources may look to the generosity of corporate sponsors. Corporate sponsorships are not only a great source of financial support, but often provide increased publicity and program visibility, or even a source of new volunteers and members. Corporate sponsors also benefit by creating goodwill in the community and improving employee morale. Before signing on with a corporate sponsor, however, museums should educate themselves about the many legal and ethical considerations involved.

### The Basics: Corporate Sponsorship Rules

Museums may be surprised to learn that there may be tax consequences to corporate sponsorships. The following provides a brief overview of the relevant legal considerations:

#### Qualified Sponsorship Payments

In general, income from activities that are not substantially related to a museum's educational and cultural purposes will be subject to unrelated business income tax or "UBIT"

(See “UBIT Focus: Museum Store Products.”) There is a safe harbor rule that creates an exception for so-called “qualified sponsorship payments.” Qualified sponsorship payments are those from a business to an exempt organization for which there is no expectation of a substantial return benefit. Within this safe harbor, qualified sponsorship payments will not be subject to UBIT, even if made for benefits unrelated to the museum’s mission. On the other hand, it is important to note that payments outside the safe harbor are not necessarily subject to UBIT; each benefit must be evaluated on an individual basis to determine whether it is related or meets another exception. So, when evaluating sponsorship payments, a museum must evaluate first whether or not the payment is inside the safe harbor. If within the safe harbor, there will be no UBIT even if unrelated. If outside the safe harbor, the museum must consider whether the return benefit is related or unrelated to determine whether the museum will need to pay UBIT on the payment.

#### *Substantial Return Benefit*

Once a museum has landed that coveted business support, everyone involved may be eager to express thanks to the corporate sponsor. However, in order to maximize corporate sponsorships and avoid surprises at tax time, museums are well advised to understand how to express thanks without triggering UBIT. The IRS does not consider a substantial return benefit to include: (1) the use or acknowledgment of the name, logo or product lines of the sponsor; or (2) goods or services that have an insubstantial value and qualify as “disregarded benefits.” However, the following benefits fall outside the safe harbor: (1) goods, facilities, services or other privileges; (2) rights to use an intangible asset (e.g. trademark or logo); (3) exclusive provider arrangements; or (4) advertising.

#### *Acknowledgment not Advertising*

The distinction between an acknowledgment and advertising is perhaps the most important to understand. While a museum may acknowledge a corporate sponsor, outright advertising on behalf of a corporate sponsor will be deemed a substantial return benefit subject to tax. The IRS defines advertising to include messages containing: qualitative or comparative language; price information; endorse-

ments; or inducements to buy the sponsor’s products. In an acknowledgment, the museum may use the sponsor’s logo and slogan, list the sponsor’s locations, telephone numbers or Internet address; and include value-neutral descriptions, such as displays of products or service listings. Hyperlinks to a sponsor’s website on a museum’s website are within the safe harbor so long as they lead to a general web page and not a promotional site that endorses a sponsor’s products or services.

#### *Exclusive Provider Arrangements*

Museums must be careful to notice the difference between exclusive sponsorship and provider arrangements. Exclusive sponsorship does not result in a substantial return benefit. However, any arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities in connection with an exempt organization’s activity generally results in a substantial return benefit. Lesson learned: museums probably should be wary of restrictive requests.

#### *Goods, Services, and Other Privileges:*

##### *Insubstantial Return Benefit*

Goods and services, such as benefit tickets, private viewings, and catalogues, will fall outside the safe harbor unless they are deemed to be “insubstantial.” These benefits are disregarded as insubstantial if the aggregate fair market value of all the benefits provided in connection with the payment during the organization’s tax year is not more than 2% of the amount of the sponsorship payment. This means that insubstantial benefits like free guest passes received by a sponsor that are worth less than 2% of the total corporate contribution will be within the safe harbor. In the case of guest passes, benefit tickets or catalogues, payments for these items may still avoid UBIT even if the return benefits are worth more than 2%, if related to the museum’s mission.

#### **Guidelines for Developing a Policy on Corporate Sponsorship**

Always sensitive to public opinion, museums must balance their need for financial support with their mission and ethical values. The American Association of Museums (AAM) has issued guidelines to help museums establish policies for developing and managing corporate support.

First, the AAM recommends that museums adopt a “defining statement” that outlines the organization’s policy and goals related to business support. Museums should also be aware of potential conflicts of interest when engaging a corporate sponsor and create a policy to address such situations. The AAM cautions museums to remove individuals from discussions or actions regarding corporate support if the individual maintains a personal interest. Individuals must disclose any conflict of interest and may not use their position in the museum for personal gain or benefit at the expense of the museum.

In order to maintain public accountability and social responsibility, the AAM recommends that museums regularly review their ethical policies and procedures related to corporate sponsorship. Ultimately, the museum’s board of trustees has the responsibility to accept or reject corporate sponsorship offers. In doing so, the trustees should always consider whether a given corporate sponsorship agreement complies with the museum’s ethical standards as well as any applicable local, state and federal laws.

### Ensuring a Lasting Partnership

Corporate sponsors provide many benefits, but museums should consider legal and ethical guidelines when pursuing a corporate sponsor. With a thoughtful approach, museums can not only attract but also retain corporate sponsors and potentially build lasting partnerships for years to come.

## UBIT Focus: Museum Store Products\*

By Laura Damerville, '07

A good gift shop is a valuable asset to a museum. It enhances the visitor experience by allowing the visitor to take home a memento of the collection. It provides museums with valuable revenue. It may even attract visitors to the museum who might not otherwise come in the door. However, if a museum isn’t careful, a gift shop can produce tax liability. The reason? UBIT.

\*This article is indebted to Celia Roady’s “Inspired by the Collections: The Unrelated Business Income Tax and Museum Merchandising,” Westlaw SK061 ALI-ABA 529 (2005).

UBIT stands for unrelated business income tax. Under tax law, tax-exempt organizations are liable for tax on any unrelated business taxable income. Unrelated business is defined as any business that is regularly carried on and not substantially related to an exempt organization’s charitable purpose. This definition sounds vague, and it is. Fortunately, the IRS has provided some guidance on what constitutes unrelated business in museum stores over the years.

In buying and producing items to sell in a museum gift shop, the following (very) general guidelines are helpful in determining which items may be sold without triggering UBIT:

#### *Consider each item for sale in a gift shop individually.*

The IRS looks at each line of merchandise sold in a gift shop to determine whether or not it generates unrelated business income. Therefore, even if most of the sales do not create UBIT liability, the few that do will still have to be monitored in order to determine how much tax is owed. In choosing items to sell, it can be helpful to consult curators and educators to evaluate which goods are related to the museum’s purposes and which are not.

Items that are reproductions or feature reproductions of collection pieces are less likely to fall under UBIT.

Posters, greeting cards and even items like umbrellas and tote bags may be exempt from UBIT if they feature a reproduction of a work in the collection.

#### *Include educational information with items.*

By including information relating the item to the museum’s collection, a museum can further its educational goals and raise public awareness about its mission. At many museum gift shops around the country, products are accompanied by a small card or hang tag that provides educational details about the item. Such details may include information about the artist whose work is reproduced or a short history of the craft or medium represented by the item.

#### *Affixing the museum’s logo to an item does not make the sale of the item related business.*

Attaching a logo to an item is not enough to exempt the sale of the item from UBIT, but if the logo is a work from the collection, the item may be regarded as related.

#### *Don’t forget that you can always sell unrelated items.*

You’ll just have to keep track of sales of those items so that you can pay UBIT.

## About the Art Law Clinic

**T**he Art Law Clinic is a project of the Community Enterprise Project of The Hale and Dorr Legal Services Center of Harvard Law School. The Art Law Clinic is offered in connection with Professor Terry Martin's seminar on Art Law. Organizations interested in participating or learning more about the Art Law Clinic should contact Polly Clark via e-mail at [pclark@law.harvard.edu](mailto:pclark@law.harvard.edu). Assistance will be available on a pro bono basis to qualifying non-profit organizations.

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