Since our last newsletter there have been a number of legal developments for nonprofit organizations. The Pension Protection Act of 2006 brought significant changes, particularly with regard to charitable giving. Two of our students examine some of these changes. Graham Green discusses the impact of the Act on fractional giving while Caroline Barnard provides an update on additional changes to charitable giving law. The newsletter also includes a collections management focus, including articles by Shuan Lue about provenance; Yuanshu Deng on deaccessioning; and Emmeline Barton on cy pres and deviation.

In other recent developments, starting next fall students will work on art law projects through the Estate Planning Clinic. Students will have the opportunity to represent both individual estate planning clients, who may be artists or collectors, as well as institutional clients. We will continue to provide legal assistance on charitable giving, cultural property, collections management and nonprofit tax issues. Going forward, this newsletter will include articles of relevance to both individual estate planning clients and institutional nonprofit clients. Please feel free to contact us with suggestions for future newsletter articles or for more information about our program.

— Polly Clark, Editor
Senior Fellow, Art Law Clinic

## Fractional Giving after the Pension Protection Act of 2006

*Graham Green '07*

Fractional giving, the donation of portions of an artwork to a museum over an extended period of time, has resulted in major contributions to our nation’s museums. Although fractional gifts comprise only 3 percent of all charitable donations to museums, the quality of works that museum donors have contributed through fractional gifts highlights the importance of this practice. Historical examples of fractional giving include the Smithsonian Institution’s Hope Diamond, contributed by Harry Winston through a series of installments over a 10-year period in the mid-twentieth century.

More recent fractional gifts include Paul Cezanne’s “Boy in a Red Vest” at the Museum of Modern Art, New York, just one of 627 works the Museum has received as a result of fractional giving.

Until recently, fractional giving was encouraged by beneficial tax deduction rules that allowed a donor to claim a charitable contribution deduction against taxable income, equal to the value of the partial donation in each year in which a fraction is donated. In general, there is no charitable income tax deduction available for a gift of less than a donor’s entire interest in property. However, a donor could give an “undivided portion” of her entire interest in property and still receive a deduction. Thus a donor could claim a charitable deduction each year equal to the portion of the gift donated to charity that year and maintain a right of possession for the remainder. For instance, if a donor gave 5% of a work, the donor could claim a charitable deduction on 5% of the work’s current fair market value, as long as the donated work was put to a use related to the purpose of...
the donee organization, and the museum was thereafter enti
tled to possession of the work for 5% of the year, 18 days.
The tax advantages of fractional giving, which allowed a
donor to capture appreciation in value of the work over the
period of the donation, no doubt stimulated this practice in
recent years.

However, in a lesser known portion of the Pension Pro-
tection Act of 2006 (the “Act”), Congress greatly diminished
the tax benefits of fractional giving. Under the Act, the
value of each deduction over the entire period of the dona-
tion is based either on the fair market value of the work at
the time of the donation of the fraction, or the work’s fair
market value at the time of the initial donation, whichever
is less. There will no longer be incentives to donate portions
of a work over time to capture appreciation in the artwork’s
value. Furthermore, all fractional interest donations must
now be completed within 10 years of the initial partial
donation. According to Marsha Shaines, Deputy General
Counsel of the Smithsonian Institution, this new provision
may stem from a belief that museums do not always get full
ownership of the work. “In fact, best practices dictate that
the museum secure a binding pledge from the donor to do-
nate the remaining fraction of the work.”

Ms. Shaines also comments that donors with modest
incomes will be especially discouraged from making partial
donations because of the new reforms. “It is not well known
that fractional gifts are used not just by established wealthy
art donors, but also by young collectors of more limited
means and taxpayers with modest incomes who inherited
valuable collections,” said Ms. Shaines. Under the old law,
such donors could have used the partial donation rules to
donate just enough of a fractional interest in the collection
each year to offset 30 percent of the donor’s adjusted gross
income, the limit for donations of tangible personal prop-
erty. Before the Pension Protection Act, the donor of mod-
est income also could combine a fractional gift with the
carry-forward rules to enable the donor to stretch out the
gift for as long as necessary to take full benefit of the chari-
table contribution deduction. After the Act’s reforms, how-
ever, the same donor with modest income may not be able
to capture fully the tax benefits of a significant donation if
the donor does not have enough income. As a result, there
will be less incentive for taxpayers with modest incomes but
valuable collections to contribute their works to museums.

In addition to discouraging new fractional donations, the
Act treats incomplete donations adversely. If a donor fails
to contribute the entire work to the donee museum before
the earlier of 10 years or the donor’s death, and the work
does not subsequently pass to the tax-exempt institution,
the Act provides for a recapture of the donor’s previous tax
benefits with interest as well as a penalty of 10 percent of
the amount recaptured.

The Act treats especially harshly donors who die while
still owning a partial interest in the work. Under the Act,
the value of charitable deductions a donor can receive is
limited by the work’s value at the time of the initial dona-
tion. By contrast, the remaining portion of the asset in the
owner’s possession at the time of death is valued at the
work’s current fair market value. Since estate taxes signifi-
cantly exceed income taxes, against which the charitable
contribution deductions were previously taken by the tax-
payer, this tax reform in the Act could result in a significant
penalty for fractional donors who do not complete their
gifts. However, Senator Grassley, who sponsored the por-
tion of the Act targeting fractional giving, has indicated that
this estate tax penalty for partial donors may be elimina-
ed. This relaxation of the Act’s treatment of partial donors
could be accomplished simply by a Treasury Department
directive to the IRS not to issue regulations on this portion
of the Act. Despite this indication from the Hill, a formal
IRS statement on this point would provide clearer guidance
and more certainty for donors, museums, and tax planners.

The wording of the Act also suggests, but does not clearly
define, a heightened “related use” requirement for the do-
nee museum. The Act requires the donee museum to “use
the property in a use” related to the organization’s mission.
According to Ms. Shaines, this statutory language as well as
the legislative history of the Act, “suggests that a museum
may actually be required to exhibit a work or take some
other active step (instead of holding it for study or storing
it for future use) in order to assure the donor’s tax deduc-
tion. Such language requires the museum to put the donor’s
tax considerations ahead of its own exhibition and educa-
tion priorities.” Given how great an impact a heightened
related use requirement would have on donee institutions,
guidance from the IRS is needed to clarify if the Act indeed
carries a heightened related use requirement and what
would constitute sufficient related use.

Currently, organizations such as the American Associa-
tion of Museums and the American Association of Museum
Directors are working with Congress to revise portions of
the Act and to clarify how the Act will impact museums.
While not all repercussions of the Act’s impact on fractional giving are certain, the Act’s role in discouraging fractional donations could be expected as early as this year. The new, less favorable treatment of fractional giving under the Act will likely challenge institutions to develop alternative means of promoting in-kind donations. For museums, finding ways to sustain or otherwise recreate these long-term relationships with individual donors could be the greatest challenge posed by the Pension Protection Act.

The Pension Protection Act of 2006 and Charitable Giving: Additional Changes

Caroline Barnard ’08

Since its inception in 2005, the Art Law Clinic Client Newsletter (the “Newsletter”) has covered many issues related to taxation and nonprofit organizations. The recently-enacted Pension Protection Act of 2006 (the “PPA”) altered many of the laws which previously applied to charitable giving and other areas of nonprofit operation. This article discusses some of the reforms included in the PPA which have the potential to significantly alter nonprofits’ relationships with donors, with a special focus on updating information that appeared in prior issues of the Newsletter.

Receipts for Charitable Donations

Prior to the passing of the PPA, a donor who wished to claim a charitable giving deduction on his or her federal income tax return needed written acknowledgement only for contributions in excess of $250. Gifts below this floor could be deducted without documentation. (A full description of the former rules applying to gift acknowledgements was set forth in Graham Green ’07’s article in the Spring 2006 issue of the Newsletter, “Gift Acknowledgements: Keeping Donors and the IRS Happy.”) The PPA states that a donor must have documentation for all gifts claimed for deduction. The recording requirement can be met either with a receipt or letter from the donee organization, showing the name of the organization and the date and amount of the contribution; or in the case of non-cash gifts, with a bank record showing the payment, such as a cancelled check. This provision goes into effect for contributions made in tax years beginning after August 17, 2006.

It is important for organizations to note that this change does not mean that letters of receipt must be sent to all donors, no matter how small the gift. As under the former regime, the donor remains responsible for providing documentation of the gift, and in many cases, a cancelled check or other record of payment will be sufficient. Unless there is a quid pro quo charitable contribution in excess of $75, the organization is not required to provide a written acknowledgement of a cash gift. However, a nonprofit is likely to receive many more requests for documentation in the wake of the PPA. If sending such receipts becomes burdensome or costly to the organization, it should alert donors to the alternate ways of fulfilling the documentation requirement.

Appraisal Rules

Arabella Yip ’06’s article, “The Appraisal Rules: To Appraise or Not to Appraise?” in the Fall 2005 issue of the Newsletter discussed the rules governing appraisal in effect before the passage of the PPA. While these basic rules still apply, the PPA has increased penalties for taxpayers who substantially misstate the value of their donated property, and has set forth more stringent educational and experiential criteria for appraisers.

Taxpayers are now subject to a substantial valuation misstatement penalty of 20 percent of the unpaid tax if their donated property is overvalued by 150 percent or more, and a penalty of 40 percent if it is overvalued by 200 percent or more. Under the former law, these penalties were effective for property overvalued by 200 and 400 percent—the PPA narrows the window in which a overvaluation can be ignored. These penalties are for charitable giving deductions, but similar changes have been made to the laws governing valuation of property for the estate and gift taxes. The PPA also sets forth penalties for appraisers who overvalue property so much that it results in a penalty to the taxpayer if the appraiser knew or should have known that the appraisal was being used in connection with a federal income tax return or claim for refund. These new rules apply to all appraisals prepared after August 17, 2006.

Recapture Rules for Property Donations

A donor may deduct gifts of tangible personal property to qualified nonprofit institutions at fair market value as long as the property will be used in furtherance of the institution’s charitable purposes. If the property is used for other purposes or sold, the deduction is limited to basis—the amount
the donor paid to purchase the property. Due to concerns of potential fraud, the PPA establishes rules that will allow the Internal Revenue Service to “recapture” some of the prior deduction if the property is sold within three years of the donation. In the year that the nonprofit disposes of the property, the donor is required to report the difference between the original claimed deduction and the basis as ordinary income. This provision only applies if the original deduction exceeded $5,000; and does not apply if the donee organization provides written certification that the property was used for tax-exempt purposes or that the intended use had become impossible—thus justifying the disposition.

The new recapture rules have necessitated some changes to the paperwork completed by nonprofits in the event of an in-kind donation. Forms 8282 and 8283 (discussed by Effie Barton ’07 in her article “Charitable Giving Focus: In-Kind Gifts” in the Fall 2005 Newsletter) have been revised to reflect the changes made by the PPA. One of the most significant changes is that Form 8282, which previously had to be filed for gifts disposed of within two years of receipt, must now be filed for gifts disposed of within three years. The tax consequences to donors caused by the new recapture rules increase the pressure on organizations to only accept property that they intend to use for tax-exempt purposes.

### Charitable Giving Incentives

The PPA does not just place limitations on charitable giving; it provides some additional incentives to give. One of the most interesting is the ability for donors aged 70½ or older to give $100,000 to charities directly from an I.R.A. These donations will not be included in taxable income; but despite the fact that the gifts will be exempt, rather than deductible, donors must obtain a written receipt or acknowledgment from the charity akin to that required for regular charitable donations. In order to qualify for the exemption, the donation must go directly from an I.R.A. account to the charitable recipient, with no stopover in a donor-advised fund or other intermediary. This benefit is available only for gifts from traditional or Roth I.R.A.s, and not other types of retirement accounts.

The PPA also includes a number of other provisions related to charitable giving and the operation of exempt organizations. In order to determine how these changes will effect your organization, you should consult an accountant or lawyer, who can help you to comply with the new regulations and use them to maximize your donated income and organizational efficiency.

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**Protecting Your Collection: The Importance of Provenance Research**

*Shuan Lue ’08*

In 1972, the Metropolitan Museum of Art acquired a 2,500-year-old Greek vase known as the Euphronios krater. The vase was so magnificent, and its acquisition was so significant, that the purchase made the front page of the New York Times. However, the Met’s joy was short-lived. Evidence began surfacing that the krater may have been dug up north of Rome by antiquities poachers in 1971. This controversy plunged the Met into a 30-year dispute with Italian authorities, which finally ended in a settlement in 2006. Recent examples such as this illustrate the importance of addressing provenance issues when a museum is crafting a collections management policy.

To research provenance, which is the history of ownership of a work of art, one creates a list of the previous owners of the work, tracing the work from its present owner and location all the way back to the artist. Provenance information varies widely in completeness and accuracy; indeed, it is unusual to find an object with no gaps in its history. There are numerous reasons why an object’s history may not be fully recorded. For example, it may have been bought or sold anonymously.

Provenance information is crucial in protecting museums from inadvertently acquiring or holding works which may have been looted during war or stolen from someone’s home, another institution, or an archaeological site. When checking provenance, a museum should:

- Gather as much information as possible on the history of the object from the donor, seller, estate, or lender.
- Check art-loss registries and other established sources of information regarding theft.
- Consult scholars and probable countries of origin regarding provenance and quality of title.

There are many tools available for researching the provenance of a particular object. When contemplating an acquisition or a long-term loan, a museum should employ research methodologies and tools such as those listed in the break-out box to ensure that the object does not have a tainted history. Additionally, when a museum is buying a work of art, it should check the reputation of any dealer involved, and get a warranty that the information given by the seller is accurate.
Museums should take extra precautions regarding two special categories of objects: 1) artwork that was displaced as a result of World War II, including Nazi-looted art, and 2) antiquities that were illegally looted from archaeological sites. The Association of Art Museum Directors (AAMD) has created guidelines for dealing with both categories of art, which can be found at http://aamd.org. These guidelines recommend the following:

- Carefully research provenance.
- Require sellers, donors, and lenders to provide all available information, as well as warranties regarding the origins and provenance of the object.
- If a museum receives information that establishes another party's claim to the object, the museum should seek an “equitable” resolution with the party.

Equitable resolution does not necessarily entail returning the work to the owner. For example, the controversy over the Euphronios krater was resolved as part of an agreement in which the Met agreed to return to Italy several antiquities which the Italian government argued had been illegally looted. In return, Italy promised to provide long-term loans of equally beautiful and important objects to the Met. Furthermore, the Met was allowed to keep the Euphronios krater and some pieces of Hellenistic silver for an extended period of time after the other antiquities had been returned to Italy.

In spite of a museum's best efforts at discerning provenance, it sometimes still finds itself facing a restitution claim from the rightful owner. The law in all American states is that the owner of a work of art can recover it from the good faith purchaser without any obligation to pay compensation. However, there are several defenses available to a museum facing a restitution claim:

- **Statute of limitations**—establishes a period of time from the accrual of a cause of action within which a right of action must be exercised. If the time period has passed, the claim is barred. The relevant time period varies by state. Furthermore, states apply these statutes in two ways:
  - Discovery rule—in most states, time does not begin running until the owner discovers, or by exercise of reasonable diligence should have discovered, that the object has been stolen or until he or she discovers who possesses it.
  - Demand and refusal rule—time does not begin running until the owner demands return of his or her property and the possessor refuses. Applied in fewer states, notably New York.
  - Laches—if the owner “sleeps on his rights” and thus creates an undue delay in asserting his claim to ownership, he is barred from pursuing a legal remedy.
- Although not a defense, the museum should pursue remedies under its warranty from the seller. A warranty will not prevent the museum from being sued, nor prevent a victorious claimant from taking the object. However, the museum could be compensated for the loss by the seller if the warranty so provides.

Because of the difficulties inherent in tracing the ownership history of a work of art, museums are often at risk of facing a restitution claim from a rightful owner. However, by undertaking careful provenance research before making any acquisition, the museum can reduce its chances of finding itself in the middle of a controversy. Such provenance research is crucial and detailed procedures should be included in every collections management policy.

### Useful provenance research tools

- **The Art Loss Register**—online database containing theft data.
- **Getty Provenance Index**—online database of material from auction catalogs and archival inventories. **Caveat:** it only contains information which the museums themselves decide to pass along.
- **Archival research**—look through a museum library’s collections of dealer and auction catalogs, exhibition catalogs, photo archives, etc.
- **Labels and other markings on the object itself**—may provide clues as to the object’s movement over time.

### Demystifying Deaccessioning

Yuanshu Deng ’08

Museum acquisitions are often announced with great fanfare and can be an important event for both the museum and community. The permanent removal of an item from a collection, termed “deaccessioning,” can be just as important, if not more.

Late last year, the directors of the Albright-Knox Art Gallery in Buffalo, NY, decided to deaccession and auction 207 antiquities in an effort to raise funds for acquiring and exhibiting modern art, pursuant to its core mission. The
gallery ultimately went through with this plan but only after months of heated debate among members of the gallery and community. Some people argued that museums as a matter of principal should not sell the public’s treasures. Others felt that the museum was compromising its educational mission by disposing of pre-modern objects and thereby removing the context of the modern pieces. On the other side, proponents of the decision to deaccession believed that it was a sign of progress for the gallery and a necessary step to becoming a world-class museum of modern and contemporary art. The situation at the Albright-Knox shows that deaccessioning is not to be taken lightly.

There are a number of reasons that museums would want to deaccession items. For instance, museums may become more selective over time. A museum might have accessioned a broad range of works during the early years of its existence when it was still figuring out its purpose. It might later want to dispose of certain items that no longer reflect its mission. There are also practical reasons for deaccession. A limited budget may make it necessary for a museum to sell certain less important or duplicate works in order to expand or improve its overall collection. The costs of space, climate control, security, and curatorial care make it infeasible for a museum to exhibit or store too many items. If a museum lacks the resources to provide adequate care for some parts of its collection, then deaccessioning those items could be the most responsible thing to do.

Though deaccessioning is not a quick and easy process, it is nevertheless done quite frequently and is perfectly legal if it is necessary, appropriate, and not forbidden by the policy of the museum or the terms of a donor's gift. Courts will generally defer to decisions of directors or trustees as to the necessity and appropriateness of deaccessioning an item. When considering whether to deaccession works from its collection, a museum should look to its collection management policy in place and follow established deaccessioning procedures, making sure to document the reasons for deaccessioning. Of course, the museum must also make sure that it has clear and unrestricted title to the items proposed for deaccessioning. Clear title means that the museum fully owns the items to be deaccessioned. Unrestricted title means that there are no preconditions imposed by the donor of the items. Deaccessioning would be inappropriate or at least problematic if an item was donated to the museum on the condition that it not be disposed of, or on the condition that it be on public display permanently or periodically. If there are legally binding restrictions on the museum’s title, then the museum should consult with legal counsel and prepare to seek court approval. A court may be sympathetic to the changed circumstances of the museum and apply the cy-pres doctrine. This doctrine allows the court to amend the terms of a gift as near as possible to the original intent of the donor, where the original intended purpose is no longer possible or practicable. Alternatively, a court might apply the doctrine of equitable deviation, which is similar to cy-pres but calls for a stricter interpretation of the donor’s original charitable intent. For more information on the judicial doctrines of cy-pres and equitable deviation, please see Emeline Barton’s article on the subject in this newsletter.

When establishing deaccessioning procedures, it is in the interest of the museum to go beyond the legal requirements for deaccessioning. Museum trustees should consider ethical standards and best practices set by museum associations. When contemplating the permanent removal of an item from its collection, the museum should anticipate possible community resistance. Notice to the public is prudent, especially when the public may be sentimental about the item facing removal. Certain members of the public may even suffer a psychic loss from knowing that a valued, educational object in the public domain could end up in private hands, so inviting their input could lead to better understanding of the museum’s decision. When considering removal of a work given to the museum, it is good practice to notify the donor or the donor’s heirs of pending deaccession actions, particularly when the donor has expressed a preference for (but does not require) one method of disposal over another. Some museums have made it a policy not only to notify the donor or donor’s representatives, but also to respect their wishes not to have a work disposed of within a certain period of time.

Various codes of ethics address what museums may do with the proceeds of deaccessioning and disposal. Use of funds for purposes other than collection improvement is a sign of poor management. Accredited museums abide by the American Association of Museum’s (AAM) code of ethics, which limits use of funds to the acquisition of new material and the direct care, or preservation, of collections. This limitation means that funds may not be used to pay the operating costs of a museum. The code of ethics for the Association of Art Museum Directors (AAMD) is even stricter, stating that art museums can only use deaccessioning funds for the acquisition of works of art for the collection.

In sum, museum directors should keep in mind the legal,
ethical, social and practical issues involved in deaccession- ing. The decision to deaccession should be carefully consid- ered with regard to the long-term perspective, in order to ensure that the plan will further the mission of the museum and benefit the museum’s audience.

**Relief from Gift Restrictions: Cy Pres and Deviation**

*Emmeline Barton ’07*

Has your museum accepted a donated painting with the stipulation that the painting always be exhibited? What happens if your museum incorporates the policy to rotate its collection in and out of storage? What if your museum has funds restricted for a specific program that the museum discontinues? Are you limited by your originating documents on what you can charge as an admission fee?

A museum seeking relief from such restrictions may look to the doctrines of deviation and *cy pres*. These are charitable trust doctrines that allow an institution to change the terms of a charitable gift. *Cy Pres* will permit changes to the fundamental purposes of the trust if present circumstances have made it impossible, unlawful, or impracticable to adhere to the original terms of the donation. Deviation allows changes to the administrative terms of a gift if the terms would hamper the accomplishment of the gift’s purposes.

Historically, these doctrines have been used as a means of last resort. The standards of impossibility, unlawfulness, or impracticability are fairly high legal standards. The typical example of a necessary *cy pres* action is a trust established to find a cure for polio. What happens to the trust when a cure for polio is found? The court may approve a change to the trust’s original purpose to one that is similar to the original intent of the donor.

Recently, there has been a movement to expand the *cy pres* doctrine to allow changes if the purposes have become “wasteful.” “Wasteful” is more than simple inefficiency, but less serious than destruction of a trust. In order for a purpose to be wasteful, the court must find that the donor would not have imposed the restrictions on the trust had the donor known about the unanticipated circumstances.

The doctrine of deviation has been used recently in the well-known Barnes Foundation case to allow for the gallery’s move from Merion, Pennsylvania to Philadelphia. Deviation was also used so that the board of the Barnes could expand the endowment’s investment opportunities, expand visiting hours, increase admission fees and hold social functions at the museum. All of these actions were strictly limited in the original trust document.

These doctrines do not only apply to charitable trusts, but can also apply to institutional funds and charitable corporations. Charitable corporations have somewhat more flexibility than charitable trusts because they have different legal structures. A charitable corporation’s board of directors is subject to the business judgment rule, which gives deference to boards unless there is a clear abuse of discretion and a decision is made in bad faith. While charitable corporations may have more freedom to modify their corporate purposes, the corporations are still held to the high standards of deviation and *cy pres* for any restricted gifts and thus must seek judicial permission to alter the purposes of these gifts.

The doctrines of *cy pres* and deviation provide flexibility for charities to adapt to changing circumstances and best meet the needs of the community. Courts will try to adhere to donor intent whenever possible but may apply these doctrines to release charities from overly burdensome donor restrictions.

**Endnotes**

4. Although charitable contribution deductions for tangible personal property are capped at 30 percent of the taxpayer’s adjusted gross income, carry-forward rules enable a taxpayer to claim the unused portions of a deduction for up to five years from the year of the donation.
6. Id.
7. This change can be found in the Restatement (Third) of Trusts § 67 (2003) and the Uniform Trust Code, §413(a) (amended 2005).
About the Art Law Clinic

The 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. Assistance will be available on a pro bono basis to qualifying non-profit organizations.

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