# The Art Pledge Program: A Call for Consignments

Pergamon Art Group, in partnership with a leading international auction house and a global accounting firm, is seeking consignments for a new consignment platform to raise significant funds for museums and related 501(c)3 charities in the Fall auction season of 2020.

## An alternative method for supporting charities in a time of need

In the aftermath of the COVID-19 pandemic, many museums and related charitable organizations are struggling to find ways to raise critically-needed funds to support ongoing operations. Earned revenue streams have all suddenly dried up, and the planned charity auctions and galas which normally help support operations have unexpectedly been cancelled, forcing them to furlough staff and close indefinitely. Without significant new funding, many museums in particular are reporting that they may go out of business.

However, as part of the CARES Act, important changes were made to encourage charitable giving, including significantly enhanced Charitable Contribution limits for cash gifts from individuals this year, from a maximum of 60% to 100% of your adjusted gross income.

> Generally, individuals that itemize deductions are limited with respect to the amount of deduction available for charitable contributions made during the year. These limits are typically determined by a percentage of the individual's adjusted gross income (AGI). As a result of the CARES Act, for individuals that itemize, the 60% of adjusted gross income (AGI) limit that previously applied for qualifying cash contributions to public charities will not apply for 2020. Thus, ***individuals will be eligible for a deduction up to 100% of AGI for 2020 for qualifying cash contributions***. (Museum Trustees Association Newsletter, 2020)

## A new vehicle for converting artwork into cash donations

Despite these more generous contribution limits, however, most donors also face a significant cash squeeze of their own, and have seen their investments dramatically sink in value, and are thus unsurprisingly reluctant to be making substantial cash contributions to help support favored institutions, even with this new tax benefit. However, some donors may have valuable artwork they could offer instead, but need to have an efficient means to turn those tangible assets into cash to take advantage of the CARES Act provisions, which only applies in 2020.

Working in partnership with one of the largest fine art auction houses and a global accounting firm, Pergamon Art Group is therefore pioneering a new vehicle to help resolve this impasse: ***The Art Pledge program***.

The Art Pledge program allows donors to offer artworks and collectibles for sale in a regular auction with a stated philanthropic purpose: only the net proceeds after the sale (and capital gains taxes are reimbursed) are gifted as a cash donation to support the operational needs of their chosen charity or museum, taking advantage of the new CARES Act regulations. This dedicated Art Pledge program also confederates donor bequests into a dedicated section of the sales catalog, promoting the charitable purpose, which will likely enhance sales results, benefitting both donors and beneficiaries alike. Finally, the sales proceeds are administered through an escrow account by our partner accounting firm to ensure the tax liability is properly calculated and returned to the donor before distribution of the charitable gift, and the net proceeds reach the museum or charity within a few weeks of the auction settlement.

## How does it work?

### *Legal Structure*

The consignment process rests on two separate legal agreements, in view of the separate commitments between the donor and the auction house, and the donor and the charity, as follows:

a) a modified auction consignment contract between the donor and the auction house, which maintains most standard terms and conditions, but includes a representation where the consignor warrants that the proceeds, net of applicable taxes, will be donated to the named charity and that consignor authorizes the auction house to market and advertise the lot as such in the marketing documentation and sales catalog. The charity may also be named as a third-party beneficiary of the sale in the contract.

b) a modified "pledge agreement" or "donor agreement" between the donor and the charity, whereby they pledge to donate the net proceeds, after applicable taxes and capital gains have been refunded, to the donee institution within a specified number of days of receipt of the auction proceeds. Furthermore, they agree that the designated accounting firm will directly receive the net proceeds into an escrow account from the auction house, and, after the capital gains tax liability has been calculated and returned to the donor, the accounting firm will directly remit the net proceeds of sale to the beneficiary on behalf of the donor, to more properly control the distribution in keeping with the charitable intent of the sale.

### *Sales Structure*

The auction house will offer any works consigned under the Art Pledge program in their regularly scheduled sales in the Fall 2020, most likely in conjunction with the November major sales cycle. Museums and charitable partners would be encouraged to solicit prospective donations from their supporters and trustees, many of whom might otherwise have donated to the cancelled galas and charity auctions this calendar year.

The auction catalog lot(s) will be prefaced with the following designation (or equivalent):

**The net proceeds (after applicable taxes) from this(ese) lot(s) will be donated to the XXXX Art Museum as an unrestricted gift in support of their operations.**

In the event one museum or charity receives a quorum of pledged artworks which would warrant a single-owner sale, a separate dedicated auction on behalf of that beneficiary would be contemplated as an alternative sales venue.

Artworks are being solicited in the categories of Impressionist & Modern Art, Postwar and Contemporary Art, Editions, Photography, Design, and Jewelry, and will be sold in separate sections of those sales catalogs with other artwork pledged on behalf of partner charitable institutions.

We will also consider pledged works from additional established sales categories, including Collectible Motorcars, American Art, Old Masters, 19th Century Paintings, Asian Art, etc., to be offered with additional auction partners who specialize in these areas, on a case-by-case basis.

Given the additional costs for processing legal and accounting paperwork, we are encouraging potential consignors to consider works with a fair market value in excess of $50,000, but any legitimate works will be taken under consideration.

The auction house will also waive all seller's commissions and ancillary fees for photography, shipping, cataloging, previews, settlement, etc., but will maintain a buyer's premium to offset the additional legal and accounting costs of the sales vehicle.

***Benefits for the seller...***

The net proceeds from sale are gifted to the designated museum (or related charity) as a cash donation, minus the capital gains tax liability, which is returned to the donor. Without a transfer of title, we thereby avoid the 'related use' and 'three-year' rules that normally apply when artwork is donated directly, and the need for a qualified appraisal for the IRS Art Advisory Panel. We can also maximize estate planning benefits for the donor by reducing their Adjusting Gross Income (AGI) by potentially as much as 100% according to the new regulations under the CARES Act, but it only applies in 2020, so time is of the essence.

***Benefits for the charity...***

The charity opens up a new category for philanthropic giving from their supporters in these difficult times, employing artwork instead of cash and securities, bypassing the onerous regulations around a direct gift, and receiving a cash donation in 2020, precisely when they need the money most.

***Benefits for estate planning...***

The IRS has opened a window for the reduction of Adjusted Gross Income by as much as 100% for cash donations to charities under the new CARES Act, but only 30% for gifts of artwork. As such, the Art Pledge program can become a powerful estate planning tool by converting artwork into cash, especially for those who anticipate a large AGI in the current fiscal year.

**Case Study**

A museum supporter owns a Picasso watercolor they acquired for $100,000 in 1990, and is now valued at $600,000. They also have a regular salary and other earnings that places their anticipated Adjusted Gross Income after itemized deductions at around $500,000.

They consign the watercolor to the Art Pledge program, and it achieves an expected $600,000 hammer price, which is then transferred at the conclusion of the settlement process to an escrow account administered by our partner accounting firm. The capital gains tax liability of $140,000 in this instance ($500,000 x 28% capital gains tax for art & collectibles) is returned to the donor or her accountant, to be paid to the IRS when taxes are due in April 2021, yielding net proceeds of $460,000 from the auction. This net total is then transferred by the accounting firm to the museum as a cash donation on behalf of the donor, and can be applied against the donor's Adjusted Gross Income, potentially dropping their taxable income from $500,000 to just $40,000 in 2020, while the museum enjoys a significant $460,000 donation in support of its operations before the end of 2020. (Actual tax savings may vary in any given instance, so prospective donors will need to consult with a CPA or tax attorney.)

**Conclusion**

For many potential donors, consigning qualified artworks to the Art Pledge program is a compelling alternative way to take advantage of the tax benefits of the CARES Act in 2020 even without access to ready cash, and to quickly support their favored museum or charity this calendar year, when the larger deduction is in effect and the needs of museums and related non-profit organizations are most acute.

**Call for Consignment**

Pergamon Art Group is currently reviewing qualified artworks and collectibles for possible submission to the Art Pledge program auction, slated for the Fall 2020. We generally recommend works with a minimum market value of $50,000, but will consider any works on a case-by-case basis for potential inclusion.

For further information, or to submit a possible consignment, please contact:

Martin Gammon
President
Pergamon Art Group
martin.gammon@pergamonart.com
415-360-4859

*Appendix 1*

## *The status quo: current IRS rules make direct gifts of artwork cumbersome*

Many museum supporters may find they have limited cash resources, especially in the current climate, but may have valuable art and collectibles that could be sold to support the operational needs of their favored museum. In these challenging economic times, many donors may not be ready to write a $50,000 check, but may have a $50,000 sculpture or painting they no longer wish to own and are prepared to donate to a museum in support of its operations.

However, the current IRS rules and reporting regulations for the charitable contribution of artwork have created a difficult landscape for philanthropically-inclined museum supporters, who might like to gift an artwork to support museum operations.

### Donating Artwork Directly to the Museum: a legal and financial minefield

Museum supporters traditionally have two ways to donate artwork in support of museums: gifting them to the museum-administered charity auction, or a direct gift to the museum for future sale.

#### *Option 1: Charity Auction*

In a traditional charity auction scenario, there is a transfer of title at the time of consignment to the museum, and as the gift is construed as an 'unrelated use' to their charitable purpose, the IRS restricts the charitable deduction to the donor's cost basis, or the current fair market value, whichever is less.

However, for works with substantial appreciation from their point of purchase, this may be a great disincentive for the donor, who in essence gives up the appreciated market value for their charitable support. They do not have to pay capital gains taxes, but the amount of their charitable deduction may be a fraction of the artwork's current fair market value.

#### *Option 2: Direct Gift*

The second traditional approach-- a direct charitable gift of an artwork to a museum for the purpose of resale-- the current tax rules and regulations have made this option cumbersome, and in some cases financially perilous, for both the donor and the museum itself.

<u>Burdens for the Institution</u>

- **Related Use...** The IRS requires that the artwork must be employed in a use directly related to the charitable purpose of the museum, like a work that would be displayed in its permanent galleries, in order for the taxpayer to claim the full Fair Market Value as a tax deduction.

- **Three Year Rule...** Likewise, the museum is required to hold the work for at least three years before disposal.
- **Forms 8283/8282...** The museum registrar or other official must also sign off on these commitments in form 8283 for objects over $500, and then subsequently inform the IRS if there is a disposal before three years in form 8282, and then the tax deduction is subject to "recapture."
- **$10,000 penalty...** The registrar or any person who identifies property as having a 'related use' to the donee's exempt purpose and who knows that the contributed property is not intended for such use is subject to a $10,000 penalty.
- **Maintenance and Sale Costs...** The museum is also on the hook for exhibition, storage, insurance, and security costs for holding the work for 3 years, and then has the burden of overseeing solicitation of an auction contract, and the substantial transactional fees of a sale at the end of 3 years, before they can realize any of the benefit of the "gift" to their financial bottom line.

<u>Burdens for the Taxpayer</u>

- **Certified Appraisal…** A special certified appraisal by a Qualified Appraiser is required for objects donated over $5000, and the costs of these formal documents can run from $500 to many thousands of dollars from an appropriate expert.
- **Art Advisory Panel…** If the artwork is valued over $50,000, then it will be brought to the IRS Art Advisory Panel and possibly subject to a revision, up or down. The IRS in recent years has estimated that on average 65% of objects are subject to a revision from the taxpayer's appraisal, a significant hazard rate. Alternatively, the taxpayer can pay $2500 for a preliminary valuation from the IRS itself, but this is not subject to appeal.
- **Significant penalties...** If the revision is deemed a "substantial valuation misstatement" of 150% from FMV, then there is the prospect of a 20% tax penalty of the underpayment, and a "gross valuation misstatement" of 200% is subject to a 40% tax penalty of the underpayment. If the artwork is valued in the millions of dollars, the tax penalty can certainly exceed any expected tax benefit and instead yield a significant loss for the donor.
- **Recapture...** Even if the appraisal and the paperwork is in order and there is no dispute with the IRS, should the museum decide to dispose of the work before 3 years, then the taxpayer is liable for a "recapture" of their deduction once the museum files the mandated 8282 form.

In short, the direct charitable contribution of artwork is compromised by significant potential liabilities and regulatory encumbrances, and burdens the museum with additional costs for 3 years, when they in fact desperately need the money now.

### *Option 3: The Art Pledge program: A new way forward*

Our alternative solution avoids these regulations because there is no transfer of title to the museum, and only the net proceeds of sale are gifted as a cash donation. Once the sale is concluded, the consignor is contractually mandated to receive from the sale proceeds her unique capital gains exposure from the sale (usually 28% of the amount of the hammer price in excess of their "cost basis"), which can then be set aside by their accountant to settle their tax liability on their upcoming tax return.  The donee institution is then gifted the net proceeds as a direct cash contribution from the donor, not a gift of artwork, which can yield higher deduction limits under the new CARES Act (100% vs. 30%) on Adjusted Gross Income.

***Key benefits of the Art Pledge Option***

- Donor benefit is not limited to just their 'cost basis' as in a traditional charity auction, and the museum does not have to administer a charity auction of their own, but just receives the net proceeds from a professionally managed auction by a leading firm.
- Donor is relieved of any capital gains liability from the sale.
- Donor has no need to solicit a Qualified Appraiser or accounting work for the IRS.
- The review and potential liability of the IRS Art Advisory Panel and associated penalties are moot, because we are only dealing now with a cash donation after a demonstrated public sale.
- Adjusted Gross Income can be reduced by as much as 100% for cash donations under the CARES Act, rather than 30% for charitable gifts of artwork, according to IRS rules.
- The museum gets cash in year 1 (instead of year 3 with a direct gift).
- The registrar has no forms to fill out or potential liabilities.
- The museum has no overhead costs for storage or transactional fees on the back end.

**Case Study: A Comparison of the Donor's Options**

A museum supporter owns a Ketih Haring oil on canvas valued at $1.4 million she acquired in 1995 for $100,000, and has an expected Adjusted Gross Income in 2020 of $1 million.

If she gave the work to the museum's charity auction (were it even to happen this year), she would not pay capital gains taxes, but could only claim her cost basis as a tax deduction.  *Net benefit this year: $100,000.*

If she gifted the work to the museum for future sale, and there was no problem with the paperwork or appraisal, she could claim the full fair market value of $1.4 million.  However, the IRS only accepts a 30% reduction in AGI for donated artwork, limiting her benefit to $300,000 this fiscal year (although the remainder might be applied in subsequent years in certain circumstances).  Furthermore, the museum would not see any financial benefit for three years or more, when it can be sold.  *Net benefit this year: $300,000.*

However, if she sold the work through the Art Pledge program, and it hammered as expected at $1.4 million, she would have an expected capital gains tax liability of $364,000 (28% x $1.3 million), and that liability would be returned to her in lieu of taxes dues in April 2021. However, the net proceeds of $1,036,000 would then be gifted on her behalf to the museum as a cash donation in 2020, in effect wiping out the entire liability for her adjusted gross income of $1 million.  *Net benefit this year: $1 million.*

In short, the substantial expansion of the deduction for cash donations in 2020 in the CARES Act makes the Art Pledge program significantly more attractive than any other option for philanthropically-inclined donors of artwork, and may yield them a significant financial benefit at the same time they are making a major contribution to their favored museum or related charity, to support continued operations, pay their staff and keep their doors open until the traditional streams of earned revenue recover in the future.

## *Appendix 2*

### *Fair Market Premium of the Art Pledge program*

To be clear, the Art Pledge program is not designed as an "end-run" around IRS regulations concerning donated artwork, as any benefactor could give the proceeds of sale from a regular auction to their favored museum right now without limitation. However, most do not pursue this option because of the accompanying capital gains tax liability (which at the federal level is a hefty 28% for art and collectibles) dampening the impact of the gift and their tax benefits.

However, based on past experience, sales of artwork for the charitable purpose of supporting museums have yielded significantly enhanced outcomes when compared to similar works in regular auctions. As such, the proper promotion of the Art Pledge program among dedicated collectors around the world, as well as to museum supporters and the local community, often yield hammer prices that are a significant premium over Fair Market Value in a normal auction sale, in many cases thereby mitigating the effect of the capital gains refund after all.

For example, a recent charity auction of artwork we helped to organize on behalf of SFMOMA demonstrates this premium effect, when items sold on behalf of the museum are compared to analogous works sold in regular auctions from the same period.

Here are a few close market comparables that demonstrate this premium effect in real terms:


7L
**MEL BOCHNER**

***Ha, Ha, Ha*, 2010**

Oil on velvet
29 ½ × 24 ¾ in.
Courtesy of the artist
Estimate: $20,000–$25,000

With a career that spans nearly fifty years, Mel Bochner has earned critical acclaim and tremendous respect for innovative artworks that challenge the intellect and pique the senses. A true pioneer of Conceptual art, he uses straightforward visual cues to investigate deep-seated assumptions—about art, physical space, and, most often, language. "What interests me is the opacity of language," Bochner has said, "because I don't believe language takes you anywhere, except around in circles." His work was the subject of a traveling retrospective organized by the Yale University Art Gallery in 1995 and was included in the 2004 Whitney Biennial. He is represented in the collections of New York's Museum of Modern Art, the Los Angeles County Museum of Art, the Art Institute of Chicago, and SFMOMA, among others.

Two very similar Mel Bochner word paintings on black velvet were sold the same year, at a regular auction and at the SFMOMA charity auction:

NY Auction
November 14, 2014
Estimate: $17,600-22,000
Hammer: $19,000

SFMOMA Auction
June 2014
Estimate: $20,000-25,000
Hammer: $45,000

***The charity auction achieved an 84% premium over the regular auction price.***

17L
## ELLSWORTH KELLY

***Tulip*, 1983**

Graphite on paper
30 × 22 in.
Courtesy of the artist and Matthew Marks Gallery, New York
Estimate: $125,000–$150,000

One of the most celebrated American artists of the twentieth century, Ellsworth Kelly has amassed an oeuvre replete with multiple artistic styles but a singular intellectual integrity. Whether working in sculpture, large-format painting, or quiet line drawings, he reveals a dedication to pushing his own creative boundaries, exploring the techniques and philosophies of a variety of art movements to achieve unmistakably personal expression. Kelly has been the subject of numerous international solo exhibitions and retrospectives, including several devoted specifically to his beautifully spare, nature-inspired drawings and works on paper. He has completed public commissions for UNESCO in Paris, the city of Barcelona, and the Holocaust Memorial Museum in Washington, D.C., and is represented in the collections of the Museum of Modern Art in New York, the Solomon R. Guggenheim Museum, the Tate Modern, the Centre Georges Pompidou, and SFMOMA.

Seven comparable botanical drawings by Ellsworth Kelly sold at regular auctions 12 months either side of the SFMOMA charity auction.

Average regular auction price: $102,000
Highest regular auction price: $146,500

SFMOMA Auction
Estimate: $120,000-150,000
Sale: $180,000

***The charity auction had a 76% premium over average sales price at regular auction, and a 23% premium over the highest sales price.***

**16L**
## CHUCK CLOSE

***Roy II*, 1996**

Digital ink jet on Somerset paper, ed. 7/10
38 ½ × 31 ½ in.
Courtesy of Carla Emil and Rich Silverstein
Estimate: $5,000–$10,000

Over the course of his forty-year career, Chuck Close has repeatedly and unmistakably reinvented modern portraiture. Working systematically with a series of grids, he constructs brazenly unbiased yet intensely personal images of friends and family members on a larger-than-life scale. The size of his works invites the viewer to participate in how they are perceived—as photorealist representations or abstract geometric forms. Close's work was the subject of a traveling solo exhibition at SFMOMA in 2006 and is included in the collections of the Metropolitan Museum of Art, New York's Museum of Modern Art, the Walker Art Center, the National Gallery of Art, the Centre Georges Pompidou, the Tate Britain, and SFMOMA.

Three other examples from this same photographic print in an edition of 10 by Chuck Close have appeared at regular auction in the decade preceding the charity auction (2003-2011):

Estimate $6,000-9,000, Hammer: $8,540
Estimate $6,000-8,000, Hammer: $7,200
Estimate $18,000-22,000 Hammer: Unsold

SFMOMA Auction
Estimate: $5,000-10,000
Sale: $28,000

***The charity auction achieved a whopping 253% premium over the average sales price at regular auction for the same print from this photographic series.***

[The evident irony here is that if the donor had chosen instead to gift this photograph directly to the museum, and claimed a $28,000 tax deduction, the IRS would surely have rejected that valuation based on past market history as a "gross valuation misstatement," exceeding Fair Market Value by 200%, and subject to a 40% tax penalty of the underpayment.]

***In short, dedicated charity auctions of property sold to benefit museums regularly yield a premium of 30%+ higher hammer prices than that of analogous objects in a regular sale context, mitigating the effect of the capital gains tax refund.***

Granted, traditional charity auctions do provide the buyer with a tax deduction for any amount over Fair Market Value they elect to bid, which does not apply to the Art Pledge program, but the simple fact that one can assemble multiple audiences to an auction with a charitable purpose seems to indicate that a modest enhancement in value is possible or even likely in our case as well.

In terms of our first Case Study above, in addition to regular collectors of Picasso watercolors who are clients of the auction house, you may now have local supporters of the museum, who might not typically follow Impressionist & Modern auctions, but would otherwise have been a generous bidder at their charity auction.  Given a new opportunity to support the museum, and perhaps acquire a valuable work of art in the process, they may be enticed to bid when they otherwise would not.  This new audience expands the pool of potential bidders and potentially the final hammer price.

Not every Art Pledge consignment can ensure it will achieve these superlative results, of course, but the preliminary evidence of these market comparables does indicate a consistent enhancement effect of a charitable sale pledge that draws upon both regular collectors of a category, as well as museum supporters attracted to the philanthropic purpose of the auction in support of their local museum.

In many cases, then, this can mitigate the federal 28% capital gains tax refund from the proceeds of sale, granting the donor close to, or some cases even exceeding, the deduction they would have realized with a direct gift, but without any of the bureaucratic hassles and potential penalties.

In certain instances, therefore, estate attorneys might of their own accord recommend this tool as an estate planning benefit for clients who face an uncommonly large adjusted gross income this year, who can now take advantage of the CARES Act provisions on cash donations, expanding the pool of potential donors for museum philanthropy.

To consign or learn more, please contact:

Martin Gammon
President
Pergamon Art Group
martin.gammon@pergamonart.com
415-360-4859