Planning for Personal Property

It's key to consider the emotional, financial, and tax implications of gifts of tangible personal property.

Patricia Schatzlein Smock | Aug 28, 2023

Tangible personal property – that is, property (other than land or buildings) that you can see or touch – is a special asset class in many estates. A client's tangibles include their jewelry, clothing, furniture, books, and other household items. Tangibles can have considerable financial value, especially in the case of antiques, sterling silver, rare stamp and coin collections, tapestries, paintings, and other works of art. Tangibles can also evoke powerful emotions, particularly to the extent that they include family heirlooms or otherwise reflect a family's history. Moreover, there are a number of special tax considerations that can apply to the transfer of tangibles, whether during one's lifetime or at death. The emotional and tax considerations that apply to this unique asset class, together with the

financial value involved, make it vital to develop a comprehensive plan for transferring tangible personal property as part of a person's estate plan.

Understanding the financial value of tangibles

To develop an effective succession plan for your client's tangible property, one must first understand the financial value of their art, antiques, and other tangibles. In some cases, clients are well aware of the value of items they have acquired or inherited. In others, family members have been surprised to inherit items that no one knew were rare or of significant value.

It is a good idea for a client to obtain an appraisal from a qualified independent appraiser to establish the value of their tangible property. Having an accurate, up-to-date value of tangible assets can help them appropriately care for those assets during their lifetime. A professional assessment of an item's financial value and provenance will also inform decisions about storing, maintaining, and insuring the piece.

A current appraisal can also help a client sort through the issues to consider in developing a distribution scheme for tangibles as part of an estate plan. For example, if a collection of maritime paintings is worth more than one originally thought, the estate may bear an additional estate tax liability, and the payment of those taxes could in turn affect the planned disposition of financial assets. If the pearl necklace a client plans to leave to their daughter is actually worth significantly more than they thought, perhaps their plan should provide for cash distributions to be made to their other children, in order to equalize their children's treatment under the plan.

Estate planning for the emotional value

After determining a client's tangible property's financial value, it is important for them to think through the emotional value of those items, both to them and to their intended recipients. A successful estate plan acknowledges the sentimental value of tangible personal property by leaving items to the recipients who would have the greatest appreciation for them. Perhaps an antique musical instrument would have special meaning when given to a grandson who studies music, while a portrait of a family ancestor would make a fitting gift to a niece who is the subject's namesake. In addition to their personal appreciation, these recipients may be more likely to use, display, and care for the items they receive.

Often, a parent will want certain children to receive specific tangible property while also providing that all children have an equal financial share in the estate. For this reason, the parent may consider an equalization clause, which would provide for distributions of cash or other assets to children who receive tangibles with less monetary value.

Tangible assets can also make for a unique and purposeful gift to a charitable organization, especially where the organization will be able to preserve and display the item and account for the donor's legacy of support.

Understanding the tax consequences

A plan for transferring tangible property may include lifetime gifts to family members or charitable organizations, as well as transfers at death. In reviewing their personal property, a client may also decide to sell certain items. Each of these types of transfers will have different tax consequences that should be considered as part of any plan.

When one transfers items of tangible personal property by lifetime gift or at death, the Internal Revenue Service (IRS) will require a value for those items for income, estate, or gift tax purposes. Transferred property is generally valued at fair market value for tax purposes. Because tangible assets, unlike marketable financial assets, do not have a readily available fair market value, the IRS will often require the taxpayer to obtain a qualified appraisal of the assets. When a taxpayer seeks an income tax charitable deduction for donating a tangible asset to charity, an appraisal dated within 60 days of the donation must be obtained if the value of that asset is greater than $5,000. When a taxpayer owns an item or a collection of tangible property items worth more than $3,000 at death, an appraisal must be submitted with the estate tax return if a return is otherwise required to be filed.

The IRS refers tax returns that report a gift of any item of art or furnishings with a value of $50,000 or more to the IRS Art Advisory Panel for possible review. The Art Advisory Panel consists of approximately 25 art experts, including curators, dealers, and auction house representatives, who meet several times a year to review art appraisals submitted to the IRS. The IRS regularly adjusts valuations in submitted appraisals based on the Art Advisory Panel's recommendations.

Tax impact of sales of tangible assets

If a client sells a tangible asset, they may realize a capital gain for income tax purposes. The income tax consequences may vary, depending upon at least two factors. The first factor is the tax basis in the asset. If they purchased the item, the purchase price will be their tax basis. If they received it by gift, their tax basis generally will be the donor's basis "carried

over" to them. If they inherited it, their tax basis will be the item's fair market value as reported on the decedent's estate tax return.

The tax rate is the second factor affecting the income tax consequences of the sale of a tangible asset. The threshold question in determining the capital gains tax rate is the holding period, or the length of time your client held the item. If they have held the tangible asset for more than one year, their gain on the sale of that item will qualify for long-term capital gain treatment (in most cases taxed at a 20% rate). If they have held it for one year or less, their gain on the sale will be a less favorable short-term capital gain (taxed as ordinary income). If they received the item by gift, their own holding period will also include the period of time the donor held the item. If they inherited the item, they will be considered to have a holding period of more than one year regardless of the date they inherited it.

However, for tangible assets, the holding period is not the end of the inquiry in determining the tax rate. Even if the holding period is over a year and the sale is otherwise eligible for the 20% long-term capital gain rate, if the item being sold falls within the category of "collectibles," their capital gain will be taxed at a 28% rate. The IRS defines "collectibles" as including all works of art, rugs, antiques, metals, and gems, and many stamps and coins, in addition to other items. The gain on sale of a collectible is also included in a client's net investment income and thus is potentially subject to the 3.8% Medicare surtax. In addition to these federal taxes, state capital gains taxes may apply.

Gifts of tangibles at death

Typically, upon a person's death, his or her tangible personal property is disposed of under his or her will. A 2011 change in Massachusetts law has

made it easier to allow for the distribution of tangible assets by will. Under Massachusetts law, a person can now provide in their will that their tangible assets must be distributed as set forth in a separate written statement or list. This tangible personal property memorandum must be in writing, be signed (and preferably dated), and describe the tangible property items and their recipients with reasonable certainty. Even though the memorandum does not need to be executed with the same formalities as a will, if a will directs that tangibles must be distributed by memorandum, the memorandum is legally binding. The ability to distribute tangible property by memorandum gives greater flexibility to individuals in creating and updating a distribution plan for their tangible assets.

If the will directs that tangible items are to pass to recipients who live far away, the estate plan should also address who will pay for the expenses of packing and shipping the items. Generally, under Massachusetts law, these expenses can be paid from estate assets only if the will specifically directs such payment. In the absence of such a direction in the will, the tangibles' recipients would be required to bear these costs, which may cause an unintended burden on the recipients.

Tangibles owned by a person at death are included in the measure of the person's gross estate for estate tax purposes. Each person has a lifetime federal estate and gift tax exemption ($12.92 million in 2023, indexed annually for inflation until January 1, 2026, when it is set to reduce roughly by half) that will be applied against his or her gross estate. If a person's assets are in excess of his or her remaining exemption amount, transfers at death may generate additional estate tax. There may also be state estate tax consequences to transfers at death. For example, Massachusetts currently has a much lower estate tax exemption than the exemption under federal law (fixed at $1 million in 2023 and thereafter).

Gifts of tangible property to charity can also be made upon death under the donor's will. Although the item's fair market value will be included in the value of the donor's gross estate for estate tax purposes, it will be offset by a charitable deduction of an equal amount.

Lifetime gifts to individuals

Tangible assets can be part of a lifetime gifting plan to family members or other individuals. These lifetime transfers are subject to federal gift tax. The gift tax consequences of lifetime transfers of tangibles to individuals can be mitigated by using the federal gift tax annual exclusion ($17,000 per donee in 2023) or the lifetime federal gift and estate tax exemption ($12.92 million in 2023, indexed annually for inflation). In addition, a lifetime gift of tangibles may have state gift tax consequences. Massachusetts has no gift tax, although lifetime gifts may have an impact on the ultimate Massachusetts estate tax amount.

Property given away during a donor's lifetime is removed from the donor's estate, and any post-gift appreciation escapes estate tax at the donor's death. However, the recipient of a lifetime gift will receive a carry-over cost basis in the property. Thus, the capital gains resulting from the recipient's later sale of an appreciated gift of property may generate a sizable income tax to the recipient. Instead of using appreciated tangibles for lifetime gifts, it might be more advantageous for a donor to retain tangibles, particularly those that may be sold shortly after transfer to the intended recipients, in his or her own name until his or her death, at which point they can be left to the intended recipients. This would allow the tangibles to receive a step-up in basis at the donor's death before passing to the intended recipients.

Lifetime gifts to charity

Making a lifetime gift of a tangible asset to charity can serve as a meaningful way to honor the emotional value often associated with this type of property. In addition, giving tangible personal property to a qualified charitable organization during one's lifetime can result in an income tax charitable deduction if a person itemizes their deductions for the year in which they make the gift. The income tax charitable deduction for a gift of tangible property to a charity during the donor's lifetime depends on whether the charity's use of the item is "related" or "unrelated" to the organization's charitable purpose. An example of "related" use is a museum's display of a donated painting. If the donee uses the gift in a way that is related to the donee's charitable purpose, the donor will receive a deduction equal to the property's fair market value at the date of gift, limited to 30% of the donor's adjusted gross income. If the gift is unrelated to the donee's charitable purpose, the donor's deduction is limited to the donor's cost basis in the property, rather than the property's fair market value, limited to 50% of the donor's adjusted gross income. In each case, the donor can carry any excess deduction forward for five years.

Last thoughts

Tangible assets form a significant part of many clients' wealth because of both their financial value and their emotional importance. An estate plan that considers the emotional, financial, and tax implications of gifts of tangible personal property will make for a smoother distribution of estate assets.

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