Dear Sir or Madam,

Attached please find a letter of proposed technical corrections to Section 1218 of the Pension Protection Act of 2006, Public Law 109-280comments, submitted on behalf of the Solomon R. Guggenheim Foundation.

Sincerely,

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Guggenheim MUSEUM

October 31, 2006

Honorable Charles E. Grassley, Chairman
Honorable Max Baucus, Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Re: Proposed Technical Corrections to Section 1218 of the Pension Protection Act of 2006, Public Law 109-280 (the "PPA")

Gentlemen:

Although the current provisions of the Technical Corrections Act of 2006 (H.R. 6264, S.4026) (the "Technical Corrections Act") do not apply to the PPA, we understand that you are accepting comments for technical corrections to the PPA. We therefore are writing at this time to express our general concerns with respect to the impact on museums of Section 1218 of the PPA regarding Contributions of Fractional Interests in Tangible Personal Property ("Section 1218"), and to highlight two issues that we believe would be most appropriately addressed in the Technical Corrections Act.

The Solomon R. Guggenheim Foundation (the "Guggenheim") was founded in 1937 for the "promotion and encouragement and education in art and the enlightenment of the public." It has fulfilled this goal through the establishment of an international network of museums and exhibition spaces around the world. The Guggenheim currently administers museums in Venice, Bilbao, Berlin, and Las Vegas, as well as its landmark Frank Lloyd Wright-designed museum in New York. Its museums attract over 2.5 million visitors per year, nearly 40 percent of whom are visitors to the flagship New York museum. Each year, the Guggenheim mounts between 20 and 30 original exhibitions, which are usually displayed in one of its United States museums, and may travel within the Guggenheim's network and to other museums throughout the world.

The Guggenheim's renowned collection began with gifts from its founder, Solomon R. Guggenheim and has been expanded in large part by gifts received from art collectors over the years. In the current era of formidable and rapidly escalating prices for art, the Guggenheim and many other museums have had to rely heavily on gifts and bequests from generous donors to allow them to continue to build their collections. The prior law governing fractional gifts of art provided museums with an effective vehicle to encourage donors to make gifts of art, particularly those significant (and valuable) works of art that are so difficult for museums to acquire by purchase. We are concerned that Section 1218 of the PPA will have a chilling effect on such gifts and, therefore, on the ability of museums to acquire works of art for the benefit of the public.

I. Overview of the Tax Law Applicable to Fractional Gifts

Under prior law, donors of fractional interests in tangible personal property were allowed to deduct a *pro rata* share of the fair market value of the property proportionate to the percentage interest of the gift, based on an appraisal at the time of each fractional gift. There was no requirement regarding the amount of time over which the gift had to be completed; and many donors reserved the right to retain their remaining interest in the property until the later death of the donor and the donor's spouse. With each fractional gift, the donee institution received the right to possession of the work for a fraction of each year proportionate to its ownership interest in the work; although case law determined that the institution did not have to exercise such right each year, so long as it had the unfettered right to possession.

Section 1218 has changed the law to require a donor to complete a fractional interest gift within ten years after the initial fractional interest gift (or upon the donor's earlier death); and limits the income, estate and gift tax deductions that the donor is entitled to receive for each fractional gift to the lesser of a proportionate share of (i) the fair market value of the work at the time of the initial gift, and (ii) the fair market value at the time of each fractional gift. Section 1218 also requires that the donee institution take "substantial physical possession" of the property during the period of co-ownership by the donor and the donee institution. If the property is not used for the donee's tax-exempt purpose, the gift is not completed within ten years, or the donee fails to take substantial physical possession of the work during the period of co-ownership, Section 1218 provides for the recapture of all income, estate and gift tax deductions the donor has taken with regard to the gift of the property, with interest and a 10% penalty tax on the amount of deductions previously taken.

We fear that the rigidity of these rules and the harsh penalties to which donors may become subject will drastically reduce the number of gifts museums receive through the very useful charitable giving vehicle of fractional gifts. With fewer incentives to give works of art to museums, more donors are likely to delay making commitments to museums. As a result, more works will remain in private hands or be sold upon the death of the collector, rather than be given to museums for the enjoyment of the public.

II. Importance of Fractional Gifts to Museums

Fractional gifts have been very useful to museums, in part because they allowed the institution to encourage a donor to *begin* giving a work of art, even if the donor was not yet willing to commit to giving up all possession of the art during her lifetime. A donor of a particularly valuable work of art would often choose to give a fraction of the work the proportionate value of which was an amount the donor would be able to deduct for income tax purposes, taking into account the contribution limit for gifts of tangible personal property (approximately 30% of the donor's adjusted gross income), and the five-year carry-forward for the value of the gift in excess of the contribution limit. The donor had to relinquish dominion and control of the art to the museum only for the portion of the year equal to its ownership interest in the work. The promise of additional fair market value tax deductions was incentive to encourage the donor to make additional fractional interest gifts once she had exhausted the carry-forwards from her initial gift. With each subsequent fractional interest gift, the institution would gain increasing rights of possession, and greater decision-making power over the location, care and treatment of the work. Even if the museum chose not to take possession of a work for its fractional share of a given year, because it would not be able to display the work that year, or because frequent packing and shipping of the work might damage it or be prohibitively costly, the curators knew that the museum would be entitled to possession of the work when it "needed" it, for inclusion in exhibitions.

The ability to take possession of a fractional interest gift when needed means that a museum can truly rely on such a gift in its collecting strategy, and does not have to continue to seek to acquire a similar work by gift or purchase. This distinguishes fractional gifts importantly from "promised gifts," in which the museum gets no ownership interest until the donor decides to give the work (usually upon death). For these reasons, it is appropriate that donors of fractional interests receive income tax deductions for the very real present-interest they give in works of art, while no income tax deduction is available to those who make promised gifts, or give future-interests.

If there were abuses under the prior law, instances where institutions had side agreements with donors that they would not take possession of the works during the donors' lifetimes, they were not widespread, and could be curbed by less drastic means than those of Section 1218. By taking away the incentive of fair market value deductions for subsequent fractional interest gifts (after the initial fractional interest), and the flexibility of allowing a donor to choose his or her own schedule for giving, we fear that the PPA has stripped fractional gifts of the attributes that made them attractive to donors and a key vehicle for museums to start a dialogue with donors, encouraging them to *begin* to give important works of art.

Although we are hopeful that Congress will consider these concerns and modify Section 1218 in the next Congress, we realize that addressing some of these issues is beyond the scope of a technical correction. There are however, two matters of a technical nature, which we hope will be addressed in the Technical Corrections Act.

III. Proposed Technical Corrections

A. Charitable Gifts Should Not Trigger Estate or Gift Taxes

Section 1218(b) and (c) provides for caps on the estate and gift tax deductions available for "additional contributions" of fractional interests, after an initial contribution, at the lesser of a proportionate share of (i) the fair market of the property at the time of the initial contribution, and (ii) the fair market value of the property at the time of the additional contribution. While these provisions mimic Section 1218(a), which limits the income tax deduction, they would produce, in most cases, the clearly unintended result of creating gift or estate tax liability for contributions of additional fractional interests to a museum, if the work of art has appreciated in value since the initial contribution. In fact, in some instances, the resulting estate and gift tax liabilities could exceed the value of the income tax deductions to the donor, resulting in a net cost to a donor to make a charitable gift.

An example of the application of Section 1218(b) would be a donor who gave an initial 10% fractional interest in a work of art worth $1 million, and gave the remaining 90% of the work to the museum as a bequest in his will when he died five years later. If at the time of the donor's death the work of art was worth $2 million, the $1.8 million dollar value of the donor's 90% interest in the work would be includable in his estate for estate tax purposes. However, his estate tax deduction for the gift of his 90% interest in the work would be limited to $900,000 (90% of the $1 million value at the time of the initial contribution). Therefore, the donor's estate would be liable for estate tax on $900,000 (the $1.8 million value, less the $900,000 deduction), despite an entirely charitable transfer of the art. This result occurs despite the fact that the donor is not responsible for or able to manipulate the market value of the work of art, and the fact that the donor has complied with the time requirements for completing the gift under Section 1218, and had allowed the institution to enjoy substantial possession of the work during the period of co-ownership.

Section 1218(c) would cause a similar result in the gift tax context. If the donor in the example above did not die, but gave an additional contribution of 10% of the work five years after the initial gift, his income tax deduction would be limited to $100,000 (10% of the fair market value on the date of the initial gift), and so would his charitable gift tax deduction. However, the donor would incur gift tax on the $200,000 value of the gift on the date of the additional contribution, offset only by the $100,000 deduction. There is no policy reason served by causing a donor to pay gift tax (or use up his lifetime exemption from gift tax) for making the second charitable transfer, which resulted in an increase in the donee museum's ownership interest in the work and greater rights of possession.

We have already heard from counsel for donors that they will advise their clients not make any new fractional gifts, for fear of such illogical and unjust results. Thus, unless this technical correction is made, the enactment of Section 1218 is likely to have the unintended consequence of eliminating the ability of museums to receive fractional gifts entirely.

B. <u>Fractional Gifts in Progress Should be Grandfathered</u>

Donors who made one or more fractional interest gifts to a museum prior to the enactment of the PPA should be allowed to give their remaining interest in those works under the rules of the prior law. Without this change, it appears that donors of such gifts-in-progress will "freeze" their gifts, to avoid having them come under the PPA, and the potential for harsh penalties under Section 1218. Museums would then have to wait until the death of the donor to receive the remaining fractional interest in the work, although that may not have been the intention of the donor when he or she began giving fractional interests. We do not believe that the intention behind this new law is served by slowing-down the process of giving to institutions; it would be an unfortunate consequence of the law if museums had to endure longer periods with smaller ownership interests in works of art than either the institution or the donor had intended when the initial fractional gift was made. Since the proposed exception could be drafted to apply only to the defined group of donors who have made documented fractional interest gifts prior to the effective date of the PPA, there would be no potential for abuse or a "flood" of gifts in avoidance of the new law if such gifts were "grandfathered" under the prior law.

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We urge you to include in the Technical Corrections Act corrections that (i) would ensure that charitable donors would not incur any estate or gift taxes as a result of any contribution of a fractional interest in tangible personal property, and (ii) grandfather gifts-in-progress, so that donors will receive the benefits of the law prior to the enactment of the PPA with respect to their additional contributions of such property. We also hope that other changes to Section 1218 will be considered by the 110th Congress that will restore incentives for charitable giving of works of art, while ensuring that those incentives are not abused.

We would be pleased to discuss these comments with you or members of your staff at any time. We appreciate your consideration of the needs of museums and the important benefits to the public that result from fractional interest gifts.

Sincerely yours,

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