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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:IT&A:01/PLR-117339-00
Date:
March 11, 2002

Re:

Legend

Donee =

Taxpayer =

Taxpayer's spouse =

Collection =

X =

State =

Dear :

This responds to your August 31, 2000, request for rulings, as supplemented by correspondence dated February 25, 2002, on behalf of the Taxpayer. Your request concerns the treatment of proposed gifts and loans of artwork pursuant to a Gift and Loan Agreement (GLA). Specifically, you request the following rulings:

RULINGS REQUESTED

Income Tax Rulings.

1. Any gift the Taxpayer makes during the Taxpayer's life of any undivided fractional interest (which for the purpose of the letter ruling request may include any fraction equal to or exceeding 1/12) in any work of the Collection accepted by the Donee subject to the terms and conditions of the GLA shall qualify as a charitable contribution under §170(c) of the Internal Revenue Code.

2. Unless an election is made by the Taxpayer under §170(b)(1)(C)(ii) of the Code, the amount of the income tax charitable contribution attributable to each gift by the Taxpayer of an undivided fractional interest in a work of the Collection to the Donee shall be determined under §170(b)(1)((C)(i) and shall equal the product of (a) such fraction times (b) the fair market value, determined without regard to the existence of the GLA, of the entire work of art at the time of the gift of the fractional interest; provided, however, under §170(b)(1)(C)(ii) the aggregate amount of all charitable contributions described under §170(b)(1)(C)(i) in such year shall not exceed 30 percent of the Taxpayer's contribution base as defined in §170(b)(1)(F). Unless

otherwise elected by the Taxpayer under §170(b)(1)(C)(iii), the limitation of §170(e)(1)(B) for gifts of tangible personal property, where the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under §501, shall be inapplicable to the subject gifts.

3. If the Taxpayer makes the election under §170(b)(1)(C)(iii) of the Code with respect to the Taxpayer's gifts of capital gain property for a taxable year, then the amount of the income tax charitable contribution attributable to any gift in that year of an undivided fractional interest in a work of the Collection that is capital gain property shall be subject to the limitation of §170(e)(1)(B) and shall equal the product of (a) such fraction times (b) another fraction, the numerator of which is the Taxpayer's adjusted basis in the Taxpayer's interest in the work immediately preceding the gift of the fractional interest, and the denominator of which is the fraction representing the portion of the Taxpayer's ownership in the entire work immediately preceding the gift of the fractional interest. In such case, the 30 percent limitation under §170(b)(1)(C)(i) shall not apply to the subject gifts.

Gift Tax Rulings.

4. The mere execution of the GLA by the Taxpayer will not constitute a completed gift of any items of artwork in the Collection under §2511 of the Code.

5. The Taxpayer's transfer, during the Taxpayer's life, of undivided fractional interests in any items of artwork in the Collection to the Donee will constitute completed gifts that qualify for the gift tax charitable deduction under §2522 of the Code.

6. The value of the gift under §2512 of the Code, and the amount of the gift tax charitable deduction under §2522 allowable for each gift by the Taxpayer of an undivided fractional interest in an item of artwork, will be the product of the fair market value of the artwork (determined without regard to the existence of the GLA) multiplied by the fraction of the item transferred. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

7. If, during the life of the Taxpayer, the Taxpayer transfers the ownership of an undivided fractional interest in any items of artwork in the Collection to the Taxpayer's spouse in accordance with the terms of the GLA, then the gift of such fractional interest will qualify for the gift tax marital deduction under §2523(f) of the Code.

8. The value of the gift under §2512 of the Code, and the amount of the gift tax marital deduction under §2523 allowable for each gift by the Taxpayer of an undivided fractional interest in an item of artwork, will be the product of the fair market value of the artwork (determined without regard to the existence of the GLA) multiplied by the fractional interest of the item transferred. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

9. If, during the life of the Taxpayer, the Taxpayer loans any items of artwork in the Collection to the Donee, then such loan will not be treated as a gift by the Taxpayer as provided under §2503(g) of the Code.

Estate Tax Rulings.

10. Upon the death of the Taxpayer, survived by the Taxpayer's spouse, only the individual fractional interest of the items of artwork in the Collection retained by the Taxpayer will be includible in the Taxpayer's gross estate. Approval rights retained by the Taxpayer that pass to his successors in interest will have no value for federal estate tax purposes under §§2031 and 2033 of the Code.

11. Any bequest to the Donee under the terms of the Taxpayer's will of the Taxpayer's retained undivided fractional interest in the items of artwork in the Collection will qualify for the estate tax charitable deduction under §2055 of the Code.

12. The amount includible in the Taxpayer's gross estate under §§2031 and 2033 of the Code, with respect to such retained undivided fractional interest, will be the fair market value of the item of artwork multiplied by the Taxpayer's fractional interest in the item. The amount deductible under §2055 with respect to the item bequeathed to the Donee will equal the value included in the gross estate.

13. Any bequest to Taxpayer's spouse of any retained fractional interest of the items of artwork in the Collection included in the Taxpayer's gross estate will qualify for the marital deduction under §2056(b)(7) of the Code.

14. The amount includible in the Taxpayer's gross estate and the amount deductible as an estate tax marital deduction under §2056(b)(7) of the Code will be the product of the fair market value of the item of artwork (determined without regard to the existence of the GLA) multiplied by the fractional interest of the item transferred.

## FACTS

The Taxpayer and Taxpayer's spouse (collectively referred to as "Donors"), residents of State, currently each own an undivided one-half interest in certain specified X prints and related works of art ("X Works"). The Donors propose to establish an art collection (Collection) at the Donee consisting of the X Works and certain X prints that the Donors previously transferred to Donee in . The Donors' primary goal in establishing the Collection at the Donee museum is to provide for long-term public enjoyment of the Collection while retaining the unity and spirit of the cohesive body of X Works of art selected and assembled over many years by the Donors. The Donee is exempt from federal income taxes under §501(c)(3) of the Code, and is a charitable organization described in §§170(b)(1)(A) and 170(c)(2). The Donee desires to accept the Collection to effectuate the Donors' purpose and goal and enhance its X Collection.

In furtherance of their purpose and goal, the Donors transferred X Works by gift to the Donee. In addition, the Donors proposed to enter into a Gift and Loan Agreement (GLA). Under the GLA, the Donors, during their lifetimes, may, but have no obligation to, transfer by gift all or a fractional interest in any items in the Collection not previously transferred to the Donee, provided that each fractional interest transferred must be at least a 1/12th interest. Items previously transferred and items to be transferred in the future are referred to as "Gifted Works." If the Donors transfer only a fractional interest in an item to the Donee, the Donors can retain possession of the artwork for a period of time each year commensurate with their proportionate interest in the item.

At any time during the Donors' lifetimes, the Donors may, in their discretion, loan any

one or more items of artwork in the Collection to the Donee. The items of artwork to be loaned are referred to as "Loaned Works." The term of the loan is to be mutually agreed upon by the Donors and the Donee. However, the Donors can refuse to loan an item of artwork or reject any proposed loan term. The Donors can also waive or terminate their possession right in an item of artwork.

Under the GLA, as long as the Donee holds and displays the Gifted and Loaned Works in accordance with the GLA, the Donors are not permitted to voluntarily transfer during their lifetimes (or at the death of the first to die of the Donors) by gift or otherwise any item of artwork in the Collection to any party other than to each other or the Donee. Notwithstanding any provision in the GLA, in the event the Donors voluntarily transfer artwork during their lifetimes to each other (or at the death of the first to die of the Donors) the Taxpayer's spouse shall have the exclusive and unrestricted right to use the property during his or her lifetime, including, but not limited to, the right to sell, mortgage, or otherwise encumber or assign the life estate, or to license or exploit any intellectual property right pertaining the artwork during his or her lifetime. The Donors propose to execute codicils to each of their wills providing that the spouse shall have a life estate in the artwork and shall have the exclusive and unrestricted right to use the property during his or her lifetime, including, but not limited to, the right to sell, mortgage, or otherwise encumber or assign the life estate, or to license or exploit any intellectual property right pertaining the artwork during his or her lifetime. In addition, if the Donee holds and displays the Gifted and Loaned Works in accordance with the GLA, then the Donors, or their legal representative, is obligated at no later than the death of the last to die of the Donors, to transfer to Donee, all of the Donors' remaining ownership interests in the artwork comprising the Collection. The items so transferred are subject to the terms and conditions of the GLA.

The proposed GLA is divided into two parts. The first part governs gifts, and the second part governs loans by the Donors of portions of the Collection to the Donee. Under the first part of the GLA, the Donee agrees that if the Donors, during their lives or at death, gift or bequeath any items of artwork (including fractional interests that will equal or exceed 1/12) of the Collection to the Donee, the Donee will hold and display such works in accordance with certain conditions ("Gift Conditions"). The conditions require the Donee to continuously display at least thirty of the Gifted Works on a rotating pattern. The Gifted Works shall be displayed in a gallery named for the Donors and prominently identified as such. The Donee shall identify the display as the Collection of the Donors. The Donee must obtain the Donors' consent to any changes in the gallery or installation design (Display Control Rights). In addition, the Donee shall pay the costs of maintaining and conserving the artwork that is in its possession. The Donee shall, subject to the Donors' consent, restore the artwork in its possession. The Donee and the Donors shall pay the restoration costs proportionate to their fractional interests. The conditions also require the Donors and Donee to pay the costs proportionate to their fractional interest to insure the artwork. Additional provisions require the Donee to pay the costs relating to constructing the art gallery, transporting the artwork, and publishing a catalog. The Donee may deaccession any Gifted Work from the Collection, but only to the extent it is replaced with a similar item of artwork typified by the Collection, that is consistent with the spirit of the Collection, and has a value substantially equal to the value of the deaccessioned artwork in the Collection. Any such acquired artworks are then to be subject to the terms and conditions of the GLA. Final editorial control over publicity concerning the Collection is granted to the Donors. Finally, the Gift Conditions require the Donee to comply with all the Loan Conditions, which are summarized below, with respect to all the Loaned Works.

The Gift Conditions are divided into three stages. Stage I commences with the execution of the GLA and runs until the death of the last to die of the Donors. Stage II commences on the date of death of the last to die of the Donors and runs until the later of the death of the Donors' daughter or 25 years from the date of the GLA. During Stage II, the Donor approval rights contained in the Gift Conditions will transfer to the Donors' daughter, if she is living. Stage III commences on the date Stage II ends. At that time certain provisions regarding maintenance, restoration, conservation, scholarly access, and insurance apply.

The second part of the GLA governs loans by the Donors of portions of the Collection to the Donee museum. The conditions require the Donee to pay all the costs relating to transportation, and maintenance. The Donee shall continuously display at least thirty of the Loaned Works on a rotating pattern unless otherwise provided in the specific loan arrangement. However, in all events the Donee must put the Loaned Works to a use relating to its exemption under §501 of the Code.

All the actions required of the Donee by the GLA must be performed in accordance with "good museum practice." If the Donee and either of the Donors or the Donors' daughter, as the case may be, are unable to agree on what constitutes "good museum practice," the GLA provides for the appointment of a mutually acceptable curator to decide the issue.

The Donee shall be deemed to be in compliance with all of the Gift and Loan Conditions unless it has been notified on a timely basis by the Donors (or after their deaths, by their daughter) of any violation. Once a gift or loan condition failure notice has been received by the Donee, the Donee shall have 60 days to cure the violation.

In the event the Donee breaches any of the Gift Conditions with respect to the Gifted Works, and the Donee fails to cure the breach after receipt of a gift condition failure notice, then the Donee's ownership rights in all of the Gifted Works shall terminate. If the uncured breach occurs during Stages I or II the ownership rights shall be transferred to another organization that is exempt from federal income taxes under §501(c)(3) and is also a charitable organization described in §§170(b)(1)(A),170(c)(2), 2055(a) and 2522(a). Donee's ownership rights are not terminated if the breach occurs during Stage III.

In the event the Donee breaches any of the Loan Conditions with respect to the Loaned Works, and the Donee fails to cure the breach after receipt of a loan condition failure notice, then the Donee shall promptly return all of the Loaned Works to the Donors or others as directed by the Donors. The loan term shall also end when the Donors, at their discretion, terminate it. In this case the Donee shall return the Loaned Work or Works in which the loan term was ended to the Donors. If the loan term ends due to the death of both Donors, and the Donee has met all the Gift and Loan Conditions, then the Donors shall be obligated at death to transfer all of the remaining ownership interests in all the Loaned Works to the Donee by gift. If upon the death of the last to die of the Donors, the Donee has not met the Gift and Loan Conditions, the Donee shall return all the Loaned Works to the legal representative of the Donor's estate or others as directed by the Donor.

The works of art of the Collection owned by the Donors are capital gain property within the meaning of §170(b)(1)(C)(iv) because they are capital assets that if sold at fair market value would result in gain that would be long-term capital gain.

LAW AND ANALYSIS

Ruling Request #1

Section 170(a)(1) of the Code provides, subject to certain limitations, a deduction for charitable contributions described in §170(c), payment of which is made within the taxable year. Section 170(c)(2) states, in part, that the term "charitable contribution" means a contribution or gift to or for the use of a qualified organization.

Section 170(f)(3) of the Code generally restricts deductions for partial interests in property, including tangible personal property. However, §170(f)(3)(B)(ii) provides that the contribution, not in trust, of an "undivided portion" of the taxpayer's entire interest in property is deductible. Under §1.170A-7(b)(1)(i) of the Income Tax Regulations, an "undivided portion" must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property. A deduction is allowable under this exception if the charitable organization is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in the property.

In the present situation, the Donors may transfer less than their entire interest in any work in the Collection to the Donee provided that the fractional interest transferred is at least a 1/12th interest. Although the Donors have retained certain insubstantial rights in the interests transferred, such as approval rights for the gallery design and the installation design (Display Control Rights), they have not retained any ownership reversion rights. If an uncured breach occurs, the Gifted Works will not revert to the Donors, but instead the ownership rights will be transferred to another organization that is exempt from federal income tax under §501(c)(3) and is a charitable organization described in §§170(b)(1)(A) and 170(c)(2). Therefore, the gift of a fractional interest in any work of the Collection accepted by the Donee subject to the GLA qualifies as a gift of an undivided portion of the Donors' entire interest in the work. See Winokur v. Commissioner, 90 T.C. 733 (1988), acq.,1989-1 C.B. 1.

Thus, the undivided fractional interest is deductible for income tax purposes under §170(f)(3)(B)(ii) and §1.170A-7(b)(1)(i) to the extent otherwise provided in §170. We conclude that any gift the Donors make during their lives of an undivided fractional interest in any work of the Collection accepted by the Donee subject to the terms and conditions of the GLA will be deductible as a charitable contribution, subject to the limitations and restrictions of §170. Accordingly, Ruling Request #1 is granted.

Ruling Requests #2 and #3

Section 1.170A-1(c)(1) of the regulations provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in §170(e).

Section 170(e)(1)(A) of the Code provides that the amount of any charitable contribution of property shall be reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of the contribution) (i.e., the amount of the charitable contribution deduction is limited to basis in the case of ordinary income property and short-term capital gain

property). Furthermore, §170(e)(1)(B)(i) states that in the case of a charitable contribution of tangible personal property, if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under §501, then the charitable contribution must be reduced by the amount of gain that would have been long-term capital gain if the property contributed had been sold by the taxpayer at its far market value (determined at the time of such contribution) (i.e., the amount of the charitable contribution deduction is limited to basis in the case of long-term capital gain property not put to a related use).

"Capital gain property" is defined in §170(b)(1)(C)(iv) of the Code as any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain that would have been long-term capital gain. Section 1221 defines a capital asset as property held by the taxpayer, excluding stock in trade, property held primarily for sale to customers in the ordinary course of the trade or business, and certain other items not relevant here.

Section 1.170A-4(b)(3)(i) defines, in part, the term "unrelated use" as a use that is unrelated to the purpose or function constituting the basis of the charitable organization's exemption under §501 of the Code. Section 1.170A-4(b)(3)(ii)(b) further explains, in part, that in the case of a contribution of tangible personal property to or for the use of a museum, the taxpayer may treat the property as not being put to an unrelated use by the donee if at the time of the contribution, it is reasonable to anticipate this. The donor's anticipation is reasonable if the object donated to the museum is of a general type normally retained by the museum or other museums for museum purposes, and the donor does not have actual knowledge that the object will not be put to an unrelated use by the donee, whether or not the object is later sold or exchanged by the donee.

Because the Donors are making a contribution in property other than money, we first address whether the reductions provided in §170(e)(1) are applicable. Specifically, the application of §170(e)(1)(B)(i) must be examined because artwork is tangible personal property, and the Donors represent that the works of art are capital gain property that if sold at fair market value would result in gain that would be long-term capital gain. However, the Donee's public exhibition of the works of the collection is a use that is related to the purpose or function constituting the basis for the Donee's exemption under §501. In addition, it is reasonable for the Donors to anticipate that the donated artwork will not be put to an unrelated use because they have no actual knowledge to the contrary. Thus, unless the Taxpayer elects otherwise for a taxable year under §170(b)(1)(C)(iii), the limitation of §170(e)(1)(B) does not apply.

Section 170(b)(1)(C)(i) of the Code imposes a limitation on the deduction allowed for any charitable contribution described in §170(b)(1)(A) made by an individual of capital gain property to which §170(e)(1)(B) does not apply. Specifically, the Code section limits the amount of the charitable contribution deduction for any taxable year to 30 percent of the taxpayer's contribution base for such taxable year. Section 170(b)(1)(F) of the Code defines "contribution base" as adjusted gross income computed without regard to any net operating loss carry back to the taxable year under §172.

If the contributions of capital gain property exceed 30 percent of the taxpayer's contribution base for any taxable year, the excess is treated as a charitable contribution of capital gain property to which the 30 percent limitation of §170(b)(1)(C)(i) applies in each of the five succeeding taxable years. However, the taxpayer may elect under §170(b)(1)(C)(iii) to

have §170(e)(1) apply to all contributions of capital gain property made by the taxpayer during the taxable year. The effect of this election, in pertinent part, is to limit the amount of the charitable contribution to the owner's basis in the case of long-term capital gain property as though the property had been subject to §170(e)(1)(B). Additionally, because the Donee is an organization described in §170(b)(1)(A), if such election is made, the 50 percent limitation of that section will apply.

Section 170(e)(2) of the Code provides that, in the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer's adjusted basis in such property shall be allocated between the interest contributed and any interest not contributed in accordance with the regulations. Section 1.170A-4(c)(1)(ii) of the regulations provides that the adjusted basis of the contributed portion of the property shall be that portion of the adjusted basis of the entire property that bears the same ratio to the total adjusted basis as the fair market value of the contributed portion of the property bears to the fair market value of the entire property.

As stated in our response to Ruling Request #1, the Donors have not retained any "substantial" rights. If the Taxpayer does not elect the application of §170(b)(1)(C)(iii), the amount of the charitable contribution attributable to each gift by the Taxpayer of an undivided fractional interest in a work of the Collection shall be determined under §170(b)(1)(C)(i) and shall equal the product of (a) such fraction, times (b) the fair market value, determined without regard to the existence of the GLA, of the entire work of art at the time of the gift of the fractional interest. However, under §170(b)(1)(C)(ii), the aggregate amount of all charitable contributions described under §170(b)(1)(C)(i) in the taxable year shall not exceed 30 percent of the Taxpayer's contribution base as defined in §170(b)(1)(F).

As previously stated, the works of art and their display are related to the Donee's purpose or function constituting the basis for the Donee's exemption under §501(c). Therefore, §170(e)(1)(B) does not apply to reduce the amount of the charitable contribution determined otherwise. However, if the Donors make the election under §170(b)(1)(C)(iii) with respect to the gifts of capital gain property for a taxable year, the amount of the charitable contribution attributable to any gift in that year of an undivided fractional interest in a work of the Collection that is capital gain property shall be subject to the reduction under §170(e)(1).

In calculating the reduction under §170(e)(1), the Donors' adjusted basis in the contributed portion of the property shall be that portion of the adjusted basis of the entire property which bears the same ratio to the total adjusted basis as the fair market value, determined without regard to the existence of the GLA, of the contributed portion of the property bears to the fair market value, determined without regard to the existence of the GLA, of the entire property. If the election under §170(b)(1)(C)(iii) is made, the 30 percent limitation under §170(b)(1)(C)(i) will not apply to the subject gifts. Accordingly, Ruling Requests #2 and #3 are granted.

Ruling Request #4

Section 2501 of the Code imposes a tax for each calendar year on the transfer of property by gift during the calendar year. Section 2511(a) provides in part that the tax imposed by §2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal and tangible or intangible.

However, the gift must be complete before the tax will apply.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or the benefit of another, the gift is complete.

Rev. Rul. 76-103,1976-1 C.B.293, holds that the transfer of property to an irrevocable self-settled "discretionary trust," does not constitute a completed gift, for gift tax purposes, if, under applicable state law, the trust property may be subjected to the claims of the grantor's creditors. Under these circumstances the grantor has retained dominion and control over the trust property, because he can relegate his or her creditors to the trust for settlement of any claims against the grantor. In the instant case, under the law of State, property transferred to a trust described in Rev. Rul. 76-103 would be subject to the claims of the grantor's creditors.

Upon executing the GLA, Taxpayer will be committed to transferring his interest in the X Works to Donee, either during his lifetime, or on the death of the last to die of the Donors. However, during the period he retains ownership of the X Works, under State law, the property would be subject to the claims of his creditors. Accordingly, under the facts presented in this case, the mere execution of the GLA will not constitute a completed gift, for gift tax purposes.

Ruling Requests #5 and #6

Section 2522 of the Code provides for a gift tax charitable deduction for the value of property transferred to organizations described in §2522(a). However, §2522(c)(2) and §25.2522(c)-3(c)(1) and (2) of the Gift Tax Regulations provide that if a donor transfers an interest in property for charitable purposes and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than adequate and full consideration) for private purposes, no gift tax deduction is allowed under §2522 unless the charitable interest is in the form of certain specified deductible interests. Under §25.2522(c)-3(c)(2)(i) the term "deductible interest" includes an undivided portion of the donor's entire interest in the property. Under the regulation, an undivided portion of the donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in the property and must extend over the entire term of the donor's interest in the property. The regulation further provides that an undivided portion of the donor's entire interest in property in property includes an interest in property whereby the charity is given the right, as a tenant in common with the donor, to possession, dominion and control of the property for a portion of each year appropriate to its interest in such property. A similar rule contained in §1.170A-7(b)(1) of the Income Tax Regulations pertaining to the income tax charitable deduction has been held to apply to the transfer of artwork. See Winokur v. Commissioner, 90 T.C. 733 (1988), acq., 1989-1 C.B. 1.

Section 25.2522(c)-3(b)(1) provides that if, as of the date of the gift, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

In the instant case, the Taxpayer proposes to transfer an undivided fractional portion of the Taxpayer's entire interest in particular items of artwork to the Donee and retain possession

of the transferred art work for an appropriate portion of each year commensurate with the retained fractional interest. Such undivided fractional interest will qualify as a "deductible interest" under §25.2522(c)-3(c)(2)(i). Further, the items passing to the Donee will be held subject to the terms and conditions of the GLA. However, under the GLA, if Donee breaches the terms of the GLA, the items in the Collection will be distributed to other organizations described in §§170(c), 2055, and 2522. Accordingly, the requirement of §25.2522(c)-3(b)(1) is satisfied because, under the GLA, there is no possibility that the items of artwork subject to the bequest will pass for other than a charitable purpose as defined in §2522. Accordingly, we conclude that assuming the terms of the gift otherwise satisfy the requirements of §2522 and the regulations thereunder, the value of the gift will qualify for a gift tax charitable deduction under §2522.

As discussed above, under the terms of the GLA, the Donee is authorized to sell, exchange or otherwise dispose of the items in the collection, and the GLA limits the use of the proceeds of sale, etc. to the acquisition of other examples of artworks that are typified by the Collection, that are consistent with the spirit of the Collection, and that are of a value substantially equal to the value of the deaccessioned artworks in the Collection. Any such acquired artworks are then to be subject to the terms and conditions under the GLA.

Under these circumstances, we conclude that the value of each gift under §2512, with respect to the transfer of such undivided fractional interest, will be the fair market value of the item of artwork multiplied by the fractional interest that is transferred to the Donee. The amount deductible under §2522 with respect to the item transferred to the Donee will equal the value of the gift. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

Ruling Requests #7 and #8

Section 2523(a) of the Code provides that in computing a donor's taxable gifts, the donor is allowed a deduction equal to the value of any interest in property that passes by gift from the donor to the donor's spouse during the calendar year.

Section 2523(b) provides the general rule that no deduction is allowable for transfers to the surviving spouse of certain terminable interests, i.e., interests in property passing to the surviving spouse that will terminate or fail, and after such termination or failure, an interest in the same property passes to someone other than the spouse.

Section 2523(f) provides an exception to this terminable interest rule in the case of qualified terminal interest property (QTIP). Section 2523(f)(2) defines QTIP to mean property (1) which passes from the donor, (2) in which the donee spouse has a qualifying income interest for life, and (3) to which a QTIP election under §2523(f)(4) applies. Section 2523(f) provides that rules similar to the rules of §2056(b)(7)(B)(ii), (iii) and (iv) apply to §2523(f). Section 2056(b)(7)(B)(ii) provides that a spouse has a qualifying income interest for life if (1) the spouse is entitled to all the income from the property payable at least annually, and (2) no person has a power during the spouse's life to appoint any part of the property to any person other than the spouse.

Section 25.2523(f)-1(f), Example 1, of the Gift Tax Regulations, describes a situation where a donor transfers by gift a personal residence to his spouse, S, and his children, giving S the exclusive and unrestricted right to use the property (including the right to continue to occupy

the property as a personal residence or rent the property and receive the income for her lifetime). After S's death, the property is to pass to donor's children. Under applicable local law, S's consent is required for any sale of the property. The example concludes that if the donor elects to treat all of the personal residence as qualified terminable interest property, the deductible interest is the value of the residence on the date the residence was transferred to S and the donor's children.

In this case, under the GLA, Taxpayer is authorized to transfer an undivided interest in items of artwork to Taxpayer's spouse during his lifetime. Under the terms of the GLA, the Taxpayer's spouse will have the exclusive and unrestricted right to use the property during her lifetime, including, but not limited to, the right to sell, mortgage, or otherwise encumber or assign the life estate, or to license or exploit any intellectual property right pertaining to the artwork.

We conclude that if, during the life of the Taxpayer, the Taxpayer transfers the ownership of an undivided fractional interest in any items of artwork in the Collection to the Taxpayer's spouse in accordance with the terms of the GLA, then the gift of such fractional interest will qualify for the gift tax marital deduction under §2523(f), provided the election is made under §2523(f)(4). See §25.2523(f)-1(f), Example 1.

Further, we conclude, that the value of the gift under §2512, and the amount of the gift tax marital deduction under §2523(f) allowable will be the product of the fair market value of the item of artwork determined without regard to the existence of the GLA, multiplied by the fraction of the item transferred. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

Ruling Request #9

Section 2503(g) of the Code provides that for purposes of the estate tax, gift tax, generation-skipping transfer tax, and special valuation rules:

> any loan of a "qualified work of art" shall not be treated as a transfer (and the value of such qualified work of art shall be determined as if such loan had not been made) if– (A) such loan is to an organization described in §501(c) (3) and exempt from tax under §501(c) (other than a private foundation), and (B) the use of such work by the organization is related to the purpose of function constituting the basis for its exemption under §501.

Under §2503(g)(2)(A), a "qualified work of art" is defined as any archaeological, historic, or creative tangible personal property.

In the instant case, the items of artwork comprising the Collection each constitute a "qualified work of art" within the meaning of §2503(g)(2)(A) because each work is properly characterized as creative tangible personal property. Further, the Donee is exempt from tax under §501(c) and is not a private foundation. Finally, the contemplated use to which the Donee will put any loaned works will be related to the purpose or function constituting the basis for its exemption under §501. Accordingly, we conclude that, under §2503(g), any loan of the items of artwork in the Collection from the Taxpayer to the Donee will not be treated as a transfer for gift tax purposes.

Ruling Request #10

Section 2031 of the Code provides that the value of the gross estate of the decedent shall be determined by including the value at the time of the decedent's death of all property, real or personal, tangible or intangible, wherever situated.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of death.

Upon the death of the Taxpayer, survived by the Taxpayer's spouse, only the individual fractional interests in the items of artwork in the Collection retained by the Taxpayer will be includible in the Taxpayer's gross estate. Approval rights retained by the Taxpayer that pass to his successors in interest will have no value for federal estate tax purposes under §§2031 and 2033.

Ruling Requests #11 and #12

Section 2055(a) of the Code provides that, for purposes of the federal estate tax imposed by §2001, the value of the taxable estate is determined by deducting from the value of the gross estate all bequests to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, and certain other fraternal and veterans organizations.

Section 20.2055-2(b)(1) of the Estate Tax Regulations provides that if, as of the date of the decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible

Under §2055(e)(2)(B) and §20.2055-2(e)(1) and (2), where an interest in property passes or has passed from that decedent for charitable purposes and an interest (other than an interest that is extinguished on the decedent's death) in the same property passes or has passed from the decedent for private purposes (for less than an adequate and full consideration in money or money's worth) no deduction is allowed under §2055 for the value of the interest that passes or has passed for charitable purposes unless the interest is a "deductible interest" described in §20.2055-2(e)(2). Under §20.2055-2(e)(2), a deductible interest includes an undivided portion, not in trust, of a donor's entire interest in the property. Under the regulation, an undivided portion of the donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in the property and must extend over the entire term of the donor's interest in the property. The regulation further provides that an undivided portion of the donor's entire interest in property includes an interest whereby the charity is given the right, as a tenant in common with the donor, to possession, dominion and control of the property for a portion of each year appropriate to its interest in such property.

Section 20.2055-1(a) provides that a deduction is allowed under §2055(a) for the value of property included in the decedent's gross estate and transferred by the decedent to certain charitable entities. In general, the amount allowable as an estate tax charitable deduction under §2055 is the fair market value of the property passing to charity. Under certain

scenarios, this value may not be the same as the value determined for estate tax inclusion purposes under §2031. See Ahmanson Foundation v. United States, 674 F.2d 761, 768 (9th Cir. 1981); Estate of Schwan v. Commissioner, T.C.M. 2001-174. See also, Estate of DiSanto v. Commissioner, T.C.M. 1999-421, (applying these principles in the case of the estate tax marital deduction); Deukmejian v. Commissioner, T.C.M. 1981-24; Cooley v. Commissioner, 33. T.C. 223, 225 (1959), aff'd. per curiam, 283 F.2d 945 (2nd Cir. 1960), (dealing with the effect of restrictions on marketability on the amount of the income tax charitable contribution deduction).

In the present case, under the terms of the GLA, the Taxpayer will unconditionally bequeath any undivided fractional interest in the items of artwork in the Collection that he owns on the date of death (other than items subject to a spousal bequest) to Donee. Such undivided fractional interest will qualify as a "deductible interest" under §20.2055-2(e)(2). Further, the items passing to the Donee will be held subject to the terms and conditions of the GLA. However, under the GLA, if Donee breaches the terms of the GLA, the items in the Collection will be distributed to other organizations described in §§170(c) and 2055. Accordingly, the requirement of §20.2055-2(b)(1) is satisfied because, under the GLA, there is no possibility that the items of artwork subject to the bequest will pass for other than a charitable purpose as defined in §2055(a). Accordingly, we conclude that assuming the terms of the bequest otherwise satisfy the requirements of §2055 and the regulations thereunder, the value of the bequest will qualify for an estate tax charitable deduction under §2055.

As discussed above, under the terms of the GLA, Donee is authorized to sell, exchange or otherwise dispose of the items in the collection and the GLA limits the use of the proceeds of sale, etc. to the acquisition of other examples of artworks that are typified by the Collection, that are consistent with the spirit of the Collection, and that are of a value substantially equal to the value of the deaccessioned artworks in the Collection. Any such acquired artworks are then to be subject to the terms and conditions under GLA. Under these circumstances, we conclude that the amount includible in the Taxpayer's gross estate under §§2031and 2033, with respect to such retained undivided fractional interests, will be the fair market value of the item of artwork multiplied by the Taxpayer's fractional interest in the item. The amount deductible under §2055 with respect to the item bequeathed to Donee will equal the value included in the gross estate.

Ruling Requests #13 and #14

Section 2056(a) of the Code provides that, for purposes of the tax imposed by §2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides that where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest passing to the surviving spouse will terminate or fail, no deduction is allowed under §2056(a) with respect to such interest: (a) if an interest in the property passes or has passed (for less than adequate and full consideration in money or money's worth) from the decedent to any person other than the surviving spouse (or the estate of such spouse); and (b) if by reason of such passing the person (or his heirs or assigns) may possess or enjoy any part of the property after the termination or failure of the interest passing to the surviving spouse.

Section 2056(b)(7) provides an exception to the terminable interest rule contained in §2056(b)(1). Under §2056(b)(7), qualified terminable interest property, is treated as passing to the surviving spouse for purposes of §2056(a) and no part of the property is to be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) which passes from the decedent; (2) in which the surviving spouse has a qualifying income interest for life; and (3) to which an election under §2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides that a spouse has a qualifying income interest for life if (I) the spouse is entitled to all the income from the property payable at least annually, and (II) no person has a power during the spouse's life to appoint any part of the property to any person other than the spouse.

Section 20.2056(b)-7(h), Example 1, of the Estate Tax Regulations, describes a situation where decedent owned a personal residence at his death. Under decedent's will, the exclusive and unrestricted right to use the residence (including the right to continue to occupy the property as a personal residence or to rent the property and receive the income) passes to his spouse, S, for life. At S's death, the property passes to his children. Under applicable local law, S must consent to any sale or the property. The example concludes that if the executor elects to treat all of the personal residence as qualified terminable interest property, the deductible interest is the value of the residence for estate tax purposes.

In this case, Taxpayer will execute a codicil to his will pursuant to which he will bequeath a life interest in any retained fractional interest in the collection to Taxpayer's spouse. Under the terms of the bequest, the Taxpayer's spouse will have the exclusive and unrestricted right to use the property during her lifetime, including, but not limited to, the right to sell, mortgage, or otherwise encumber or assign the life estate, or to license or exploit any intellectual property right pertaining to the artwork. The bequest is authorized under the terms of the GLA.

We conclude that any bequest to Taxpayer's spouse of a life interest in any retained fractional interest of the items of artwork in the Collection under the terms described above, will qualify for the estate tax marital deduction under §2056(b)(7) provided the election under § 2056(b)(7)(B)(v) is made. See § 20.2056(b)-7(h), Example 1.

Further, we conclude that the amount of the estate tax marital deduction under §2056(b)(7) allowable for each bequest by the Taxpayer of an undivided fractional interest in an item of artwork will be the product of the fair market value of the artwork multiplied by the fraction of the item transferred, determined without regard to the existence of the GLA.

## CONCLUSIONS

1. Any gift the Taxpayer makes during the Taxpayer's life of any undivided fractional interest (which for the purpose of the letter ruling request may include any fraction equal to or exceeding 1/12) in any work of the Collection accepted by the Donee subject to the terms and conditions of the GLA shall qualify as a charitable contribution under §170(c) of the Internal Revenue Code to the extent otherwise provided by §170.

2. Unless an election is made by the Taxpayer under §170(b)(1)(C)(iii) of the Code, the

amount of the income tax charitable contribution attributable to each gift by the Taxpayer of an undivided fractional interest in a work of the Collection to the Donee shall be determined under §170(b)(1)((C)(i) and shall equal the product of (a) such fraction, times (b) the fair market value, determined without regard to the existence of the GLA, of the entire work of art at the time of the gift of the fractional interest; provided, however, under §170(b)(1)(C)(ii) the aggregate amount of all charitable contributions described under §170(b)(1)(C)(i) in such year shall not exceed 30 percent of the Taxpayer's contribution base as defined in §170(b)(1)(F). Unless otherwise elected by the Taxpayer under §170(b)(1)(C)(iii), the limitation of §170(e)(1)(B) for gifts of tangible personal property, where the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under §501, shall be inapplicable to the subject gifts.

3. If the Taxpayer makes the election under §170(b)(1)(C)(iii) of the Code with respect to the Taxpayer's gifts of capital gain property for a taxable year, then the amount of the income tax charitable contribution attributable to any gift in that year of an undivided fractional interest in a work of the Collection that is capital gain property shall be subject to the limitation of §170(e)(1)(B) and shall equal the product of (a) such fraction, times (b) another fraction, the numerator of which is the Taxpayer's adjusted basis in the Taxpayer's interest in the work immediately preceding the gift of the fractional interest, and the denominator of which is the fraction representing the portion of the Taxpayer's ownership in the entire work immediately preceding the gift of the fractional interest. In such case, the 30 percent limitation under §170(b)(1)(C)(i) shall not apply to the subject gifts.

4. The mere execution of the GLA by the Taxpayer will not constitute a completed gift of any items of artwork under §2511 of the Code.

5. The Taxpayer's transfer, during the Taxpayer's life, of undivided fractional interests in any items of artwork in the Collection to the Donee will constitute completed gifts that qualify for the gift tax charitable deduction under §2522 of the Code.

6. The value of the gift under §2512 of the Code, and the amount of the gift tax charitable deduction under §2522 allowable for each gift by the Taxpayer of an undivided fractional interest in an item of artwork, will be the product of the fair market value of the artwork (determined without regard to the existence of the GLA) multiplied by the fraction of the item transferred. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

7. If, during the life of the Taxpayer, the Taxpayer transfers the ownership of an undivided fractional interest in any items of artwork in the Collection to the Taxpayer's spouse in accordance with the terms of the GLA discussed above, then the gift of such fractional interest will qualify for the gift tax marital deduction under §2523(f) of the Code, provided the election is made under §2523(f)(4).

8. The value of the gift under §2512 of the Code, and the amount of the gift tax marital deduction under §2523 allowable for each gift by the Taxpayer to the Taxpayer's spouse of an undivided fractional interest in an item of artwork, will be the product of the fair market value of the artwork (determined without regard to the existence fo the GLA) multiplied by the fraction of the item transferred. Approval rights retained by the Taxpayer will have no value for gift tax purposes.

9. Any loan of the items of artwork in the Collection from the Taxpayer to the Donee will not be treated as a transfer for gift tax purposes under §2503(g) of the Code.

10. Upon the death of the Taxpayer, survived by the Taxpayer's spouse, only the individual fractional interest of the items of artwork in the Collection retained by the Taxpayer will be includible in the Taxpayer's gross estate. Approval rights retained by the Taxpayer that pass to his successors in interest will have no value for federal estate tax purposes under §§2031 and 2033 of the Code.

11. Any bequest to the Donee under the terms of the Taxpayer's will of the Taxpayer's retained undivided fractional interest in the items of artwork in the Collection will qualify for the estate tax charitable deduction under §2055 of the Code.

12. The amount includible in the Taxpayer's gross estate under §§2031 and 2033 of the Code, with respect to such retained undivided fractional interest will be the fair market value of the item of artwork multiplied by the Taxpayer's fractional interest in the item. The amount deductible under §2055 with respect to the item bequeathed to the Donee will equal the value included in the gross estate.

13. Any bequest to the Taxpayer's spouse of any retained fractional interest in the items of artwork in the Collection as provided in the proposed codicil and the GLA will qualify for the marital deduction under §2056(b)(7) of the Code, provided the election is made under §2056(b)(7)(B)(v).

14. The amount includible in the Taxpayer's gross estate and the amount deductible as an estate tax marital deduction under §2056(b)(7) of the Code will be the product of the fair market value of the item of artwork (determined without regard to the existence of the GLA) multiplied by the fraction of the item transferred.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This ruling is directed only to the taxpayer requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely yours,
Associate Chief Counsel
(Income Tax and Accounting)
By: KARIN G. GROSS
Senior Technician Reviewer
Branch 1

Enclosures (2)
Copy of letter
Copy for section 6110 purposes
cc: