

Tangible Personal Property: Advising Estate and Financial Planning Clients Concerning Furniture, Art, Collectibles and Similar Assets

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Introduction/Overview:

While most practitioners assume that planning for tangible personal property is a simple matter that the estate planning attorney can and should address, for the client that can be a dangerous assumption. Often practitioners have knowledge or information that counsel is not provided, a longer and more ongoing relationship with the family to understand the issues involved, and the ability to address a myriad of ancillary issues that would otherwise fall between the planning cracks. Catching those loose ends and assuring that the overall planning is coordinated is exactly the role practitioners are growing into as trusted advisers.

Example: Is it likely that the estate planning attorney will understand what personal property is owned by the client's business or professional practice? Only the CPA may have that knowledge. Most estate planners draft generic personal property clauses that will be ineffective for property owned in business solution. Further, if there is a casualty, has the client properly insured the assets involved? If paintings that the client considers personal were purchased by her dental practice for display in the office, will a personal insurance policy cover them? There are a myriad of such issues that can be overlooked.

While lawyers call it "tangible personal property" but many heirs call it "a fight!" Client bequests of coin collections, family heirlooms, grandmother's china and similar property should be a positive step of their passing on a legacy and memories to the next generation. Too often it becomes a personal nightmare. Practitioners are often ideally suited to prevent these tragedies if they take a broad view of their role in the process and bring all their knowledge of the client to the fore.

While this article focuses on bequests of personal property, Proper planning for tangible property requires that a number of disciplines and issues be addressed, including:

- Insurance and protection
- Business and Professional Practice Issues
- Title and ownership
- Gifts and Bequests

The following checklist addresses many of the issues involved, but as with all such planning a good measure of inquisitiveness and common sense, coupled with the independence of a practitioners (family members are often far too emotional) can be vital to helping guide a client to achieving their goals.

✓ Business and Professional Practices Complicate the Personal Property Issue:

When a client is asked by his or her estate planning concerning the disposition of personal property, they consider the tangible assets in their home. Generally, unless the client has some specific or strong desire concerning personal property dispositions, the discussion and planning rarely extends beyond the inclusion of a pretty boilerplate clause in the client's will. Consider the following and the implications to the importance of a CPAs role in this process.

Example: Jane Smith owns an S corporation that provides advertising services. Jane has previously been married several times and is presently married to her third husband, an advertising sales executive working in her company. She has children only with her first husband. The advertising business over the years has accumulated an impressive collection of modern art, furniture and other collectibles to decorate the offices with a sophistication necessary for the businesses client base. Depreciation is not allowed for art and collectibles except in the unusual circumstance that they are subject to wear and tear. Simon, 103 TC 247. However, the reality is that clients have commonly purchased these items in the business entities. Jane anticipates that her children will inherit her art collection under the will she signed with her estate planner. The reality is that the art and related items are owned by her S corporation and, absent express provisions to the contrary, will be purchased as part of the business buy-sell agreement by her new husband and several other partners.

Few estate planners look into the ownership of business personal property, and even fewer clients understand the ramifications. CPAs, who have knowledge of the client's business matters, and become part of the client's estate planning team are uniquely situated among all client advisers to identify these types of inter-disciplinary issues. A CPA, with access to business depreciation and Section 179 records may be the only professional to be aware of the existence of important personal property for which a client has specific desires. Although Section 179 requires that property must be qualified IRC Section 1245 property in order to be expensed, property can be misclassified. With a deduction of up to \$250,000 in Section 179 property in 2009 tangibles that should be characterized as non-deductible may be overlooked.

Planning for client's tangible property when the client has professional practices and business should thus consider:

- Which entities own which property.
 - If a operating entity or professional practice owns the property, the distribution of that entity's equity will control the distribution of the personal property unless express provisions to the contrary are made in the governing document. There may be income tax consequences as well (e.g., IRC Sec. 1245 recapture, etc.).
 - If a family limited partnership (FLP) owns personal use property it could undermine the FLPs tax objectives and asset protection

objectives. Estate of Charles E. Reichardt v. Commissioner, 114 TC 144.

- If a trust owns personal use property the identify of the beneficiaries using the property must be consistent with the provisions of the trust and the trustee must have the power and authority under the trust instrument to hold personal use property.
- Is the property properly insured by that particular entity.
- Do the governing documents for the entity address any special treatment of that property (e.g., if there is a valuable art collection does a young partner buying in automatically share in that asset).
- How does the clients estate planning documents (will, revocable trust) coordinate concerning this property with the governing business documents.
- What other issues might exist.

✓ **Scheduled Property Insurance Can Help or Hinder the Bequests of Personal Property:**

Clients commonly leave key personal assets off their insurance policies for a myriad of reasons:

- To save insurance costs.
- Because they are not aware that the property is not covered under the blanket or general coverage limits in the policy.
- To avoid documenting an asset they believe can transfer without IRS knowledge if it is not listed.
- Because the insurance is paid for through a business.

Practitioners should inquire as to appropriate insurance coverage during a financial review, and recommend bringing in an independent insurance consultant if there are complications or uncertainties. Practitioners should consider the following issues:

- Is the property appropriately listed. Mistakes do occur when insurance company staff input descriptions of property into policy riders. In some instances a transposition or incorrect date could have significance. Be certain that the client has reviewed the details of each entry.
- Are the listings complete?
- If there is a letter of instruction or a specific bequest in the client's will as to personal property are those listings consistent with the schedule property on the insurance policy. Does the practitioner have copies of the list or letter of instruction in the client's estate planning permanent file.
- Are the values listed current. Many clients never review the values, which can change substantially over time. In recent recessionary times many values might be much lower than previously listed permitting cost savings by appropriately adjusting values. If inflation increases significantly in the future, current values could prove woefully inadequate. Some insurance policies use

periodic inflation adjustments to values. But these could prove significantly incorrect in either direction, especially during volatile economic periods.

- Is the correct entity listed as the owner of the property.
- Are there conditions concerning the location, storage or protection for the particular property and if so is the client adhering to these.
- Does the client have adequate photographs and other details concerning the property properly preserved. Should the practitioner have copies of these records in a permanent file.
- If the client has multiple residences, is the personal property located in each residence properly insured. If the residences are in different states has it been verified which policies cover which listed property.

✓ **Ancillary Probate and Tangible Personal Property:**

Many clients worry excessively about the costs and complications of the probate process. While this is often over done, extensive personal property holdings can present unique issues that are completely overlooked. If a client owns tangible personal property in a state other than the state in which they are domiciled, addressing that property may be important. Valuable art work in a different state, even if located in a rented apartment in that state, could trigger the need for an ancillary probate proceeding on the client's death. Further, tangible property in a different state could be subject to that state's estate or inheritance tax system with surprising results. Consider whether it might be advisable for the client to consult with an estate attorney about transferring title to a revocable living trust to avoid these issues.

✓ **Powers of Attorney/Living Trusts and Personal Property:**

Executing a durable power of attorney is routine for almost every financial plan. However, has the client really considered the possible implications of making an agent (or successor trustee under a revocable living trust) responsible for tangible property.

- Your fiduciary cannot know how to insure property, or which property to insure without factual detail. Many clients, especially the elderly engaged in estate planning and fearing an estate tax eliminate personal property from insurance coverage under the ploy that the IRS will therefore not discover it on audit. Apart from the obvious fraud issues, that property will not be covered by insurance, unless it falls under the general blanket coverage involved.
- Another issue raised if valuable personal property is omitted (either to save cost or feign its non-existence for estate tax purposes) is that if the client becomes incapacitated, the most authoritative source of information, existing scheduled property data, will not be adequate for those assisting the client to assure proper coverage. If you, as the practitioner are the agent or trustee, or representing the agent or trustee, caution them about the potential liability that could arise.

- **Example:** Your client, Mary Jones, intentionally omitted art work from her list of scheduled property on her homeowner's policy believing that the art would simply pass to her heirs without notice by the estate tax authorities. Unexpectedly, Mary becomes incapacitated. The agent under her durable power of attorney (or successor trustee under her revocable living trust) continues to pay insurance premiums on existing coverage. There is a fire and the house burns. The children present their lawyer a personal letter of instruction their mother Mary had written directing the allocation and distribution of the valuable artwork. Is the fiduciary liable? Should the fiduciary had investigated the home to assure adequate coverage? If the artwork would have been obvious on such a review, should the fiduciary be held personal liable?
- What does the power of attorney provide for concerning gifts? If an agent does not understand the value of a collection, gifts could destroy a substantial asset. What does the gift provision provide for? If the client desires that certain heirs eventually receive certain collectibles, the gift provision should be tailored to reflect that. Yet in most instances clients sign "boilerplate" or standard powers with gift clauses that don't address these nuances.

✓ **It is Often About Emotions, Not Just Money:** Distributions of tangibles by gift during the client's lifetime, or at death under a will or living trust, often has much more to do with inter-personal relationships, emotions and other qualitative considerations, then with tax, legal or other formal matters. This makes planning difficult and less susceptible the merely applying logic or objective considerations.

✓ **What Factors Matter?:**

There are a host of factors which clients might evaluate in determining what to gift or bequeath.

- Reactions and issues depend on type of property. People view guns, versus art, etc. differently.
- Differences exist between genders on how this is handled.
- Some people feel if they gave an item to decedent they should get the item back themselves.
- **Example:** John and Mary Jones received an exquisite 1,000 year old Oriental vase from their daughter Jenny for their 50th anniversary. John and Mary's wills left all property to the survivor and then on the second death to the children as determined in the executor's discretion. When Mary died shortly after John, Steven, their eldest son and a lawyer, was named executor. Steven was well aware of the sentimental attachment Jenny had to this special and costly gift she gave their parents. Steven divided up the property as he felt appropriate. Because of a long held grudge with Jenny over a trifling family issue decades old, he intentionally took the Oriental vase for himself. The fireworks began.

- If property is left to two children and the issue of a deceased child the relationships between the generations can vary substantially. Younger generation may be viewed differently by older generation and this can create conflicts.

✓ **Spouses of Children Often Complicate the Dynamics:**

Apart from all the jokes about son-in-laws and daughter-in-laws and the trouble they cause, interposing non-blood relatives in the distribution of such emotionally laden assets as a parent or grandparent's personal property can often exacerbate what in even congenial families can be a difficult task.

- What should the client do about spouses of beneficiaries. Should they be expressly prohibited in the will, trust or letter of instruction from participating in meetings or conversations concerning the distribution of personal property? Accounting practitioners almost invariably have a longer and more frequent history with the family than an estate planning specialist merely hired to complete a will. Practitioners may be aware of family relationship issues that the clients won't realize are important enough to inform the estate planner, or which they intentionally hide for embarrassment.
- Many people feel strongly that if it is to be divided up in person spouses of heirs should not be present for this since it may create more issues.
- This is particularly true of some beneficiaries don't have spouses and others do and there is a feeling of the couple ganging up.
- When beneficiaries are not descendants, e.g., nieces and nephews, they may not know each other which can change dynamics and they may have very different relationships with each other.

Discussing these issues with the client, or bringing them up at an estate planning meeting, may not appear like a significant service to offer, they really could prove invaluable to the client and his or her family.

✓ **"Fairness" Is that the Client's Objective:**

Many clients endeavor to distribute their estate equally to their heirs. If there are four children, the most common dispositive scheme is 1/4th to each. However, for personal tangible property, equal is rarely possible because these assets are rarely fungible, or divisible, and are often unique and have non-quantifiable emotional value. Thus, instead of equality some overarching concept of fairness may be the guiding concept for the client. That fairness concept, however, is rarely communicated. Documenting it might minimize the conflict that heirs may experience.

- Consider each beneficiary's perception of fairness to keep the peace.

- Are beneficiaries motivated by monetary gain or personal wishes for property. Does Junior really want grandma's china because of childhood memories or is he looking for the value of the antique china? Or perhaps he doesn't care a hoot but just wants to make sure Sis doesn't get it!

✓ Who Determines the Allocation of Property:

- What if children are in litigation with each other. May need a referee to divide property.
- Spouses with multiple marriages and dies there could be children from one or more previous marriages and the current marriage and they may not get along well. One spouse dies and may leave to surviving spouse who cuts out deceased spouse's children.
- If a beneficiary is an executor and charged to divide property you have a conflict in the role of an executor trying to be fair and the role of beneficiary.
- Many wills defer the decision as to allocation of property to the fiduciary (executor or personal representative). In some instances this can be an effective approach, in other's a recipe for disaster. If a neutral party is selected as fiduciary this might be optimal. In other instances, such as when the heirs are amicable, naming an heir who is familiar with the property and the desires of the various heirs can be ideal. The only way for a client to make an appropriate determination is to talk through the options and the possible consequences of each.

✓ Second and Later Marriages:

Second and later marriages complicate the allocations of personal property. One of the most problematic approaches is the almost ubiquitous language many estate planning attorneys put in wills and trusts simply distributing personal property to the surviving spouse, or as the executor or personal administrator directs.

- If the surviving second (or later) spouse is given a life estate in the primary residence, does the furniture go along with the life estate or might the children from another marriage strip the home of all art and furniture without violating the life estate.
- A similar issue can arise if the home is bequeathed to a QTIP trust for the surviving spouse with the intent that on his or her death the house will be preserved for the children of the prior marriage.
- If property has particular emotional attachment it may warrant expressly addressing even if the monetary value is modest. **Example:** Jane Smith died and her husband Larry Smith remarried to Ida. All of the furniture and belongings of Jane stayed with the house. Jane and Larry's children were agreeable with this concept at the time. However, when Larry died and all the personal property,

including personal belongings such as Jane's jewelry and religious objects would kept by Ida, the Jane's daughters were incensed.

✓ **Tax Allocation and Related Cost Issues:**

Generic tax allocation clauses are commonly used by attorneys, but are potentially problematic if there is valuable personal property. If the relationships of the heirs is already volatile, a poorly crafted tax allocation clause can turn the situation into an explosive battle.

- If a beneficiary is going to retain value personal property bequeathed they will need to either have adequate resources to pay the allocable estate taxes associated with such property, or the will or trust must allocate the taxes to other bequests.
- **Example:** Tom Smith bequeaths his art collection worth \$250,000 to his daughter and his antique furniture worth \$150,000 to his son. Tom hopes each child retains this property. The remainder of Tom's estate consists of a house worth \$1.5 million and \$4 million of investment assets. Since his only heirs are his son and daughter these assets are divided equally between his son and daughter. Tom's will directs that each beneficiary pay his or her allocable share of taxes. This is fair since the personal property his daughter will receive is valued at more, she will pay more taxes. There is also no issue as to liquidity to pay the estate taxes associated with the bequests of personal property because there is adequate liquidity flowing to each beneficiary under the residuary (remainder) of the will.
- **Example:** Tom Smith bequeaths his art collection worth \$250,000 to his niece and his antique furniture worth \$150,000 to his nephew. Tom hopes that each of his niece and nephew retains this property. The remainder of Tom's estate consists of a house worth \$1.5 million and \$4 million of investment assets and these assets will be divided equally between Tom's two children. Since his only remaining heirs are his son and daughter the estate, after the specific bequests, is divided equally between his son and daughter. Tom's will directs that each beneficiary pay his or her allocable share of taxes. This is "fair" but there is a significant issue as to liquidity to pay the estate taxes associated with the bequests of personal property because there is no liquidity flowing to each personal property beneficiary since all of Tom's liquid assets flow under the residuary (remainder) of the will to his children. Tom could mandate in the will that all estate taxes be born by the residuary and not by the personal property heirs.
- Failing to address the tax allocation could result in ambiguities that create suits among heirs, or that force heirs to sell the property the client/testator wished them to have, in order to pay tax. With the substantial increase in the federal estate tax exclusion to \$3.5 million this is far less of an issue than in the past, but it is not clear what the future rates will be for the estate tax, or the amount of exclusion. Further, state estate and inheritance taxes can be significant in some instances.

✓ **Unreported Cash Holdings and Safe Deposit Boxes:**

Safe deposit boxes can create a host of issues:

- What is in a client's safe deposit box? Does anyone really know?
- What precautions should be taken to assure a proper accounting when the box is opened?
- What is disclosed on the estate tax return?
- Is there a list of the personal property and contents of the box?
- Are the contents insured? Should they be?

✓ **Should Heirs Physically Meet?:**

- The most direct and simplest approach IF it is workable is for the heirs to meet.
- Consider having an independent company list all property before the meeting so they have details and values for everything.
- Geographic issues may make this impossible. It's becoming more common for the executor to circulate photos or post digital photographs on a family website.

✓ **Minimizing the Likelihood of Disputes:**

- The people involved need to really deal with the real issues. If there are hostile relationships, especially in second and later marriages they will have to be addressed.
- Involve and coordinate all relevant people. Try to foster cooperation between the parties.
- Remember the old maxim: "An ounce of prevention is worth a pound of cure."
- If the decedent knows or anticipates an item will be a problem perhaps they can document a specific bequest of that item that would otherwise be in issue and it will avoid the problem. Example: There is one vintage motorcycle and each of the grandson's want it. Make a specific bequest of it to one named person.

✓ **Side Letter of Instruction to Distribute Property:**

- Consider preparing a side letter with details.
- 28 states permit a side letter to dispose of tangibles. Many states require that it be dated and in existence when the will is executed.

- More than a dozen permit an evolving letter that can be updated anytime. The advantage of an evolving side letter is you can include statements of wishes concerning personal property (e.g., why you divided it the way you did).
- 22 states that don't permit a side letter to a will, such as Illinois. In these states you might complete a side letter to a revocable living trust. This might avoid the statutory restriction on the use of side letters with wills in those states.
- If the side letter is non-binding the fiduciary (executor or trustee) may still feel a strong moral obligation to follow the instructions.
- If details are written it may avoid/minimize tensions and arguments.
- Side letters can be beneficial or problematic. Most attorneys believe a side letter is best if in testator's own handwriting and if it includes statements as to why they are dividing assets in the particular manner that they choose. This is information that would not normally be included in a will.
- Issues and conflict can be created by side letters. Was the person competent when they signed it? Did they have sufficient mental capacity to make a binding letter? Was their undue influence at the time?
- Delaware permits a list of tangible personal property. When the list concept was developed you are only speaking of insignificant household contents but it can really include very expensive art, etc. So the fact that a law permits a side letter doesn't make it necessarily advisable.

✓ **What Not To Do:**

- Whatever is done, don't ignore the issue.
- Many wills provide that if children cannot agree item is sold. This could be a tragedy to sell a family heirloom. This might also give the one difficult family member the ability to destroy a family legacy. Is this really what anyone wants? Must discuss how to break up property if heirs don't agree.
- You can leave the decisions as to how to distribute personal property up to the executor but this is tough as it may alienate the executor from the other heirs.

✓ **Ways to Divide or Allocate Tangible Personal Property:**

- E-divvy up. Give each heir "points" and have them bid at a silent auction on the properties. This enables each heir to try to get what they really want. For example, if you have an independent company list and appraise all personal property, give each heir the total number of points that corresponds to the dollar value of all tangibles. This way, each heir is on equal footing.
- Consider drawing lots.
- Consider a silent auction, with one bid each heir.

- Consider a rotational selection system. Example: Oldest picks first down to youngest. Then for round two youngest up to oldest.
 - Should this be done in aggregate or by category?
 - If children of different gender it could be a problem.
 - How are inequities made up (e.g. out of residue) or should they be? Should cash be paid to equalize?
 - Having cash equalization causes heirs to be serious about what they are getting.
 - Issues of having to value the assets to equalize with cash which can be costly or problematic.

✓ **Other Tips and Issues:**

- Consider an independent appraisal of all personal property.
- Don't put heirs in the same room if they don't get along.
- Ask heirs to prioritize what they would like.
- Per stirpes versus per capita.
- Shipping and insurance costs should be considered. Who bears and how will this influence decisions.
- Consider and plan for digital estate planning.
 - This can be very emotional.
 - Example in Time Magazine. Memories on Facebook. Very emotional. All pictures are on line at snapfish, etc. These are all password protected. May be inaccessible without a court order to get the password.
 - Legacy locker. New concept to store passwords in a safe manner.
- Religious and cultural issues may impact what is done. Religious associations with personal property may influence which heir should receive the property. Without an understanding of the religious underpinnings these matters can never be addressed properly.

✓ **Conclusion:**

Planning for personal tangible property sounds seductively simple and it affects everyone. But the common presence of this matter belies the unbelievable complexity, substantial problems and family rifts it can create. Planning is really critical.