Abstract: Many collectibles are more sought after, and more valuable, than ever. But that value has tax consequences when collectibles are sold at a profit, donated to charity or transferred to the next generation. This article explains those tax consequences and some of the applicable IRS rules.

Do you know the tax impact of your collectibles?

One person's trash is another person's treasure. That's never truer than when dealing with collectibles — those seemingly innocuous objects for which many people will pay good money. In fact, many collectibles are more sought after, and more valuable, than ever. But that value comes with tax consequences when you sell collectibles at a profit, donate them to charity or transfer them to the next generation.

Sales

The IRS views most collectibles, other than those held for sale by dealers, as capital assets. As a result, any gain on the sale of a collectible that you've had for more than one year generally is treated as a long-term capital gain.

But while long-term capital gains on most types of assets are taxed at either 15% or 20% (or 0% for taxpayers in the 10% or 15% ordinary-income tax bracket), capital gains on collectibles are taxed at 28% (or your ordinary-income rate, if lower). As with other short-term capital gains, the tax rate when you sell a collectible that you've held for one year or less typically will be your ordinary-income tax rate.

Determining the gain on a sale requires first determining your "basis" — generally, your cost to acquire the collectible. If you purchased it, your basis is the amount you paid for the item, including any brokers' fees.

If you inherited the collectible, your basis is its fair market value at the time you inherited it. The fair market value can be determined in several ways, such as by an appraisal or through an analysis of the prices obtained in sales of similar items at about the same time.

Donations

If you want to donate a collectible, your tax deduction will likely depend both on its value and on the way in which the item will be used by the qualified charitable organization receiving it.

For you to deduct the fair market value of the collectible, the donation must meet what's known as the "related use" test. That is, the charity's use of the donated item must be related to its mission. This probably would be the case if, for instance, you donated a collection of political memorabilia to a history museum that then puts it on display.

Conversely, if you donated the collection to a hospital, and it sold the collection, the donation likely wouldn't meet the related-use test. Instead, your deduction typically would be limited to your basis.

There are a number of other rules that come into play when making donations of collectibles. For instance, the IRS generally requires a qualified appraisal if a deduction for donated property tops $5,000. In addition, you’ll need to attach Form 8283, “Noncash Charitable Contributions,” to your tax return. With larger deductions, additional documentation often is required.

Estate planning

Transfers of collectibles to family members or other loved ones, whether during life (gifts) or at death (bequests), may be subject to gift or estate tax if your estate is large enough. And you may be required to substantiate the value of the collectible.

For estate tax purposes, if an item, or a collection of similar items, is worth more than $3,000, a written appraisal by a qualified appraiser must accompany the estate tax return. Gifts or bequests of art valued at $50,000 or more will, upon audit, be referred to the IRS Art Advisory Panel.

Even if your estate isn’t large enough for gift and estate taxes to be a concern (or the federal gift and estate taxes are repealed, as has been proposed), it’s important to include all of your collectibles in your estate plan. Even an item with little monetary value may have strong sentimental value. Failing to provide for the disposition of collectibles can lead to hurt feelings, arguments among family members or even litigation.

Proper handling

Collecting can be addictive. But the tax implications are difficult to sort out. We can help you determine how to properly handle these transactions.

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