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Exclusive: Investing in art, collectibles requires careful planning

By Brian Bandell – Real Estate Editor, South Florida Business Journal
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Oscar Seikaly of NSI Insurance, insures art and collectables, and has his own impressive collection on display at the NSI offices in Miami Lakes.
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Whether it's spending $100 million for an original Andy Warhol painting, $28 million for a 1956 Ferrari 290 or $3 million for an X-wing starfighter used in the original "Star Wars," investing a significant amount of money in physical items requires careful wealth management planning.

Many wealthy people find fulfillment in filling their homes with art and collectibles, but they could get hit with a huge tax bill if they sell these items, or they die and their heirs need to pay estate taxes based on their value. With the threat of hurricanes in Florida, having iron-clad insurance coverage on pricey art and collectibles is a must.

While art and collectibles don't have the same high liquidity as stocks and they don't general cash flow like real estate, they can be a lucrative asset class. According to the 2023 Knight Frank Luxury Investment Index, the value of art owned by wealthy individuals increased 30% in the 12 months ended June 30, while the value of their watches and jewelry grew 10% over that time. Over the past 10 years, the value of their art more than doubled.

The increase in value can create challenges. Coral Gables Trust CEO Donald Kress said he previously had a client from Chicago with a huge art collection that represented over 70% of her estate's value. He worked with her to create family limited partnerships that owned the art and shifted the ownership of those partnerships to her children.

Coral Gables Trust Co. CEO Donald A. Kress

COURTESY OF CORAL GABLES TRUST CO.

Another of Kress' clients had over $10 million in Ferraris that he assumed his heirs would keep. But he later learned they didn't want the sports cars.

"If you are a serious collector, you need to engage in planning strategies to keep value out of your estate for federal estate tax purposes," he said.

However, Kress noted that the huge value increases cited for art are based on pieces that trade at auction, not on the majority of art that doesn't sell in a given year. Buyer tastes vary greatly, with some art styles gaining in value and others falling out of favor, he said. The worst-case scenario is an estate forced to sell an art collection during an economic downtown, Kress said.

"In negative markets, even if you have a good collection, people are financially squeezed and there's pressure on sellers," he said. "You don't want to sell at the same time a lot of other people are trying to sell."

An informed buyer

While beauty is in the eye of the beholder, the value of high-end art and collectibles isn't strictly subjective. There are steps buyers can take to ensure they're receiving real value in exchange for their dollars.

Reed Horth, owner of Miami-based art dealer Robin Rile Fine Art, said buying art for investment, as opposed to personal enjoyment, is a tricky gray area because trends change. What's important is that the buyer works with an art consultant to make sure they're buying an authentic piece, he said. There have been instances in recent years of replica art being sold for millions of dollars.

Buyers also need a professional to monitor the transaction because art sales are sometimes used to launder money, and there might be a lien or financial encumbrance on the art, Horth said. The most expensive art is usually purchased with all cash, but less expensive pieces may have loans on them.

"It's a largely unregulated market," Horth said. "You need an extra set of eyes on it."

Ownership structures

Once a buyer purchases art or a collectible, they need to decide how to structure the ownership.

Most high-priced art and collector pieces are not owned in an individual's name, but in a trust structure or a limited liability company, said Carlos Battle, a senior wealth advisor at J.P. Morgan Private Bank in Miami. An LLC protects the asset from creditors against the individual and offers a more simple way to transfer the asset to the next generation, usually as a gift, he said.

Battle noted the maximum amount a person can gift to heirs over their lifetime without paying taxes on it is $12.92 million. That amount will be cut in half in 2025 unless Congress takes action. He encourages wealthy clients to make gifts before 2025 to take advantage of the larger amount while they still can.

It's often best to gift assets to heirs sooner, in case they appreciate in value, Battle said.

"If the asset is worth $10 million and I gift it to the kids now, I used that amount toward the limit," Battle said. "But if I keep that asset in my own name and it increases much more in value and exceeds the limit, then my estate has a big tax bill."

If the art and collectibles are worth well above the gift limit, one way to cover some of the estate taxes is to secure a life insurance policy that's worth about the same amount as the taxes that would be owed, Battle added.

A charitable remainder trust for art and collectibles that are intended for sale has many tax benefits, said attorney Romney C. Rogers Jr., of Fort Lauderdale-based Rogers, Morris & Ziegler. The owner can create a trust with a charitable beneficiary and gift the art to the trust, which results in a charitable tax deduction. The trust could eventually sell the asset – likely avoiding capital gains tax – and then the funds left in the trust could be paid out to the wealthy individual annually, like interest payments. When the individual dies, whatever balance remains in the trust must go to the designated charity, Rogers said.

Another way to avoid a big capital gains tax bill on art and collectibles is a deferred sales trust, said Grant Conness, managing director of Global Wealth Management in Fort Lauderdale. This allows sellers to defer capital gains tax for 10 to 20 years while reinvesting the proceeds of the sale into income-producing assets and collecting a monthly payment, he said. The downside is the seller can't use the funds from the sale right away.

Grant Conness, Global Wealth Management

GLOBAL WEALTH MANAGEMENT

"A lot of time, people don't think about tax ramifications in the collectible world like they would with real estate or other investments," Conness said. "But if you do advanced planning, you can alleviate the tax liability."

People with a huge art collection could create a nonprofit organization to run their own museum, said Oscar Seikaly, CEO of Miami Lakes-based NSI Insurance Group. Related Group Chairman Jorge M. Pérez and the Rubell family set up their museums in Miami. Seikaly said a museum allows people to store large pieces outside their homes, take charitable deductions, avoid estate taxes and share the art with the community. However, it's often expensive to run a museum.

"With a museum, the art is out of your hands, but according to what you want done with it," Seikaly said. "But you can't be involved once you give it away."

Oscar Seikaly of NSI Insurance, shows off some of his contemporary art on display at the NSI offices in Miami Lakes. NSI insures art and collectables, and Seikaly has his own impressive collection on display at the NSI offices in Miami Lakes.

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Insurance a priority

Documentation is crucial for insuring valuable items, Seikaly said. Owners must show how they acquired the piece and identify when it was created. He recommends appraising items worth $1 million or more every two years to capture their gain in value. If an item that was last appraised five years ago is destroyed, the insurance carrier will often pay its last appraised value and not any appreciation since then, he said.

Property owners should plan for a hurricane by keeping a list of the most valuable pieces they must secure, Seikaly said. When there's a storm threat, those items should be moved to a safe place; the insurance company may even cover the cost of moving valuable art into storage, he said.

The art should also be stored in a secure place in the home where it's unlikely to be damaged, especially by direct sunlight, he added.

Insurance companies are often picky about where valuable art is kept because of storm risks. Seikaly said an executive recently moved to Florida and wanted to place three pieces of valuable art in his Brickell Avenue condo, but his insurance company told him the location was too risky.

“Ten years ago, they would never ask these questions,” Seikaly said. “But the insurance company doesn’t look at a particular client, they look at exposure. They already have $4 billion worth of exposure in downtown Miami.”

Coral Gables Trust’s Kress said some collectors reduce insurance costs by installing more security, storing art in vaults or loaning it to museums, which often cover insurance. Some people even display a copy of the art in their home, while the real painting is in a vault.

Seikaly has 80 pieces in his office from his personal art collection, and NSI Insurance covers the cost of insuring them. That’s an option for collectors who want to place their art in their offices or real estate developments. Seikaly decided to gift other pieces to a museum, but only after he gets to enjoy them for a few more years.

“I used to say I will never sell my art, I will leave it to my kids,” Seikaly said. “But my kids don’t have the same taste. They will take half of it.”