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the next
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THE ASPEN INSTITUTE
PROGRAM ON PHILANTHROPY
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The Aspen Institute **Artist-Endowed Foundations Initiative | AEFI**, an initiative of the Institute's Program on Philanthropy and Social Innovation, conducts research, publication, professional education, and leadership programs to strengthen the emerging artist-endowed foundation field's charitable impact in art stewardship and cultural philanthropy. www.aspeninstitute.org/aefi

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Flaws in the Testamentary Plan or Document

ADDITIONAL ENTRIES

Omission of Copyrights. Page 8.

Omission of Copyrights, Further. Page 8.

ADDITIONAL CITATIONS

²⁰ Minnigh and Stutzman. *Planning for Authors, Musicians, Artists, and Collectors* (Portfolio 815-3rd: Estate Planning Series). Bloomberg BNA Tax Management, 2018. Page 10.

²¹ *Ibid.*

Notes on Estate Planning for Artists Endowing a Private Foundation

Preface

The National Study of Artist-Endowed Foundations, the flagship research program of the Aspen Institute Artist-Endowed Foundations Initiative/AEFI, was initiated in 2007 as the first in-depth examination of private foundations created in the US by visual artists. The Study's initial research findings were released in 2010. Subsequent updates, *Study Report Supplement 2013* and *Study Report Supplement 2018*, track the field's evolution at five-year intervals. Additional publications distill the Study's findings specifically for artists, including *A Reading Guide to the Study Report for Artists and Their Family Members* (2013) and *A Guide for Artists and Their Lifetime Foundations: The Dos and Don'ts* (2018). This publication, *Notes on Estate Planning for Artists Endowing a Private Foundation* (2019), continues that effort. AEFI publications are available at www.aspeninstitute.org/aefi.

AEFI publications are written for a non-specialist audience. The information in all AEFI publications is general and solely educational and nothing in their contents is intended as legal advice, nor can it be used in place of advice from qualified legal counsel.

The mission of AEFI is to help the next generation of artist-endowed foundations make the most of its donors' generosity in service to a charitable purpose. It aims to do this through research, publication, leadership convenings, and educational programs that fill the significant information gap facing individuals involved in creating and leading new artist-endowed foundations. By developing and sharing important information, AEFI aims to shorten the steep learning curve inherent in these complex entities and help ensure that charitable resources are spent on charitable purposes in art stewardship and cultural philanthropy, not costly lessons.

The findings of the National Study of Artist-Endowed Foundations, most recently updated in 2018, point to a number of practical concerns about estate planning for artists, particularly those who intend to endow a private foundation. This publication briefly summarizes these key issues with the aim to help artists engage more effectively in the estate planning process and more successfully realize their intentions for cultural philanthropy and the posthumous stewardship of their creative works.

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The Challenge for Artists

It is important to acknowledge that many artists will not be well served by creating a tax-exempt charitable entity as the means to steward their creative works posthumously. This includes artists whose primary estate planning concern is to provide a financial benefit to family members, a function that by definition will require a non-charitable vehicle such as a noncharitable trust or a simple noncharitable bequest. It also includes those artists whose works have only a nominal current market value and who are unable to provide sufficient alternative sources of economic support (such as easily liquidated real estate holdings, financial investments, or a life insurance policy) to make a foundation financially viable.

But what of those artists for whom a private foundation in the form of a charitable trust or nonprofit corporation could indeed be an appropriate option in light of a public benefit purpose and sufficient assets? They have a different set of concerns.

Once committed to the decision to create a foundation, the choices such artists make in estate planning can have a significant impact on the viability of the entity they intend as the mechanism to fulfill their charitable intentions for art stewardship and cultural philanthropy. Failing to act, waiting too long to act, acting without appropriately qualified guidance, or acting but making uninformed choices—i.e., not querying the potential results of the choice that has been recommended—can compromise the best intentions and undermine the most generous commitment of resources. To help avoid these pitfalls, AEFI offers a partial checklist of issues that should be considered by artists intending their estate plans to endow a foundation.

Failure to Plan

- *Intestacy:* If an artist does have intentions for the posthumous disposition of their creative assets involving a tax-exempt charitable foundation, it is essential that they make an estate plan. Failing to execute a will or a “*will substitute*” (such as an inter vivos revocable trust) means that the artist will die “*intestate*” (without a will) and their assets will be dispersed among their heirs as defined by state intestacy law and by formula under that law. Even if it were created during the artist’s lifetime, a foundation is not considered an heir under state intestacy laws and as such, absent specific testamentary provisions, may receive no assets at all or only a limited consideration provided by the statutory heirs at their discretion.”¹
- *Too Late:* Artists who delay estate planning until late in their lives do a disservice to their family members and limit their options for the posthumous stewardship of their creative legacies. Trusts to provide for children can be established and funded annually with gifts valued at a level below the annual gift tax exclusion amount. Over the years, these gifts will produce a significant corpus, but only if the artist begins this process when in their early

middle age, at the latest. Similarly, life insurance policies are commonly used in an estate plan as a means to inject liquidity into an estate, which can be crucial in dealing with nonliquid assets such as an art collection.² Unfortunately, this option isn't available to older artists. Should they have few assets other than artworks, artists that intend to endow a foundation but have waited until late in life to plan their estates may be left with the difficult choice of splitting up their collection between family members and the foundation. The downsides of this option are discussed, below.

Unintended Consequences

- *Artists' Corporations:* If an artist incorporates their studio practice or other business enterprise and bequeaths the ownership interest in this corporation to their foundation, the foundation will likely be subject to significant expense to resolve this situation. Private foundations are generally prohibited by law from holding more than 30 percent of an ownership interest in a corporation. The foundation will have three options: (1) terminate the corporation and pay what may be significant taxes on that event; (2) secure approval from the Internal Revenue Service affirming that the corporation will be operated as a “*functionally-related business*” (one integral to the foundation's charitable purposes other than as simply a source of financial support) and, as such, will not be subject to the private foundation excess business holdings prohibition or the tax on unrelated business income; or (3) retain ownership of the corporation, but play no role in its operation, which must be independent of the foundation. Even with the second and third options, net proceeds from sales of art owned by the corporation will be subject to the corporate income tax. Lastly, a foundation owning an interest in an S corporation is significantly disadvantaged, regardless of whether or not the business is ruled to be functionally related to the charitable purpose, because proceeds from an S corporation in all cases are taxed additionally as unrelated business income.³
- *Disclaiming:* Artists may be advised to use “*disclaiming*” as an estate planning strategy (for example, bequeathing assets to family members who then accept only some of the assets and disclaim the rest, whereby these pass to the artist's tax-exempt charitable foundation as the previously identified contingent beneficiary and thus are eligible for the estate tax charitable deduction). Beneficiaries who disclaim assets that then pass to the foundation cannot subsequently participate in decisions with respect to those disclaimed assets, nor can they exercise control over the individuals who will direct deployment of the disclaimed assets. Should family members serve on the board of the foundation, or any entity, that receives assets they have disclaimed—for example, artworks, real property, or financial assets, that organization will be required to adopt policies specifically excluding these family members from participating in decisions about those assets as well as excluding them from

decisions to elect, appoint, hire, or compensate the individuals who will make those decisions. Failure to follow these procedures can result in serious estate tax consequences.⁴

- *Copyright Termination*: If an artist transfers their copyrights during their lifetime to a revocable trust or to any entity whether it be charitable or not (i.e. a public charity, private foundation, or a studio corporation), the artist no longer will own those rights directly and thus will not be able to transfer them to the foundation by will, which could be a crucial matter. Transfer by will by the copyright creator is required in order to extinguish the “*copyright termination rights*”—the rights of statutory heirs to claim the copyrights after the artist’s death by terminating the existing transfer, regardless of whether the artist intended their copyrights to be owned by the foundation.⁵

Unfortunate Choices

- *Termination Timeframe*: Distributing an artist’s assets posthumously through grants, gifts, and sales is a time consuming and complicated task that often takes several decades. If the terms of an artist’s bequest stipulate that the foundation must complete distribution of all the assets it receives from the artist within a short period, such as ten years or less, and then terminate, the artist has created the possibility that the pressure of this limited time frame will necessitate expedient choices that may not best serve the artist’s intentions.⁶
- *Underfunding*: If the artist underfunds their foundation, for example by bequeathing it artworks with little current market value and failing to provide additional resources to support the charitable use of those artworks through scholarship, exhibitions, publications, etc., the foundation will not be viable. Most likely, in dealing with this nonviable bequest, the foundation’s board will find it necessary to terminate the foundation, which will involve making hard choices, under the pressure of time, about where to place the remaining works by the artist that it owns. The results may not be what the artist would have wished.⁷
- *Executor/Trustee Fees*: If an artist’s testamentary document provides no cap on executor/trustee compensation, the fee charged to the artist’s estate likely will be set by state law, which may define specific limits (e.g., New York) or more subjectively, may only require that the fee be “*reasonable*” (e.g., Florida). While perhaps of less concern to small and mid-size estates, an estate of substantial value with no specified fee cap will generate significant executor/trustee fees under state law. Particularly when the primary beneficiary is a charitable organization, the artist may wish to cap these fees while still providing appropriate compensation to their executor/trustee.⁸

- *Art Dealer as Executor:* If an artist appoints their art dealer as executor/trustee, they will create a major “*conflict of interest*” for this individual with respect to their primary obligation to the artist’s estate and beneficiaries. A conflict of interest exists when an individual’s private interests, in this case to optimize their own income from art sales commissions, conflict with their fiduciary duties to prioritize the interests of the parties—the estate and its beneficiaries—for which they are responsible. It is advisable to avoid this situation.⁹

Unexpected Ramifications

- *Family and Foundation:* If the artist splits their artworks between their family members and the foundation, the family members and the foundation will find themselves constrained with respect to such matters as dealer representation and art sales. For example, should the family members serve on the board of the foundation, it may result in a breach of their fiduciary “*duty of loyalty*” (the legal requirement to act without personal economic conflict) if sales of the artist’s works that they own compete with or take precedence over sales of the artist’s works owned by the foundation. As a result, it will be necessary for family members and the foundation to engage separate art dealers.¹⁰ This typically results in family members retaining permanent representation and engaging in ongoing sales while the foundation undertakes only occasional, low-profile sales, often in varying geographic locales and with different dealers, and often waiting several years beyond settlement of the estate to initiate sales. This arrangement can limit the foundation’s economic capacity to implement its charitable purposes. If this situation cannot be avoided, an important aspect of estate planning and estate administration in such cases is to provide sufficient liquid assets to the foundation to sustain its functions initially without art sales.
- *Family and Foundation, Further:* If the artist splits their artworks between the foundation and their family members, whether or not the family members who own the artist’s artworks serve on the foundation’s board, they are prohibited from receiving a benefit from the foundation’s activities. For example, it could be a prohibited benefit were the foundation to participate in and promote a for-sale exhibition featuring the artist’s works owned by the foundation as well as those owned by the family members. As such, in addition to being separately represented, the foundation and the family members may not be able to jointly participate in shared for-sale exhibitions, whatever the setting.¹¹
- *Family and Foundation, Additionally:* If the artist splits their artworks between the foundation and their family members, the foundation will be limited with respect to the charitable activities it conducts that pertain directly to the artist’s works owned by the family members, whether or not they serve as members of the foundation’s board. The foundation will not be able to provide grant support to or directly conduct projects—exhibitions, publications, films, scholarly initiatives, etc.—focused on the artist’s works owned by the

family members. Likewise, with an eye to conflict of interest, the foundation will not be able to include the family members who own the artist's works as members of the committee that selects works for inclusion in the artist's catalogue raisonné, although such family members can be a valuable source of information to the committee, which will be composed entirely of independent members.¹²

- *Family, Foundation, and Copyrights:* If the artist bequeaths their artworks to the foundation and separately bequeaths the copyrights in those same works to their family members, the foundation will be prohibited from licensing the use of those copyrights from the family members, except at no cost. More important, the foundation may not be able to undertake activities—exhibitions, publications, films, scholarly initiatives, etc.—the effect of which is to significantly enhance the financial value of those copyrights to the private benefit of the family members.¹³
- *Family, Foundation, and the Artist's Corporation:* The private foundation excess business holdings prohibition limits a foundation from owning more than 30 percent of an interest in a corporation, whether by the foundation on its own or in combination with its “disqualified persons” (major donors and their heirs, whether or not they serve on the foundation's board, as well as members of the foundation's board). As a practical matter, this means that the foundation cannot share ownership of the artist's corporation with the artist's family members or anyone who serves on the foundation's board. When two artist-spouses together own the corporation, which holds works by both artists, this constraint will delay transfer of the ownership interest to the foundation until both artists are deceased.¹⁴
- *Family, Foundation, and Real Property:* The private foundation prohibition on “self-dealing” (any transaction between a foundation and its insiders, except for a few narrow exceptions) limits the ways that disqualified persons and foundations may interact with respect to the artist's real property, among other things. If the artist's estate plan bequeaths the studio to family members, as disqualified persons they may not lease or sell the studio to the foundation, except at no cost. If the foundation receives the studio, it cannot in any case lease, lend, or sell it to the artist's family members.¹⁵

Flaws in the Testamentary Plan or Document

- *Challenges:* If an artist's estate plan fails to provide for immediate heirs, for example by disinheritting or only nominally providing for the artist's spouse or by making inadequate provisions for minor children, and leaves the bulk of the artist's assets to the foundation, the artist can expect their estate plan to be challenged.¹⁶

- *Omissions*: If the artist intends by the terms of their testamentary document to create a charitable trust that will be recognized by the Internal Revenue Service as a private foundation, but the trust indenture omits the specific provisions required by the Federal Tax Code to create a private foundation, the Internal Revenue Service most likely will reject the foundation's application for tax exemption. The artist's executor/trustee will have to ask the court to approve revisions to the testamentary document and then resubmit the foundation's request for exemption.¹⁷
- *Nonaligned Assets*: If the artist's estate plan directs assets to the foundation that are inconsistent with its charitable purpose, for example bequeathing a collection of unfinished artwork that has no financial value to a foundation established to liquidate its art assets in order to fund grants, the foundation will likely need to disclaim the bequest. How these assets are then dispersed depends on whether the estate plan has been properly written to include an alternate recipient in the event of a disclaimer.¹⁸
- *Noncompliance*: If the artist's bequest to the foundation creates a situation such that the foundation cannot be operated in compliance with private foundation law or the charity laws of the respective state, for example by distributing asset ownership in a way that results inevitably in prohibited transactions between the foundation and the artist's family members, the artist's executor/trustee will have to ask the court to revise the terms of the bequest.¹⁹
- *Omission of Copyrights*: If an artist's will/estate plan fails to specify disposition of the artist's copyrights, they will by default become part of the artist's residuary estate, being distributed to the residuary beneficiary/(ies), who may or may not be an individual(s) the artist wishes to control the copyrights. If the primary beneficiary is the artist's foundation, such an omission severs the copyrights from that charitable bequest. If such a will also fails to specify a residuary beneficiary, the copyrights will be subject to the law of intestacy, being distributed to and divided among the artist's heirs designated by state law.²⁰
- *Omission of Copyrights, Further*: If an artist bequeaths an artwork to a tax-exempt charitable entity without including the work's copyright in the bequest, its value will be attributable to the estate tax charitable deduction only if the entity will use the artwork in fulfilling its charitable purpose, for example as a museum. A bequest of a work to a tax-exempt charitable entity for use unrelated to its charitable purpose, such as for sale to generate income, will not be eligible for the estate tax charitable deduction unless it includes the copyright interest in the work.²¹

How Can Artists Avoid These Problems?

Many of these issues, above, derive from the impact of private foundation law and regulations. This is not surprising since the section of the Federal Tax Code dealing with private foundations contains some of the most complex provision of the federal tax system.²² As such, it is advisable for artists to have both their estate plan and the plan for their foundation reviewed by an exempt organization attorney expert in private foundation law. While many trusts and estates attorneys are familiar with private foundations as mechanisms to accomplish an estate plan, and thus view themselves as expert in private foundation law, they may in fact be less familiar with the practicalities of operating a private foundation over the longer-term, particularly those holding the types of assets owned by artists and interacting with the types of art-related activities common among artist's family members. Likewise, while art law attorneys may be expert in matters of art transactions, and art litigating attorneys may be expert in managing legal disputes that hinge on art concerns, these are not the same bodies of law as trusts and estates law and/or private foundation law. Artists must be willing to retain appropriately qualified legal counsel for these important purposes.

As with all professional services in today's world—legal, medical, accounting, investment—the burden in the estate planning process falls on the individual consumer of the services, in this case the artist. Artists cannot be passive, but must actively engage by taking the steps required to provide for their creative works posthumously. In so doing, they should begin planning their estate in early middle age at the latest, work with appropriately qualified professional advisors, interrogate the options suggested by those advisors, seek a second opinion, and understand the potential results of the choices they make. There are no guarantees in life, but artists can make thoughtful and well-considered estate plans, and in so doing, they will weight the scales in favor of successful cultural philanthropy and posthumous stewardship of their creative works.

¹ See the Sam Francis estate, per Frederick M. Nicholas, "Artists Beware," *Foundation Management: Innovation and Responsibility at Home and Abroad*, ed. Frank L. Ellsworth and Joe Lumarda (Hoboken, NJ: John Wiley and Sons, 2003).

² Stephen K. Urice, "Creativity and Generosity: Considerations in Establishing an Artist-Endowed Foundation, in *The Artist As Philanthropist*, Volume 2.

³ Jill S. Manny, "Artist-Endowed Foundations Holding Stock in Artists' Corporations," in *The Artist as Philanthropist, Study Report Supplement 2013*.

⁴ Nathan Kiyam, "Disclaiming Artists' Estate Assets and the Potential Impact on Artist-Endowed Foundations," in *The Artist as Philanthropist, Study Report Supplement 2018*.

⁵ Lee-Ford Tritt, "Statutory Copyright Terminations and Artist-Endowed Foundations," in *The Artist as Philanthropist, Study Report Supplement 2013*.

⁶ "Estate Distribution Foundations" in *The Artist as Philanthropist, Study Report Supplement 2018*.

⁷ *Ibid.*

⁸ Philip Boroff, "Judge Awards Three Pals of Robert Rauschenberg \$25 Million," *Artnet News*, August 3, 2014.

⁹ Gustave Harrow, “Reflections on Estate of Rothko: The Role of the Legal Advisor in Relation to the Artist,” *Cleveland State Law Review* (1977).

¹⁰ Joseph L. Sax, “Public Benefit Obligations and Legacy Stewardship Activities of Artist-Endowed Foundations: Are They In Conflict?” in *The Artist as Philanthropist*, Volume 2.

¹¹ Marion R. Fremont-Smith, “Federal and State Laws Regulating Conflict of Interest,” in *The Artist as Philanthropist*, Volume 2.

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Harrow.

¹⁷ Internal Revenue Service, Life Cycle of a Private Foundation: Private Foundations—Required Provisions for Organizing Documents, <https://www.irs.gov/charities-non-profits/private-foundations/private-foundations-required-provisions-for-organizing-documents>

¹⁸ See the Joseph Cornell estate, as documented in “Joseph Cornell Estate Papers, circa 1911, 1944–1986,” Smithsonian Archives of American Art.

¹⁹ Fremont-Smith.

²⁰ Minnigh and Stutzman. *Planning for Authors, Musicians, Artists, and Collectors* (Portfolio 815-3rd: Estate Planning Series). Bloomberg BNA Tax Management, 2018.

²¹ *Ibid.*

²² Urice.