



A Taxing Story of Arizona Artist Ted DeGrazia

by Ira Feldman, CPA

Last week, Ted DeGrazia gathered up 100 or so of his paintings, valued upwards to \$1.5 million, and set out on horseback into the rugged Superstition Mountains east of Phoenix Arizona, together with several rag tag friends, to start a roaring bonfire to reduce the art works to ashes. What prompted this dramatic protest was his opposition to Federal inheritance taxes, which the artist complained, could reach 77% of the assessed value of his art works after he dies. — Wall Street Journal; May 21, 1976.

DeGrazia further told the *Wall Street Journal* ... “suppose I turn out something like Rembrandt, and I die and Uncle Sam says it’s worth a million dollars. Where does the estate tax money come from?”

Shortly after this article was published, I was introduced to DeGrazia (he preferred going by his last name) by his attorney to see if anything “professional” could be done about his taxes. Over the years and up until his death in 1982, I

got to know him as a friend and a highly intelligent, but eccentric, individual. At the young age of 35, I had much to learn from this friendship. He complained not only about the estate taxes, but also the large amount of income taxes he and his corporation were required to pay. What could I do about this? Of course, I thought I could do everything to save taxes ... and his life works. And, in fact, we did.

DeGrazia Gallery in the Sun was located on 10 acres of land on Swan Road (in Tucson) and consisted of his gallery, which displayed his paintings, and a sales area, which sold some of his reproductions, but mostly trinkets and tourist objects. The Gallery was a major stop on the tourist circuit.

I immediately set about to accomplish my new client’s mission, a challenging task for a young CPA. Looking back at what we accomplished over the next six years, even though some of our tax structuring would not work under current tax laws, we were able to reduce his and his wife’s combined income and estate taxes by perhaps 90%. The result of that savings now is his legacy, a major single artist museum in Tucson,

Arizona, which he constructed with his own hands and lots of help from his buddies.

So, what were these magical solutions? Nothing more than carefully structured planning to minimize income and estate taxes.

First, I noted his C-Corporation (at that time S-Corporations were not used as much) was making substantial profit from the sale of his original reproductions and the trinkets sold in

the Gallery's store. He was just starting to become well recognized, so sales and profits were multiplying, as were his taxes. He and his wife, who also worked for the corporation, took salaries of \$10,000 each per year. The corporation paid income taxes on the remaining income at about a 50% tax rate.

None of our other professional clients suffered taxes the way DeGrazia did. So why not implement the garden

variety planning we used for our doctors and lawyers (even CPAs)? The answer was obvious. We increased both their salaries to a level appropriate of their creative abilities. Then we installed a Defined Benefit Pension Plan. At age 68, that created about \$450K per year in tax deductions for the C corporation. By the time DeGrazia passed away in 1982, we were able to accumulate over \$1.2 million each in the retirement plans.

DeGrazia's ultimate goal was for his art and his financial accumulation to provide a place where his art could be displayed for future generations. After all, he was an "artist of the people." And if it could be endowed with his savings (now greatly enhanced by his lower tax rate), ordinary people could visit without having to pay an entrance fee.

The solution was the DeGrazia Art & Cultural Foundation – A Private Operating Foundation, formed in 1978. This Foundation would provide a legal structure which could continue in perpetuity. Not only is a POF unusual, but the manner in which it was to be operated on the grounds of the "gallery" in Tucson posed some significant tax-exempt application discussions. The Application for Exemption was submitted to the IRS, and after a number of discussions and document submissions, was approved in March 1979. A tax-exempt organization (501(c)(3)) is not supposed to inure to the benefit of its benefactor. What stuck in IRS craw was that there was a significant area in which his art objects were sold to the general public visiting the gallery. While typical for a normal museum, this "co-working" arrangement with his C Corporation posed a concern that the museum would be used as a draw to enhance his gallery sales income. The gallery did not sell his originals and only occasionally sold reproductions. In addition, this single artist museum was one of two which I could find in the United States.

The solution? Physically segregate his sales gallery from the museum where his paintings were being dis-

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played. Thus the museum was not being used as a lead to sell paintings in the gallery. In fact, unlike most museums which have a sales area as you leave, our sales area was where you first entered.

The next step was to make maximum cash contributions each year (using 50% of AGI limitations) to cut the individual tax rate from that increased salary in half. His C corporation had little remaining income or tax. Part of their annual income tax deduction was increased by contributing some of their stock in the C corporation (at its current value) to the Foundation. The contributions were “filled-up” by additional cash added from their after-tax salary.

Then came time for estate planning. He and his wife, Marion, owned their stock in the C corporation, paintings, etc. as community property, except for their retirement accounts in which they had individual balances. We determined that the original oil paintings and other original art objects, including original reproductions, were not owned by the C corporation since he had never assigned ownership of them to the corporation after he created them. The C corporation sold non-art copies of his creations, cards and other items under its license with him (documented under his employment agreement) and received royalties from licenses issued to reproducers of his art in the form of bells, Christmas ornaments, figurines, etc. Thus, his and his wife’s estates consisted of ownership of the C corporation, direct ownership of their art creations, retirement plan benefits and savings from the salaries they earned.

Both DeGrazias stated on a number of occasions that they wanted the Foundation to be the beneficiary of all of their assets, disinheriting their adult children and the surviving spouse (each had their own separate community share). The only exception was an education trust set up for his then young son, Domingo, to provide college education funds. This estate

plan was executed through the use of a revocable trust for each of them. When he died in 1982, his community share of the estate plus his retirement plan benefit passed to the Foundation (a 501(c)(3) organization). Thus, no estate taxes, and no income taxes on the retirement benefit. Marion died some years later and eventually her assets passed on to the Foundation. ■

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