

Rochester Institute of Technology

**RIT Scholar Works**

---

Theses

---

4-2019

## **Museums and the Tax Code: A Fraught Friendship**

Elisha Muir  
etm3975@rit.edu

Follow this and additional works at: <https://scholarworks.rit.edu/theses>

---

### **Recommended Citation**

Muir, Elisha, "Museums and the Tax Code: A Fraught Friendship" (2019). Thesis. Rochester Institute of Technology. Accessed from

This Thesis is brought to you for free and open access by RIT Scholar Works. It has been accepted for inclusion in Theses by an authorized administrator of RIT Scholar Works. For more information, please contact [ritscholarworks@rit.edu](mailto:ritscholarworks@rit.edu).

ROCHESTER INSTITUTE OF TECHNOLOGY  
COLLEGE OF LIBERAL ARTS

MUSEUMS AND THE TAX CODE: A FRAUGHT FRIENDSHIP

THESIS SUBMITTED  
IN PARTIAL FULFILLMENT OF THE  
BACHELOR OF SCIENCE DEGREE  
IN MUSEUM STUDIES  
DEPARTMENTS OF PERFORMING ARTS AND VISUAL CULTURE AND HISTORY

BY  
ELISHA MUIR

APRIL 2019

The members of the Committee approve the thesis of Elisha Muir submitted on April 25, 2019.

*Tina Lent*

---

Tina Lent, Ph.D.  
Primary Advisor

*Cassandra George Ramos*

---

Cassandra George Ramos  
Secondary Advisor

*Tina Lent*

---

Tina Lent, Ph.D.  
MUSE Program Director

## **Abstract**

Museums benefit immensely from their position in the American tax code and its peculiarities, but the fundamentals of this relationship are often muddled, confusing, and difficult to explain. But with recent alterations to the federal tax code and an atmosphere of apprehension in the field, understanding and explanation are critical to proper decision-making and governance. This thesis addresses that need through multifaceted research and analysis of historical data, expert analysis, and crucially case law at both the federal and state level. The result of this will be to expand the currently anemic body of current literature on the topic and bring the issue to mind more saliently for professionals in the field.

## **Table of Contents**

Explanation of Terms .....	3
Introduction .....	5
How Tax Policy Affects Donor and Museum Behavior: A Literature Review .....	6
Background.....	13
Case Law and State Law .....	15
Findings and Analysis .....	23
Conclusion.....	23
Bibliography .....	25

## **Explanation of Terms**

Museums, as charitable organizations, are able to claim exemption from federal income tax under section 501(c)(3) of the Internal Revenue Service code. The concept of a nonprofit corporation is relatively recent, being suggested first with the Tariff Act of 1894 and made explicit with the introduction of the corporate income tax in 1909, but fundamentals of charitable giving in America have much deeper roots. Museums are not the only beneficiaries of the nonprofit tax code, with the 501(c)(3) status covering the following types of organizations: “Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations.”

This is not the only kind of nonprofit status, however. Perhaps the most important other designation for museums to understand is section 501(c)(4) “social welfare organizations.” A chief distinction between the two is limitations on political activity and lobbying: whereas 501(c)(3) corporations are prevented from politicking or direct lobbying, 501(c)(4) nonprofits are able to do so freely. Challenges to this distinction on First Amendment grounds have met with failure, meaning the stipulations is highly unlikely to change either through judicial or legislative action in the foreseeable future. Fortunately, this rarely poses a problem to museums, especially due to the actions and speech of people who work for an institution not generally being considered as representing an institution.

The other twenty seven types of nonprofit organizations are less relevant to museum operations, with many sections devoted to veterans organizations, retirement funds, healthcare and insurance. However, of particular interest to museums is section 4947 regarding non-exempt charitable trusts, explicitly referred to as a “loophole closer” by the IRS. 4947(a)(1) trusts, while

not exempt from tax themselves, still allow donors to deduct charitable contributions from their individual tax burden. As these trusts are set up and used by individuals and donors themselves, they have unique restrictions and characteristics that endowments operated by museums themselves do not. Oftentimes, there are more limitations or stipulations associated with these donations, the strength of which are usually determined by the size of the contribution.

By contrast, endowments run exclusively by an eligible charity are tax-exempt, and contributions towards them are, as with all charitable contributions, tax deductible. Even though there are a great deal of restrictions on how endowment funds can be used, these restrictions often being determined by an institution's board in accordance with an ethics policy, cultural institutions often rely strongly on funding from endowment income. According to the Association of Art Museum Directors, an average of 22% of art museum funding comes from endowment income<sup>1</sup>, and as the Great Recession showed interruptions to that funding source can have devastating consequences.

There are a variety of tax deductions relevant to museums as charitable organizations. Tax deductible charitable contributions are donations, whether cash or in kind, that individuals can use to lessen their yearly tax burden. This can mean deducting charitable contributions from yearly income tax, but of particular importance to museums is the ability to deduct from estate tax, occasionally referred to as the "death tax." The prevalence of planned giving is directly related to the ability to write off donations of appraised art or artifacts, alongside direct financial contributions, from estate tax burdens.

---

<sup>1</sup> "Art Museums By the Numbers 2016.Pdf," accessed April 18, 2019, <https://aamd.org/sites/default/files/document/Art%20Museums%20By%20the%20Numbers%202016.pdf>.

How the tax code operates at the federal level is also, by and large, how it operates at the state level, with exemptions from state corporate income tax and availability of charitable giving deductions are near universal. Property taxes are one area where state and federal taxes differ, due to property taxes only being able to be levied by the former. While exemptions from property tax for charitable institutions are widespread, this particular area of the tax code often ends up defining and regulating museum behavior most heavily.

## **Introduction**

On a word association level, museums and taxes are rarely paired. Museums bring to mind Doric columns, oil paintings, and stodgy old academies, while taxes elicit thoughts of endless forms, accountants, and numerous financial liabilities. But museums and taxes are closely related as changes in the tax code that might seem unrelated, like a new targeted property or sales tax, might have immediate and sweeping consequences for cultural institutions. And museums that understand their place in the tax code are often able to wield that knowledge to prevent and preempt the most potentially harmful changes. Unfortunately, many of the most salient bits of information are buried in the annals of state case law or the scattered histories and perspectives of professionals in and around the field. While the collection and connection of that information can be tiresome, once aligned, the simplicity and intuitiveness of the fundamentals become clear.

Understanding these relationships and the history behind them is crucial in determining what an institution's response to potential changes or disruptions to the system should be. Furthermore, while museums and museum professionals assess and redefine the role and identity of museology regularly, many of these discussions neglect some crucial context that a better understanding of the tax code and tax law can provide. Governments and courts, often solely

through the tax code, are able to provide highly prescriptive visions of what the role of a museum is.

In short, this thesis answers two questions: how did the tax code as it relates to museums develop in the United States, and how does the tax code affect museums today? Neither question is simple or narrow, but the implications of both are wide-ranging and relevant, now more than ever. While the changes over time may be few, that only makes questions of what the future might hold all the more interesting.

### **How Tax Policy Affects Donor and Museum Behavior: A Literature Review**

This paper synthesizes the available literature on museum policies as it relates to tax policy in the United States. As the data and research show, changes made to the tax code generally only affect museums insofar as they affect the behavior of donors, who, due to the circumstances of the US tax code are those in the highest income tax brackets. While direct government funding and subsidy do play an important role in affecting museum actions and policies and governance, it is often the indirect subsidy afforded through tax write-offs for charitable contributions that form the foundation for museum operations and activities. These forces are not merely academic or theoretical, as they affect the survival and stability of museums, as well as determine whether they will reflect a narrow band of shareholders or a broad public, whether they will commit themselves to prestige or access. As the literature shows, what may seem like minutiae in tax policy can have massive ripple effects across the cultural sector.



It is worth noting that the literature summarized here is centered around law and economics. This is in part due to a dearth of available materials from museum professionals, as they tend to focus on more granular fiscal problems, rather than engaging in the kind of macro-scale research and quantitative analysis that the topic necessitates. This does not diminish the importance of their voices and perspectives; in fact, this gap means that there are a great many sources from outside the field that question the value of museums, especially art museums, without consulting those in the field. Ultimately, even with the somewhat limited perspectives available, the story the data tell does not change.

There are two major aspects of the tax code in the US that impact museums most directly: nonprofit status and tax-deductible charitable contributions. Nonprofit status means that qualifying institutions pay no income tax on charitable activity. This means that operating a museum or gallery is tax free, but a gift shop within the institution, is still subject to relevant tax. Today, while gift shops and other profit-seeking activities increasingly form an important portion of a museum's operating budget, sponsorships and donations are directly incentivized and encouraged by the tax code.

Charitable donations are the second way the US tax code most directly affects museums. Charitable donations can be written off as an income tax deduction by the donor. This applies both to direct, monetary donations, as well as gifts in kind. For as long as there has been an income tax in the US, there has been a provision for charitable deductions, stretching back to the mid 19<sup>th</sup> century. The rationale for this is sound: when behaviors are taxed, individuals are disincentivized from engaging in them, and as charitable activities are generally viewed as being inherently valuable, they are given an implicit subsidy through the government. A result of this, intended or not, is that individuals who have greater income tax burdens have the largest capacity

to benefit from charitable contributions, meaning they have the most power in determining which institutions, and which kind of institutions, thrive.

Gifts in kind are especially important to understanding how this provision affects museums, as the ability to donate land or objects with high valuations means more benefit for the donor. Throughout US history (especially in the mid 20<sup>th</sup> century) art donations were used as a loophole through which a donor's large tax burden was substantially reduced by a relatively small investment. While these loopholes were "closed" through various tax bills, the basic behavior is difficult to stamp out. After all, as the value of an object is inherently subjective, and as the government rarely steps in to act as an appraiser, the field is left largely to self-govern. As a result, even now, the tax code not only rewards high-income donors but particularly benefits those who give donations of art in kind.

These effects have remained extremely stable over time. With every tax code alteration, the value of art as a type of investment grows, and so, too, do the benefits of supplying works whose value is expected to grow over time. This is a result of the ability to deduct appreciated appraisal value of donated works from subsequent tax burdens. Donations in kind are not a one-time benefit, but an ongoing source of value for institution and individuals. This makes donations into an effective subsidy of high-income individuals whose tax burden is expected to remain relatively high even greater, as well as of corporate donors whose tax burden in the US is relatively high, even after the recent tax cuts.

What factors of tax policy most affect museums, and how much is determined by donors? How do these impact museums' missions and their interactions with the public? And what tools are available to most incentivize policies and actions in the public good?

The research is clear that museums, especially art museums, are often most heavily impacted by donor behavior.<sup>2</sup> While the discussion of including the public as shareholders has taken root in the field of museums recently, the current tax setup incentivizes museums to cater to the shareholders they already have, the wealthy who are able to take advantage of the US tax system, and not necessarily the general public who comprise the larger community.. The concept of a tax credit, as opposed to a tax deduction, is one solution offered to create a more diverse donor body,<sup>3</sup> but there isn't a good way to avoid the influence that donors have on museum governance and especially museum boards.

In the US, 38% of museum revenue comes from private sector donors.<sup>4</sup> For a large institution such as The Metropolitan Museum of Art, a whopping 37% of revenue comes from their endowment.<sup>5</sup> Although direct government subsidy in the form of funding or grants does comprise a sizeable portion of the operating budget of most museums, with the AAMD tallying at least 15% for art museums,<sup>6</sup> this support can actually reduce the level of private donations,<sup>7</sup> indicating further that it is indirect government subsidy through the tax code and donor involvement that most affect museum operating budgets, and subsequently their behavior.

---

<sup>2</sup> David Yermack, "Donor Governance and Financial Management in Prominent US Art Museums," *Journal of Cultural Economics* 41, no. 3 (August 2017): 215–35.

<sup>3</sup> Sigrid Hemels, "Tax Incentives for Museums and Cultural Heritage," in *Tax Incentives for the Creative Industries*, ed. Sigrid Hemels and Kazuko Goto (Singapore: Springer Singapore, 2017), 107–35, [https://doi.org/10.1007/978-981-287-832-8\\_7](https://doi.org/10.1007/978-981-287-832-8_7).

<sup>4</sup> Hemels. need shortened title here.

<sup>5</sup> Leila John, "Museums and the Tax Collector: The Tax Treatment of Museums at the Federal, State, and Local Level," *University of Pennsylvania Journal of Business Law* 15, no. 3 (2013): 877.

<sup>6</sup> "Art Museums By the Numbers 2016.Pdf."

<sup>7</sup> Luigi Di Gaetano and Isidoro Mazza, "'Better an Egg Today than a Hen Tomorrow' on the Implications of Deaccess Policies for Donations to Museums," *Journal of Cultural Economics* 41, no. 3 (August 2017): 237–58.

For example, with decreasing availability of private donations, other sources of revenue must be pursued, such as for-profit activity like on-site food and gift shops.<sup>8</sup> Additionally, large institutions that rely on endowments are nudged towards catering further to their elite clientele, who benefit most from donating sizeable endowments and the use of charitable trusts.<sup>9</sup> Interestingly, while these do not necessarily work directly toward the public good, these activities generally don't lead to a corruption of the underlying mission of institutions. Profit-seeking behavior is, at least theoretically, more out of necessity than malice.<sup>10</sup>

One way that this reliance on, and catering to, the wealthy can be curbed, although seemingly counterintuitive, is by placing restrictions on donations.<sup>11</sup> This is due to the transfer of power away from museum managers and administrators, as this diminished control means they are better able to focus on operational efficiency and increased program services. However, this can backfire in the event of poor economic conditions, as these restrictions, coupled with general distaste for deaccessioning, can result in dire straits for an institution in trouble.

Perhaps the most troublesome way the US tax code impacts museums, specifically art museums, is through the acquisition of objects that later appreciate in value.<sup>12</sup> Donors are incentivized to effectively treat the art market as another way to invest, almost following the real estate (?) idea of “buy low, sell high.” As donations are tax exempt for institutions and tax deductible for the donors, art museums accept donations valued highly by appraisers, whose tastes are not necessarily the same as the public which the museum serves. This is perhaps the

---

<sup>8</sup> John, “Museums and the Tax Collector.”

<sup>9</sup> Stephanie Dunn, “Please Don't Make Me Pay Taxes: How New IRS Law Helps Art Collectors Avoid Hefty Taxes,” 2017, 39.

<sup>10</sup> Andras Kosaras, “Federal Income and State Property Tax Exemption of Commercialized Nonprofits: Should Profit-Seeking Art Museums Be Tax Exempt Note,” *New England Law Review* 35 (2001 2000): 115–76.

<sup>11</sup> Yermack, “Donor Governance and Financial Management in Prominent US Art Museums.”

<sup>12</sup> Don Fullerton, “Tax Policy Toward Art Museums,” Working Paper (National Bureau of Economic Research, June 1990), <https://doi.org/10.3386/w3379>.

most direct way that museum policies and activities are impacted by the tax code, as it means that many objects an institution accepts reflects the taste and value of a select high-income portion of the public.

Tax exemptions for museums are crucial to their operating in the public trust, as it allows them to undertake operations that wouldn't be profitable in the private sector. However, as the literature shows, these exemptions have been abused for as long as they have existed. To combat this, various methods have been employed at the federal policy level (although the purpose of this can be seen as somewhat antagonistic towards museums and their missions.) Capping the ability to deduct capital gains on charitable donations was one fix employed,<sup>13</sup> although this has been demonstrated to be only of mixed effectiveness.<sup>14</sup> The underlying issue here is that art and other similarly appraised objects, on an economic level, can be understood much like any other kind of investment, and as a result, even if an institution truly is operating in the public good it is fundamentally influenced by this reality.

Stymying these effects, though difficult, is not impossible. Many other countries have examples of a incentives for museums supported and influenced chiefly by the public, and in doing so better reflect and support them. For publicly funded museums, a study from Turkey indicated that by increasing volunteer and community involvement in an institution, institutions are not only incentivized to reflect their local communities but are also seen as more valuable by the public.<sup>15</sup> Conversely, this makes the museum less likely to act as a private corporation,

---

<sup>13</sup> Susan Wagner, "The Implications of Changing the Current Law on Charitable Deductions-Maintaining Incentives for Donating Art to Museums," *Ohio State Law Journal* 47, no. 3 (1986): 773-98.

<sup>14</sup> Fullerton, "Tax Policy Toward Art Museums."

<sup>15</sup> Burak Herguner, "Public Value as a Framework for Reforming Publicly Funded Museums," *International Journal of Public Sector Management* 28, no. 6 (August 10, 2015): 461-74.

because as the most important metric for success becomes public value, monetary value is further diminished in importance.

Additionally, maintaining tax incentives for donation, but restructuring them, goes a long way towards creating a more diverse group of donors in terms of income level. As mentioned previously, substituting a tax credit for a tax deduction would allow the participation of lower-income individuals, whose tax burden is generally too small to benefit in any meaningful way from a deduction.<sup>16</sup> This would also mean that admissions costs are easier to justify for a lower-income museum visitor. Receiving a tax credit to subsidize or cover entirely the cost of admission means that institutions could maintain admissions costs necessary for their operation while broadening the type of public that has the resources to visit them.

In terms of collections management, there are numerous suggestions from economists, many of them contradictory. Some suggest that deaccessioning is a major long-term fiscal health risk, because it discourages private donations,<sup>17</sup> as well as damages public trust. Many economists, however, suggest that deaccessioning is directly in the public good,<sup>18</sup> as it reduces preservation costs for institutions and allows them to reallocate resources towards public facing services.

There is broad, near-universal agreement on the inherent value of museums and their operations, and every source says as much at least once. Criticisms and analyses of failings are motivated by an interest in seeing institutions operate at their best and in the public interest. In the simplest terms, the best way for museums to operate in the public good and adhere to their

---

<sup>16</sup> Hemels, “Tax Incentives for Museums and Cultural Heritage.”

<sup>17</sup> Di Gaetano and Mazza, “‘Better an Egg Today than a Hen Tomorrow’ on the Implications of Deaccess Policies for Donations to Museums.”

<sup>18</sup> Peter Temin, “An Economic History of American Art Museums,” n.d.

missions is to allow a broader base of the public the opportunity to participate in governance so more of the community benefits from the services a museum provides and the tax structures that allow them to operate.

## **Background**

There is a piece of unassailable protection in every spending and taxation bill passed on Capitol Hill, tucked away in the weeds of arcane legal jargon. Mentioned nowhere in the Constitution, and yet associated deeply with American identity, it has survived for more than two centuries with little more than empty rhetoric levied at it. Section 501(c)(3) of the Internal Revenue Code, which allows nonprofit organizations exemption from federal taxes and tax deduction for charitable contributions, enjoys near-unanimous support and is under no serious threat.

Yet, despite this being so favorable to museums and other nonprofits, there is an air of discomfort, almost discontent, around the topic. Spending hawks love to take aim at grants and programs that amount to fractions of a percent of any budget, and museums and museum professionals prepare for apocalyptic conditions when the smallest changes are made or suggested.

The American idea of charity was forged in the absence of federal government, comprising religious institutions, education organizations, and even healthcare providers, and the more contemporary idea of a “private foundation” developed in the era of industrialists at the turn of the 20<sup>th</sup> century, solidifying with the 1909 introduction of the corporate tax.<sup>19</sup> These two points of origin are directly reflected in the 501(c)(3) status: tax exemptions allow charitable institutions to operate by the public for the public good, and tax deductions reflect the influx

---

<sup>19</sup> Paul Arnsberger et al., “A History of the Tax-Exempt Sector: An SOI Perspective,” 2008, 31.

capital and property that created so many of the most venerable American institutions. While anyone who pays taxes can theoretically benefit from charitable tax deductions, the simple fact is that few except the very wealthy actually have the resources to benefit from this deduction. In effect, this means charitable institutions, as seen through the tax code, are alternately for the American public and the wealthiest Americans.

This duality is present in every area of nonprofit governance and presents itself in some truly unexpected ways. Importantly, while it is at least disconcerting that there is such a class divide built into the nonprofit tax status, it should be noted that it is not *ipso facto* bad. Some of the issues that arise from this stratification are theoretical in nature, and others sound worse than they are. By and large, museums do excellent work and crucially do so in a way that is purely beneficially to the public and American people at large.

Understanding the tax code and its effects allows museums to better cope with and address these topics. In the decades-long struggle to democratize the museum and diversify its stakeholders, much has been done on the public facing side, in the exhibits and collections items on display. However, administrative and management changes have advanced glacially, if at all. Boards and donors look largely the same today as they have over the more than two century history of American museums, and there is only so much museums can do to change this, if they even want to in the first place.

The core of nonprofit tax policy has remained unchanged for its entire history, with only minor tweaks to the policies surrounding it over the years. While this topic does not hold the appeal of visitor studies or development of new technologies in the museum space, every museum professional should understand this, on some level, so that they know when and where



to focus their fear and energy. The following case studies (or examples) illustrate why this is important.

## **Case Law and State Law**

Looking at the federal level only tells one part of the story. While exemption from income taxes is a massive boon to museums, that is not the only tax they contend with, let alone the only direct tax. Below the federal level, there is a remarkably varied body of case law discussing taxes at the state and regional level, mostly regarding property tax. Most museums have some sort of physical component, whether educational facilities, galleries, or archival space, and most of the time cultural institutions will be able to acquire an exemption from taxes paid on property. Unlike the federal level, though, individual states have a much more active, prescriptive role in determining what the activities of a museum are and should be.

In New Mexico, for example, a museum seeking property tax exemption must not only qualify as a 501(c)(3) by the IRS but also “... provide educational services and [grant] free admission to each student who attends public school in the county in which the museum is located.”<sup>20</sup> Not only this, but tax exempt status can be denied for being deemed not open enough to, or focused enough on, serving the public, as happened in the case of *Georgia O’Keefe Museum v. County*<sup>21</sup>. The Court of Appeals, in ruling against the museum, cited not only its prominent gift shop but also its high entry costs and lopsided operational budget as precluding it from meeting New Mexico’s museum standards, at least for those seeking tax exempt status.

Through this combination of case law and legislation, museums in New Mexico are given a remarkably clear vision for what a museum should be, which is a far cry from the more laissez

---

<sup>20</sup> *Georgia O’Keefe Museum v. County*, 62 P. 3d 754 (Court of Appeals 2002).

<sup>21</sup> *Georgia O’Keefe Museum v. County*, 62 P. 3d 754 (Court of Appeals 2002).

faire attitude taken at the federal level. Furthermore, in citing a ruling related to educational activities of a non-museum nonprofit, in this case the NRA, an indifference to (or dismissal of) any unique role that museums might play in an educational sense is shown, making explicit the idea that a museum's educational activities should be analogous to a school lesson, informational session, or training. While museums and museum professionals might wrestle with the identity and purpose, the courts are far less contemplative.

The Barnes Foundation means many things to those in the museum field, but the Pennsylvania Supreme Court was unambiguous in a 1960 ruling against the institution. In finding it had vacated its duty to public access, the Court wrote, "A painting has no value except the pleasure it imparts to the person who views it. A work of art entombed beyond every conceivable hope of exhumation would be as valueless as one completely consumed by fire."<sup>22</sup> Public access may well be seen as a virtue or responsibility in the museum field, but as far as Pennsylvania is concerned, it is a requirement, a fundamental quality of museums. Without it, their value, and their tax-exempt status, are placed in question. At the state level, questions of museum identity and purpose are not academic; they have specific, prescriptive qualities and characteristic, and their fiscal health depends on those criteria being met.

Some states go even further, and are more explicit, in their requirements, going beyond simply being open to the public or primarily focused on education. In a case involving the tax exempt statutes Kalamazoo Aviation History Museum details, a qualifying Michigan science museum must not only "[make] a substantial contribution to the relief of the burden of the government in education the people," but "make substantial contribution to the relief of the

---

<sup>22</sup> Com. v. The Barnes Foundation, 398 Pa. 458 (Supreme Court 1960).

government's burden of producing "scientific" information."<sup>23</sup> Interestingly, the Court of Appeals reversed a lower court's decision here, maintaining the museum's tax exempt status on the grounds that the interpretation of available laws was too prescriptive, stating that "we see no reason why tax-exempt status should not be accorded to a museum which preserves and informs the public about part of our history." As cases like this show, opinions and interpretations of available legislation and case law can vary wildly, and this volatility makes any broad characterization of state-level museum tax law extremely difficult.

Taxes at the state level are often both more complex and more volatile, as a long running conflict between the Getty Museum and California attests to. Owing to certain quirks in the way California conducts property tax exemption, the Getty and Los Angeles were embroiled in a decade-long battle over paid, and subsequently refunded, property taxes on a building under construction.<sup>24</sup> While initially taxed for the property, two separate appeals found in favor of the Getty, making it clear that a property that is intended for a qualifying charitable institution can be exempted during its construction just the same as a building in use might. For the Getty, this was a frustration more than anything, but for an institution on smaller margins or with a less sizeable endowment, the \$180,351.05 ostensibly owed to Los Angeles could very well have been a significant impediment to operations, let alone the costs of dealing with a court battle lasting a decade.

What this cross section of cases elucidates is the diversity of perspectives on the purpose and characteristics of a museum, at least as far as the various state tax codes and case law are

---

<sup>23</sup> Kalamazoo Aviation History Museum v. City of Kalamazoo, 346 NW 2d 862 (Court of Appeals No. 65328).

<sup>24</sup> J. Paul Getty Museum v. County of Los Angeles, 148 Cal. App. 3d 600 (Court of Appeal, 2nd Appellate Dist., 7th Div. No. 68154).

concerned. While there are a great many cases and regulations that detail what a museum is not, what is notable about state-level tax code is that it often instead details what a museum is, and what its explicit responsibilities are. Furthermore, many of the frustrations and trepidations of the American public can be seen in cases involving cities or counties challenging an institution's tax status. Because these cases deal with property taxes, which are often used to support a region's education system, it's hardly surprising that a certain level of scrutiny is employed, as museums often boast exceptionally valuable locations and estates.

Many of the most blatantly unethical abuses of the tax code have been settled decades ago, as the case law showed. A federal appeals court ruled against a highly questionable tax avoidance scheme The Metropolitan Museum of Art engaged in via a 1930 litigation against the Sun-Herald Corporation. Here, it was made explicit that a museum cannot take advantage of its nonprofit status to conduct for-profit activity tax-free, ruling that a newspaper owned and operated by The Metropolitan Museum of Art could not unfairly benefit from its parent corporation's tax exempt status.<sup>25</sup> This can be seen as a precursor to rulings and regulations regarding things like museum gift shops, as is seen in the many rulings that cite gift shops and related for-profit behavior as evidence opposed to a museum gaining or retaining nonprofit status.

A good portion of federal cases related to museum tax status focus in on what museum behavior can be considered taxable. A 1999 case, ruling in favor of the Museum of Flight Foundation, serves as an excellent nexus for cases of this ilk.<sup>26</sup> What's interesting about this case is that the court, here, is highly sympathetic to the mission and purpose of the museum, saying

---

<sup>25</sup> Sun-Herald Corporation v. Duggan, 73 F. 2d 298 (Circuit Court of Appeals, 2nd Circuit 40).

<sup>26</sup> Museum of Flight Foundation v. US, 63 F. Supp. 2d 1257 (Dist. Court 1999).

that a lease of historic aircraft to Boeing “significantly advanced the Museum's mission to restore and display historic aircraft.” In a very real sense, there is a direct benefit to having a clear mission statement and engaging in activities that uphold that mission.

Even in this very broad look at the case law, it should be clear that there are myriad statutes and rulings that shape the roles, responsibilities, and activities of an American museum. Although museums are given some latitude to self-regulate, especially in matters related to provenance and accessions/deaccessions, the fact is that museum activity is *de facto* highly regulated. Every gift shop opened, expansion started, and partnership forged is watched by the relevant county, city, and state, and particularly for medium-to-large sized museums, mistakes and irregularities are swiftly identified and, where possible, punished. The power wielded over museums by states through property tax exemptions cannot be understated, and connects directly to what the actual risks of changes to the tax code generally, and the most recently one specifically, are.

The part of the 2017 federal tax change, officially known as the Tax Cuts and Jobs Act, most relevant to the museum field relates to the SALT (state and local tax) deduction. The SALT deduction allowed individuals who itemized their taxes to write off state and local taxes when filing their federal tax return. This deduction benefitted high income individuals in high tax states, like New York and California, most directly. Taxpayers in such states both had the most taxable income and had that income taxed in large sums. With the most recent tax bill, the SALT deduction was capped at \$10,000. For many in the museum field, the fear here was that individuals who once benefitted from the deductions would be less charitable in the future.

These fears reflect a bearish attitude towards the possibilities and power of new sources of donations. This reliance of higher-income supporters at first glance might seem archaic or too

risk-averse considering the expanding resource pool from grassroots campaigns, crowdfunding, and contributions enabled more broadly by the internet and social media. Unfortunately, the fears are well-founded, as this “new money” is highly volatile and the beneficiaries can seem at times arbitrary. As the authors lay out in the book “New Power,” oftentimes there is little rhyme or reason to the success stories of non-traditionally funding, and the failures are far, far more numerous.<sup>27</sup>

Additionally, these donors are generally unmotivated by potential benefits of the tax code, largely because those benefits are almost nonexistent to small donors. As the US uses a tax-deductible system, a tax-deductible donation of \$35 dollars means very little to someone making \$15/hour, compared to the benefits of someone donating several thousand on a six-figure salary. Further complicating things is the reasons for donating, as small donors are significantly more interested in donating to causes they are personally aligned, or that they identify, with, both because their more limited resources demand greater scrutiny, and because the only benefits they see will be in personal fulfillment and social capital.

All of which is to say, any upsets to the traditional donor base that aren't offset by other revenue sources could potentially mean lean times for American museums. Along with the fact that museums by large don't (or more often can't) rely on grant funding to make up for a significant portion of their operating budget, these hypothetically minor hiccups can have sizeable ripples. Combined with growing scrutiny of, and backlash to, things like gift shops by state governments and the public at large, and the continuing effects of crippling blows to

---

<sup>27</sup> J. Heimans and H. Timms, *New Power: Why Outsiders Are Winning, Institutions Are Failing, and How the Rest of Us Can Keep up in the Age of Mass Participation* (Pan Macmillan, 2018), <https://books.google.com/books?id=kFQ7DwAAQBAJ>.

endowments in the wake of the Great Recession, and there is a real potential that museums are being squeezed in too many directions without a powerful alternative.

Of course, the worst of the worst case scenarios all predicate on only changes for the worse taking effect. At the time of writing, states like New Jersey are already sending through legislation to replace or approximate the SALT deduction, and while federal grants may be less plentiful and have lower utilization rates than other points in history, grants at the state level can often be just as or even more generous, with New York acting as an excellent example of a robust grant-making government.

The point of all this is that museums are venerable not just because of their inherent value to the public and the government, but also because of the specifics of their operations. Museums, in many ways, are extremely well-suited to weathering the types of problems and changes outlined here, as for centuries they have endured without the direct aid of governments or the public at-large, and that most fundamental provision of the tax code museums are offered, nonprofit status, is so deeply entrenched as to be virtually unassailable.

On a more cynical level, if there happens to be a sharp uptick in museum closures, this should come as no surprise. Museums, at least over the last several decades, have gone through boom and bust cycles in a sort of facsimile of the economy at large; that museums might close their doors should be less surprising than the fact that so many were able to stay open at all. The oft-touted statistic that there are more museums in America than McDonald's restaurants<sup>28</sup> is more indicative of an immense saturation of institutions than some growing national desire for gallery spaces and nontraditional learning.

---

<sup>28</sup> "There Are More Museums in the U.S. than There Are Starbucks and McDonalds – Combined - The Washington Post," accessed April 23, 2019, [https://www.washingtonpost.com/news/wonk/wp/2014/06/13/there-are-more-museums-in-the-us-than-there-are-starbucks-and-mcdonalds-combined/?utm\\_term=.1b7f1a13f43e](https://www.washingtonpost.com/news/wonk/wp/2014/06/13/there-are-more-museums-in-the-us-than-there-are-starbucks-and-mcdonalds-combined/?utm_term=.1b7f1a13f43e).

One area the federal tax code is abundantly clear on is nonprofit political activity. 501(c)(3) nonprofits are extremely limited in their ability to conduct political activity, with the IRS allowing them to conduct direct or indirect lobbying only to an “insubstantial degree” and disallowing electioneering, or actively campaigning, entirely.<sup>29</sup> Considering the existence of the 501(c)(4) designation, this is a fairly reasonable stipulation. What is curious about this is the level to which governments, state, federal, and other, consider museums to be independent entities.

The adage, “don’t bite the hand that feeds you,” is of course applicable here, and it is largely sensible for museums to avoid political activity entirely to avoid the ire of benefactors. But doing so is not always a straightforward consideration, and the delineation between 501(c)(3) and 501(c)(4) is not always perfectly clear. Consider the Supreme Court case of *Regan v. Taxation With Representation of Wash.*, wherein the organization Taxation With Representation (TWR,) a registered 501(c)(3), was taken to court over whether its activities counted as “lobbying.” In delivering the majority opinion, Justice Rehnquist said, “we conclude that Congress has not violated TWR's First Amendment rights by declining to subsidize its First Amendment activities,” and the court also took pains to note that this situation could have been avoided by a change in registration.<sup>30</sup>

The key takeaway from a ruling like this is that the government is keenly aware of its role in subsidizing speech, directly and indirectly, and it is not afraid to remind nonprofits of that. Mercifully, this scrutiny does not apply to individuals working for a museum, who are

---

<sup>29</sup> Heather Hope Kuruvilla, *A Legal Dictionary for Museum Professionals* (Rowman & Littlefield, 2016).

<sup>30</sup> *Regan v. Taxation With Representation of Wash.*, 461 US 540 (Supreme Court 1983).



hypothetically free to voice their own political opinions without jeopardizing a museum's tax status.

## **Findings and Analysis**

Museums, as nonprofit institutions, are completely exempt from federal taxes. This means that, for nearly all their activities, museums need only be concerned with good governance and achieving their missions. This exemption also extends to taxes on capital gains investments, and stocks, meaning that institutions can meet their long-term funding needs purely through responsible money management, rather than making sure all their activities and programs are “profitable.” Of course, these resources can evaporate in events like the Great Recession, meaning they are still bound by the laws of economic gravity, but by and large museums can focus on stability over profitability.

In lieu of shareholders concerned with profit, museums are beholden to a wide array of “stakeholders,” with their public, board of trustees, professional associations (e.g. AAM), and governments providing crucial feedback and more implied or loose requirements for conduct. Tax exemption and nonprofit requirements, in restricting certain behaviors, allow museums to focus completely on fulfilling their commitment to the public good. If a museum does engage in some for-profit activity, such as the gift shops that many institutions operate, they are free to do so without jeopardizing their status. These activities are taxed as normal businesses would be, but the museums are free to use the resultant funds to keep the lights on or subsidize expensive programs.

## **Conclusion**

The unique benefits that American museums receive, and the behaviors of the American donor class, are unlikely to change in an overall meaningful way in the near future. This isn't

because there will be no changes, but because almost every party involved with the system is happy with how it currently operates. When one tax incentive evaporates, another sprouts to replace it, usually at a different level of government. And even as new ways to interact with donors grow and mature, they show only sporadic or mixed efficacy in upsetting the current donor structure, especially where tax incentives are concerned.

All of this is to say that most museums are probably safe, and none of which is to suggest that museum professionals have no need to understand the forces and policies that fund and support their field. Taxes and legislation can be dry, complicated, and confusing, but where museums are concerned there is scarcely a topic that should be more universally understood by people upstairs and downstairs, fundraisers or no. All the technology and technique in the world cannot preserve a collection whose financial backing has dried up.

## Bibliography

- Di Gaetano, Luigi, and Isidoro Mazza. “‘Better an Egg Today than a Hen Tomorrow’ on the Implications of Deaccess Policies for Donations to Museums.” *Journal of Cultural Economics* 41, no. 3 (August 2017): 237–58.
- Dunn, Stephanie. “Please Don’t Make Me Pay Taxes: How New IRS Law Helps Art Collectors Avoid Hefty Taxes,” 2017, 39.
- Fullerton, Arnsberger, Paul, Melissa Ludlum, Margaret Riley, and Mark Stanton. “A History of the Tax-Exempt Sector: An SOI Perspective,” 2008, 31.
- “Art Museums By the Numbers 2016.Pdf.” Accessed April 18, 2019.  
<https://aamd.org/sites/default/files/document/Art%20Museums%20By%20the%20Numbers%202016.pdf>.
- Com. v. The Barnes Foundation, 398 Pa. 458 (Supreme Court 1960).
- Georgia O’Keefe Museum v. County, 62 P. 3d 754 (Court of Appeals 2002).
- Heimans, J., and H. Timms. *New Power: Why Outsiders Are Winning, Institutions Are Failing, and How the Rest of Us Can Keep up in the Age of Mass Participation*. Pan Macmillan, 2018. <https://books.google.com/books?id=kFQ7DwAAQBAJ>.
- J. Paul Getty Museum v. County of Los Angeles, 148 Cal. App. 3d 600 (Court of Appeal, 2nd Appellate Dist., 7th Div. No. 68154).
- Kalamazoo Aviation History Museum v. City of Kalamazoo, 346 NW 2d 862 (Court of Appeals No. 65328).
- Ladies Literary Club v. Grand Rapids, 298 NW 2d 422 (Supreme Court No. 63898).
- Museum of Flight Foundation v. US, 63 F. Supp. 2d 1257 (Dist. Court 1999).
- Regan v. Taxation With Representation of Wash., 461 US 540 (Supreme Court 1983).
- Stockton Civic Theatre v. Board of Supervisors, 66 Cal. 2d 13 (Supreme Court 7662).
- Sun-Herald Corporation v. Duggan, 73 F. 2d 298 (Circuit Court of Appeals, 2nd Circuit 40).
- “There Are More Museums in the U.S. than There Are Starbucks and McDonalds – Combined - The Washington Post.” Accessed April 23, 2019.  
[https://www.washingtonpost.com/news/wonk/wp/2014/06/13/there-are-more-museums-in-the-us-than-there-are-starbucks-and-mcdonalds-combined/?utm\\_term=.1b7f1a13f43e](https://www.washingtonpost.com/news/wonk/wp/2014/06/13/there-are-more-museums-in-the-us-than-there-are-starbucks-and-mcdonalds-combined/?utm_term=.1b7f1a13f43e).
- Don. “Tax Policy Toward Art Museums.” Working Paper. National Bureau of Economic Research, June 1990. <https://doi.org/10.3386/w3379>.
- Hemels, Sigrid. “Tax Incentives for Museums and Cultural Heritage.” In *Tax Incentives for the Creative Industries*, edited by Sigrid Hemels and Kazuko Goto, 107–35. Singapore: Springer Singapore, 2017. [https://doi.org/10.1007/978-981-287-832-8\\_7](https://doi.org/10.1007/978-981-287-832-8_7).
- Herguner, Burak. “Public Value as a Framework for Reforming Publicly Funded Museums.” *International Journal of Public Sector Management* 28, no. 6 (August 10, 2015): 461–74.
- John, Leila. “Museums and the Tax Collector: The Tax Treatment of Museums at the Federal, State, and Local Level.” *University of Pennsylvania Journal of Business Law* 15, no. 3 (2013): 877.
- Kosaras, Andras. “Federal Income and State Property Tax Exemption of Commercialized Nonprofits: Should Profit-Seeking Art Museums Be Tax Exempt Note.” *New England Law Review* 35 (2001 2000): 115–76.
- Temin, Peter. “An Economic History of American Art Museums,” n.d.

Wagner, Susan. “The Implications of Changing the Current Law on Charitable Deductions-  
Maintaining Incentives for Donating Art to Museums.” *Ohio State Law Journal* 47, no. 3  
(1986): 773–98.

Yermack, David. “Donor Governance and Financial Management in Prominent US Art  
Museums.” *Journal of Cultural Economics* 41, no. 3 (August 2017): 215–35.