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Working Session on Art Law

THE ART OF DEALING WITH ART

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General Reporters

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A. Background

The Private Client Commission's focus this year will be the art market, which has grown at an extraordinarily fast pace in recent years. In January 2015 the world's two largest auction houses Christie's and Sotheby's announced an increase in their quarterly revenue of around 17% year on year, while in February Sotheby's broke the record for the highest sales total at any London auction with a staggering figure of GBP186 million. The art fair Art Basel recently attracted record attendance with 92,000 visitors in 2014. Needless to say, this growing market has led to a growing need for legal advice.

The Private Client session will address some of the most important aspects of the rules governing art assets which we, as private clients lawyers, will need to deal with now and in future. In particular, we will be considering the tax issues which arise in connection with the ownership and acquisition of artworks, and the legal requirements which our clients must consider when buying and selling art (including cultural heritage schemes and the recovery of stolen art). We will also consider succession law and art, bearing in mind that, while artworks can act as a convenient repository for wealth which will appreciate over time, for many families they will have more personal connotations as well, having been passed down through generations or serving as a powerful indicator of individual taste.

B. Introduction

Please return the completed Questionnaire and your answers to the case studies below by **Saturday 28 February 2015**.

Please answer the following questions (including those following the case study), with reference to statute and case law as appropriate. We would be particularly interested in any illustrative examples of case law which may be relevant to the issues raised. Please provide answers which are as detailed as possible, including where relevant explanations of why a particular question or fact pattern does not raise any issues in your country.

Introductory questions

1. In which jurisdiction(s) do you practise art law? Do your answers cover other jurisdictions as well? **England & Wales. No**
2. How long have you been practising in the art law field?

3. How would you describe the majority of your art law cases:
- Inheritance law related Trade law related
- Tax law related Insurance law related
- IP law related Litigation
- Corporate matter of art dealers incl. art dealer/artist relationship other: _____
4. Would you describe Art Law as your main area of practise? How much of your working time do you spend on art law related matters (in %)? **No. About 5%**
5. What are the major changes and challenges relating to your work on art law related matters in recent years (in a broad sense, eg. acquisition of clients, required expertise, material law questions)? **Number of taxes that can apply. The surprisingly diverse areas and issues that can arise in relation to art.**

Taxation

6. What determines liability to tax of moveable assets for individuals in your country (e.g. habitual residence, domicile)? **Domicile and residence. In some circumstances, where it was purchased, with what and where it was moved from/to.**
7. What determines liability to tax for structures holding moveable assets in your country? **Broadly, domicile and residence of the settlor/transferor and beneficiaries/participants, whether the settlor/transferor is excluded, residence of the structure, whether or not clean funds were used to fund the structure, the nature of the assets held and how it is structured.**
8. Has your country planned or proposed to introduce any new taxes on individuals who are either non-resident or non-domiciled with moveable assets in your country?
No new taxes that I am aware of.
- Has your country planned or proposed to introduce any new taxes on structures holding moveable assets in your country? **No new taxes that I am aware of.**
9. Does your country have any favourable tax schemes in life or on death for people who own items of significant cultural value? **Yes** If so, is an election required to participate in these? **See below.**

Heritage property can be given for national purposes or for the public benefit without any IHT or CGT charge arising (s.25 IHTA 1984). This includes transfers under the Cultural Gifts Scheme. The list of bodies can be found in Schedule 3 of the Inheritance Tax Act 1984 (which includes most public museums, galleries and archives in the United Kingdom). This exemption

is extended to gifts of national property outside any special scheme (for example a gift to a relative) which were potentially exempt transfers (or “PETs”) when made, and where the property is subsequently donated for national purposes or sold by private treaty to a national body by the recipient or accepted in lieu of tax. In each case the subsequent donation, sale or offer in lieu must have taken place before the original PET became a chargeable transfer.

Conditional exemption: in certain circumstances an application can be made to postpone the payment of IHT on transfers of value of heritage property made available to the public. A claim must be made within 2 years of the transfer of value or within a longer period as HMRC may allow. Liability can be deferred indefinitely but may subsequently become chargeable. Various undertakings have to be given: to look after it, make it available for the general public to view and keep it in the UK. Derogation from any of these points will cause the art to lose its National Heritage Asset status and become subject to taxation.

Items which have been granted conditional exemption from IHT or CGT can be purchased by private treaty by a body listed in Schedule 3 of the IHTA 1984 at a price which is beneficial to both the purchaser and private vendor. This is known as a Private Treaty Sale. Such a sale will not give rise to a charge to IHT or CGT. For example when an item that has been granted conditional exemption from IHT, which would have been payable at 40% but for the exemption, is sold to a Schedule 3 body the purchasing body will usually only pay about 70% of the item’s agreed open market value. So an item valued at £100,000 can be acquired for £70,000. This is made possible under an arrangement known as the *douceur*. It involves sharing the benefit of exemption between the vendor (typically 25%) and the purchaser (typically 75%). Hence the vendor normally obtains a sweetener of 25% and the purchase price is reduced by 75%, of the IHT and CGT otherwise payable.

An asset can be offered to HMRC in lieu of IHT. The Secretary of State has to agree to accept such assets. The standard of objects which can be accepted is very much higher than that required for the conditional exemption.

The Cultural Gift Scheme was introduced in 2013 and allows the donor to reduce their tax bill with a pre-eminent work of art, archive or other cultural item. Anyone donating such an item in their lifetime will be able to claim a tax reduction equal to 30% of its value against their Income or Capital Gains Tax bill, or a combination of the two. The object must be pre-

eminent or currently or formerly kept in a significant building. The individual must have a tax liability in the UK and wholly own the object(s). In order to make full use of the tax reduction, it can be spread over 5 years. There is no minimum period of ownership.

Buying and selling art

10. Is there any specific legal basis such as statutory codes or laws, or guidelines or regulations applied by market players or dealers which is applicable to art transactions (whether domestic or foreign¹ dealers are involved) in your jurisdiction (please also indicate, if any legislative procedures are currently planned or ongoing):

An artist has a right to a royalty on any resale of his work subsequent to the first transaction, if he has taken a copyright over that work of art. This is applicable until the copyright expires, and is set out in the Artist's Resale Rights Regulations 2006, which implemented the European Directive on the resale right.

- a. Are such requirements applicable to any person trading art? Or does it depend on certain criteria, such as legal entity/private person (i.e. a collector selling one of his pieces of art), size or revenue/profit?
- b. Are there different requirements for selling, leasing (eg. investment), lending (eg to a museum)?
- c. Are there differences in regard to the type of art (eg. age, origin etc.)? If so, what are the determining factors/definition of such art?
- d. Are there any other factors that determine the applicability of such requirements/ duties (eg. price, temporary transaction (eg. loan for an exhibition))?
- e. What, in your jurisdiction, would be defined as a piece of art of national importance? Please provide details, including whether there is legislation in place which governs or imposes restrictions on dealing with art of national importance. It must be an object, or collection of objects, of national scientific, historic or artistic interest, either in its own right or due to a connection with historical buildings. An assessment of whether or not a piece of art is a National Heritage Asset is made by HM Revenue & Customs,

¹ Foreign art dealers, who for example sell at an art fair in your country.

although in reality they take advice from the Museums, Libraries and Archives Council.
See further 13 below.

11. What are the consequences if the requirements referred to in question 11 are not met? To what extent may the art dealer be held liable?
12. If an expert makes an error (e.g. attributing a painting incorrectly) under what circumstances would he be liable?
13. From a practice point of view, what are the major legal challenges in relation to trading art in your jurisdiction and what advice do you give clients with respect to art transactions?

One challenge is if the painting is of cultural importance then the Reviewing Committee on the Export of Works of Art (“RCEWA”) can put a temporary block on the export of the art giving purchasers in the UK the opportunity to match the purchase price and keep the work in Britain. Where an export licence is objected to by an expert advisor it is referred to the RCEWA to ascertain whether it meets the Waverley criteria. If the committee finds that the criteria is met it recommends to the Secretary of State that a decision on a licence application should be deferred for a specified period to enable an offer to purchase to be made at or above the fair market price, which will also be recommended by the committee. To avoid unfairness a bid from within the UK must constitute “a matching offer”. To this end RCEWA, under its published guidance, recommends a “fair market price”. The applicant need not accept less (or indeed an offer at any level) but refusal may result in a decision by the Secretary of State to refuse to grant a licence. The fair market price will commonly include not only the applicants successful bid but also elements normally excluded when calculating a douceur.

Title issues and recovering stolen art

14. How does one establish title to art in your jurisdiction? **Provenance** We would be particularly interested in relevant case examples involving modern forms of art such as graffiti.
15. What principles or rules apply to the recovery of stolen, illicitly exported or looted art?
16. Does your jurisdiction participate in any international restitution schemes to assist in the recovery of stolen, illicitly exported or looted art? **The UK is a member of UNESCO.**

Succession

17. What determines succession to moveable assets in your country? **Domicile**

18. Are there any restrictions as to who can inherit artworks of national importance? Not that I am aware of, although there are the above mentioned restrictions on a **non-UK resident beneficiary moving the art of cultural significance abroad.**
19. How would an individual donate artworks to an institution or charity during his/her lifetime or on death? **By Will on death. Outright gift during lifetime (which could be done under the Cultural Gift Scheme mentioned above).**

Case study

You are very pleased to receive a referral of two new clients from one of the many charming AIJA members you met at the London Congress 2015. Suzanne is Argentinian and Frederick is English, and they married in a lavish ceremony in Venice in 2011, attended by many celebrities and paparazzi. The couple have two children: Alberto (born in 2012) and Victoria (born in 2014).

Frederick comes from a wealthy family and has inherited many artworks which are kept at his family's rural mansion. Last time Frederick visited his family home, he decided to give Alberto a painting for his third birthday so he put a label reading "For Alberto" on the back of his favourite Rembrandt.

Suzanne also has a keen interest in art, and has built up her own extensive collection. Suzanne and Frederick currently travel the world, going to galleries and attending auctions to find pieces to add to Suzanne's collection. They are considering moving to your country and living there until the children go to university. Suzanne would like to bring her collection with her, initially to hang in their new home but she is also considering selling some pieces through auction houses.

20. What pre-arrival tax planning opportunities in relation to Suzanne's artworks would you advise? **Assuming Suzanne is not domiciled or deemed domiciled in the UK, one opportunity would be for her to settle the art (before it comes to the UK) onto an offshore trust which then holds the art in an offshore company, with some form of licence to allow her to hang the art in her house. This would avoid CGT on a sale and be outside her estate for IHT purposes. The latter is attractive because she would, due to Victoria's age, be likely to be deemed domiciled in the UK by the time Victoria goes to university and Suzanne leaves. If IHT is not a concern then some form of leasing arrangement with an offshore company holding the art might be attractive**

to avoid CGT. (This assumes that any new Government elected in May does not change the non-dom rules!)

21. Once they have moved to your country, what estate and tax planning opportunities should Frederick and Suzanne consider in relation to their artworks? Prepare a Will to ensure it devolves according to their wishes (as opposed to the intestacy rules) and secures the full IHT spouse exemption (if Frederick died first this would be limited to £325,000 assuming Suzanne is non-UK domiciled, unless Suzanne made an election to be UK domiciled; if so she would have to be outside the UK for 4 successive tax years to lose this status). Assuming Frederick is UK domiciled he could consider giving art away during his lifetime (e.g. to his children) so that it falls outside his estate after 7 years. He could consider taking out term assurance (written into trust) over that period. Such art could stay in the rural mansion provided a proper chattels lease were put in place (otherwise it would be a gift with reservation of benefit). If it were thought that any art would secure the conditional exemption then this could be carved out during lifetime or death and perhaps held in trust, depending on their wishes. The Cultural Gift Scheme could also be used, if necessary.
22. Who will have a financial claim to the artworks if either Frederick or Suzanne dies without leaving a Will? For Frederick, being UK domiciled, the UK intestacy rules would apply so that, from 1 October 2014, the first £250,000 would go to Suzanne together with half the balance outright, and the children would take the other half on statutory trusts. Suzanne and the children (or any other person financially dependant upon him) could also have a claim under the Inheritance (Provision for Family and Dependants) Act 1975. For Suzanne, assuming she is domiciled in Argentina, Argentinian advice should be sought. The IPFDA 1975 would not apply to her estate if she is non-UK domiciled.
23. In relation to question 23, would the position be different if Frederick and Suzanne were not married? 22? Yes. For Frederick, just the children would inherit under the intestacy rules. If Suzanne cohabited with Frederick as his spouse in the same house for the whole period of 2 years before the date of death then she would be able to make a claim under the I(PFD)A 1975. For Suzanne, Argentina advice, would, again, need to be sought.
24. When either Suzanne or Frederick dies, what estate tax will be payable on the artworks? Inheritance Tax ("IHT"). It applies to an individual's worldwide estate if they are domiciled or deemed domiciled in the UK. If not so domiciled (e.g. for Suzanne) only the UK situs assets are subject to IHT.

25. Has Frederick made an effective gift of the Rembrandt to Alberto for succession and for tax purposes?

Succession

Arguably not. To be capable of constituting delivery to Alberto the act must be overt and unequivocal; spoken or even written words (otherwise than by Deed or declaration of trust) cannot suffice to effect the transfer. There has to be some non-verbal behaviour by the parties. Typically delivery in these circumstances takes place by the donor touching/labelling/listing the items or handing over the keys to the donee in the presence of an independent third party who prepares a statutory declaration. The fact that Alberto is 3 does not help!

Tax

No. The painting would remain part of Frederick's estate for IHT purposes (a gift with reservation of benefit).