



Private Collections in the public domain

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ALLEN & OVERY



This paper compares the tax regimes in force in the UK, France, Germany, Italy, Belgium, the Netherlands, Switzerland and the US, and looks at the extent to which they facilitate public enjoyment of privately owned collections, with a focus on art collections owned by private individuals.

The appendices to this paper contain more detailed discussion of the tax issues relevant to the ownership and transfer of works of art in the various jurisdictions.

We have not focussed on the different connecting factors that will determine whether an individual is a taxpayer in one jurisdiction or another. Rather, the aim of this paper is to highlight the kinds of mechanisms that governments have developed to encourage private owners to open up their collections for enjoyment by the public, or to transfer ownership of their collections to the public domain.



Antonio Canova
The Three Graces, 1814-7
Victoria and Albert Museum, London
ArtFunded 1994

Summary

Most jurisdictions offer incentives to encourage outright gifts of works of art to cultural institutions (although there is a notable absence in the UK of income tax relief for gifts of works of art).

However, for collectors who do not want to part with their collections, less is being done by governments to encourage them to loan their collections to cultural institutions. "Conditional exemption" regimes operated by some jurisdictions do offer some incentives in the form of inheritance tax mitigation, but these are generally only offered for items of very significant public importance, and the definition of public importance is in some cases outdated.

We have looked at the privileges afforded to a tax payer wishing to give away or lend items in his country of residence. However, it is also worth noting that tax reliefs are, for the most part, purely domestic and there is limited harmonisation across states, so cross border giving or lending can be even less attractive than domestic giving/lending. Clearly, governments are interested in encouraging the retention of items of great national importance. However, recent jurisprudence of the European Court of Justice signals a move towards harmonisation in the taxation of charities and their donors (at least amongst member states of the EU) and so the hope is that as governments do more to encourage public access, a process of harmonisation may also be seen.

Questions

- > What constitutes pre-eminence and should the criteria be revised?
- > How can we improve cross border co-operation in terms of gifts? Should there be more harmonisation across states?
- > How can we promote additional planned giving in the UK and what lessons can be learnt from abroad?
- > There are currently no income tax incentives for gifts of works of art in the UK - what value is to be gained by introducing such an incentive?
- > Conditional exemption - is the current balance between private ownership and access sufficient?
- > Should private collectors be encouraged to donate their works of art to established museums/ galleries rather than seek to set up their own galleries?

Comparison of Tax Incentives

1. I want to retain the ownership of my collection, but I am considering lending my collection to a public institution, or opening up my collection to the public. What tax privileges are available to me?

Caption to add
ArtFunded 0000



What income tax incentives are available to me?

The Netherlands

If I am a *Dutch* tax payer, I will generally pay income tax at a 30% rate on privately owned net assets on the basis of a notional return of 4% (i.e. 1.2% on my net wealth). Assuming that I own works of art for my personal enjoyment, rather than as an investment, the works of art are not considered property for income tax purposes and therefore not taxed, just as any other kind of moveable property in personal use is not regarded as property for income tax purposes. There is an exemption for works of art which are not in personal use and which are not held for investment purposes and which are loaned to a Dutch museum, but since the effect will be the same in tax terms whether I keep the works in my home or loan them out to a museum, there is no particular incentive for me to loan rather than retain them. However, if I do choose to lend my works of art to a museum, any income that I receive in consideration of the loan is tax free.

Germany

If I am a *German* tax payer owning works of art that are regarded as items of valuable cultural heritage, provided that I meet certain conditions as to public accessibility, I may deduct any expenses relating

to the preservation of those works in computing my taxable income. This relief is available up to a limit of 9% of my income in the year in which the expenses are incurred as well as in the following 9 years. This goes some way to helping owners to pay the costs of upkeep of the cultural heritage, in return for granting public access. There is no absolute standard to determine public accessibility. Rather, this is to be determined in the circumstances, recognising the interests of the owner and security needs. Items may be dedicated to a museum for the full ten year period or to several regular exhibitions over the period, and it is not necessary that all works should be presented at each exhibition.

Italy

Italy operates a regime which would enable me to deduct 19% of the expenses incurred in the preservation of any works of cultural interest (notified as such under the applicable law for the protection of the cultural heritage) from my tax bill. Although this is similar to the German regime described above and is subject to restrictions regarding sale, no conditions as to public accessibility are imposed.

If I am a tax payer in any of the other jurisdictions under review, I would not be entitled to any income tax privileges for making my collection publicly accessible. Indeed, in all jurisdictions other than the

Netherlands, income from fees paid in consideration for the loan is subject to full income tax under normal principles.

What inheritance tax incentives are available to me as executor or beneficiary of works of art?

If I have inherited the works of art as a beneficiary of a deceased's estate, it is likely that there will be inheritance tax to pay in respect of those works (although note that most jurisdictions provide for exemption from inheritance tax where assets pass to the surviving spouse, and in some cases to descendants). In some jurisdictions, inheritance tax is met by the deceased's executors, and in other jurisdictions, the burden falls on the beneficiary. However, a number of jurisdictions offer mitigation of inheritance tax liabilities in return for granting public access to works of art and for ensuring the retention of the works of art within the jurisdiction. This is generally for items of significant public importance, although there are no unified criteria across the jurisdictions.

United Kingdom

If I have inherited items of pre-eminent importance to the nation, or of significant cultural value and the deceased's estate is subject to UK inheritance tax, the items may be completely exempt from inheritance tax under the "conditional exemption" regime if, amongst other commitments, I provide suitable undertakings to retain the items in the UK and grant public access for an agreed amount of time per year per year. This may be achieved by loans to cultural institutions or by display in a private house which is open to the public.

Germany

Germany operates a similar conditional exemption regime for inheritance tax which relieves either 60% or 100% depending on the value of the works. As with the UK system, this exemption depends on conditions as to public access. It is a specific condition of the exemption that the annual costs of maintenance of the work exceed its annual revenues.

Italy

In Italy, there is also a conditional exemption regime providing relief from inheritance tax for items declared to be of public interest ("notified" cultural goods). However, although there are restrictions on sale, the conditions do not include a requirement for public access, so although this would operate as a

mechanism to encourage me to keep the works in Italy, it would not encourage me to provide public access.

Belgium

The Flemish Government is considering introducing a conditional exemption regime for works of art that are included in the list of protected moveable property of the Flemish community.



2. I am considering transferring my collection outright to a cultural institution. What tax privileges are available to me?

What income tax incentives are available to me?

If I am a taxpayer in any of the jurisdictions under review, I will be entitled to claim deductions against my taxable income for certain kinds of gifts to certain cultural institutions.

In a number of jurisdictions, income tax relief is available for gifts in kind of works of art to certain cultural institutions. The success of these incentives largely depends on the manner in which the regime is administered and the ease with which the donor understands its operation. Also of significance is the eligible recipient of the gift (for example, compare the public museum requirement in Belgium with the wider public or private museum requirement in Italy).

Switzerland

As a Swiss taxpayer, I can make gifts of works of art to entities which are exempt from tax on the basis of their public or charitable purposes and obtain a deduction for income taxes up to a maximum of 20% of my net income.

Frank Auerbach
Mornington Crescent, Summer Morning II, 2004
Ben Uri Gallery, The London Jewish Museum of Art
ArtFunded 2006

Comparison of Tax Incentives

Italy

If I am a taxpayer in *Italy*, I can make a gift of a work of art to a public museum or certain private museums and off set 19% of the gift's value against my income tax liability. However, the conditions for the deduction and the application procedure are complex, and there has not been wide up-take of this mechanism. Since 2005, as an alternative to the 19% deduction, I can also deduct from my taxable income (up to the lesser of 10% of my total income or Euro 70,000.00) the value of gifts of works of art made to certain private museums. The procedure applicable to this deduction is simpler than the procedure applicable in order to obtain the 19% deduction.

In addition, *Italy* operates a procedure for transferring goods of artistic and cultural interest to the State in lieu of income tax (and more recently also in lieu of VAT liabilities). It is the only jurisdiction out of those under review where this mechanism is available (although we understand that in Ireland and Spain similar regimes exist for income taxes). This is more valuable than the tax deductions for gifts of works of art to cultural institutions because the full value of the work is credited against tax, but it is obviously only appropriate for items accepted by the State as being of major public significance. Nevertheless, this measure appears to have been applied rarely. This may be due to

the complexity of the procedure, a lack of knowledge as to its existence and to the wide discretion retained by the State in accepting the transfer in lieu of tax.

Belgium

In *Belgium*, there is a fairly cumbersome regime in force for gifts of works of art to, or for the benefit of, certain public institutions. The donor-Belgian taxpayer may claim relief from income tax for the cash value of the works of art as assessed by the Minister of Finance acting on the opinion of a commission which looks at issues of valuation and international fame. The relief is limited to 10% of the net income of the donor and an absolute limit of 325,300 Euro per annum, which would offer comparatively little benefit if I have a very substantial income and items of significant value to give away.

The Netherlands

If I am a *Dutch* tax payer, I may claim relief from income tax for "annuity" gifts to cultural institutions. This is an arrangement under which I would agree - in a notarial deed - to donate fixed and equal payments over a period of at least five years. Such gifts may be made in cash, but the regime also allows gifts in kind - for example, I might agree to donate one-fifth of the ownership of a painting over a period of five years. There is no upper limit on the amount of the deduction and carry forward to future tax years is allowed.



Elie Pacot
Ewer and basin, 1711-2
Victoria and Albert Museum, London
ArtFunded 2007

There is also a regime for tax relief on one-off gifts, but this would be less valuable to me as it is restricted to 10% of my income.

Germany

As a *German* tax payer, since January 2007, I can make gifts of art to cultural institutions or non-profit organisations and obtain a deduction of up to 20% of my taxable income for that year. If the value of my contribution to the cultural institution

exceeds 20% of my taxable income for that year, the remaining amount can be carried forward into the following year.

United States

As a US taxpayer, broadly, I can obtain a deduction of up to 30% of my income for gifts of works of art to public charities and a deduction of up to 20% for gifts of works of art to private charities. I can carry forward any excess for the succeeding five

Comparison of Tax Incentives

years. i.e I can offset income tax to 100% of the value of the gift. There are anti avoidance provisions which restrict the availability of the deduction for gifts of property that are owned by the donee for less than three years.

United Kingdom

If I am a *UK* taxpayer, I can claim relief against tax on my income (and capital gains) for gifts to any recognised charity. This can include public museums and private charitable foundations. The relief is generous in that it is available up to the full amount of my taxable income (and gains) for the year of the gift or the previous year. It was originally only available for cash gifts and, although now extended to certain securities and land, the UK Government has stopped short of allowing relief for gifts of works of art.

One way around the absence of income tax relief for gifts of works of art might be for me to make a substantial cash donation to a charity (in order to obtain relief) followed by a purchase by the charity of items from my art collection. However, recently introduced rules dealing with transactions between charities and "substantial donors" mean that the benefit of the relief for my cash gift may be neutralised by restricting the tax reliefs for which the recipient charity itself is eligible.

France

If I am a French taxpayer, I can benefit from an income tax credit if my subscription serves to finance the purchase of works of art for a French public museum. This is subject to a limit of 66% of the value of my gift, up to 20% of my taxable income. If my donation that year exceeds 20% of my taxable income, the amount in excess can be deducted over a five-year period. [effectively covered under Gift taxes below]

(Note that French companies can (i) deduct from profits the value of works of living artists in equal amounts over a five-year period, (ii) benefit from a 90% tax credit by contributing to the purchase by French public bodies of heritage treasures, or (iii) benefit from a 40% tax credit by purchasing heritage treasures for myself, provided that such items are placed in a museum or a library for 10 years as of their date of purchase).

German School
The Cotehele Annunciation
Panels, 1498-1500
Museum of London
ArtFunded 2006

What inheritance tax incentives are available to me as the executor or beneficiary of works of art?

United Kingdom

In the *UK*, the "acceptance in lieu of inheritance tax" scheme enables works of art judged to be of pre-eminent national importance to be offered in part or full payment of inheritance tax. This scheme provides the biggest annual boost to public collections in the UK. In the past ten years, the scheme has acquired works of art valued at more than £250 million.



A similar arrangement exists under the UK's National Trust legislation which enables owners of stately homes to donate these and their contents to the National Trust. The Trust opens up the bulk of the estate for public enjoyment, whilst permitting the former owners to reside in a smaller part of the property. Although this can be attractive to those with particularly large and old estates, who no longer have the finances to cover the onerous repair and maintenance costs, the National Trust increasingly needs to look for a substantial endowment in addition to the gift in order to make such a public investment sustainable.

I am an owner of conditionally exempt works of art (discussed above) and decide to sell the item, the "Private Treaty Sale" regime would also encourage me to consider selling the item to one of a number of specified public bodies (known as 'Schedule 3 bodies') rather than on the open market to avoid withdrawal of the conditional exemption and capital gains tax liability on the sale, the tax benefits are split between the seller and the Schedule 3 body, and are normally shared so that the seller receives 25% of the tax saving (known as the 'douceur') and the Schedule 3 body receives 75%. Although I would achieve a purchase price that is lower than the open market value, I will generally be better off than I would have been (after tax) if I had sold in the open market.

Comparison of Tax Incentives

The Netherlands

The Netherlands operates a similar regime to the UK "acceptance in lieu" scheme for moveable works of art which are –broadly – of great national or historical value. 120% of the value of the work of art is taken into account in computing the inheritance tax set-off which, in theory, makes the scheme attractive. However, the Dutch government does not disclose which works of art have been acquired by this means and it is thought that there has not been a significant uptake.

Germany

There is also a provision under the *German Fiscal Code* which would enable me as a German beneficiary to grant works of art to the state in lieu of tax, but this is used relatively infrequently principally because of issues about valuation. More attractive is the mechanism which allows me to hand over a work of art to a German charitable foundation within two years of my inheritance and achieve a retroactive exemption from the tax that was paid in respect of the inheritance.

Belgium

Belgium also operates an "acceptance in lieu" regime for items belonging to the nation's moveable cultural heritage or which enjoy international fame (which is subject to a similar cumbersome procedure as for gifts to public museums described above). As with parallel regimes in other jurisdictions, the conditions are regarded as too restrictive and a modernisation review is currently under way.

Italy

Italy's acceptance in lieu regime for inheritance tax operates along broadly the same lines as gifts in lieu of income tax discussed above, with some differences. Notably, for income tax, the filing of a proposal to transfer the goods to the State in satisfaction of the tax does not suspend the payment of the tax. Once the transfer has taken place, I can request the repayment of the tax paid in the period between the filing of the request and the actual transfer, or use the tax credit resulting from the transfer for the payment of income taxes becoming due after the transfer. On the other hand, for inheritance tax, the filing of a proposal to transfer the goods to the

State suspends the payment of the tax. If the value of the goods is lower than the tax, I would pay the difference while, if the value is higher, I would not be entitled to a refund by the State.

Switzerland

Three cantons in *Switzerland*, Geneva and Jura and Waadt (Vaad) allow for the payment of inheritance taxes through donations to the canton of works of art of particular artistic, historic or scientific importance (so called *dation en paiement*). The canton of Freiburg (Fribourg) is currently planning such a regime.

France

France operates a regime called "dation en paiement" which allows for the payment of inheritance and gift taxes through donations of works of art, provided a prior approval has been granted fixing the value of the items. The "dation en paiement" will be effective upon acceptance by the taxpayer of the value assessed.

In addition, France exonerates from inheritance and gift taxes gifts of works of art to the State and I can choose to make the gift during my lifetime, and retain possession until I die. Alternatively, I can choose to make the gift on my death, and stipulate that my spouse can retain possession during her lifetime.



Diego Velázquez
'The Rokeby Venus' 1648-51.
National Gallery, London.
Presented in 1906 as a gift
by the Art Fund.

Am I entitled to any exemptions from sales or gift taxes when I transfer works of art to cultural institutions?

Sales taxes

As a taxpayer in any of the jurisdictions under review, I will generally not pay tax on the capital gain when I gift a work of art to a cultural institution, either because there is a specific exemption for such gifts, or because gains on gifts/sales of works of art owned by taxpayers for personal enjoyment (rather than as an investment) are generally not subject to tax.

Note that in the UK, the Private Treaty Sale procedure referred to previously in the context of the conditional exemption also confers a capital gains tax exemption on sales of pre-eminent works to Schedule 3 bodies, with the benefit of the exemption shared between the seller and purchaser by reflecting this in the sale price.

Gift taxes

Lifetime and testamentary gifts to cultural institutions are generally exempt from gift and inheritance taxes in most of the jurisdictions under review.

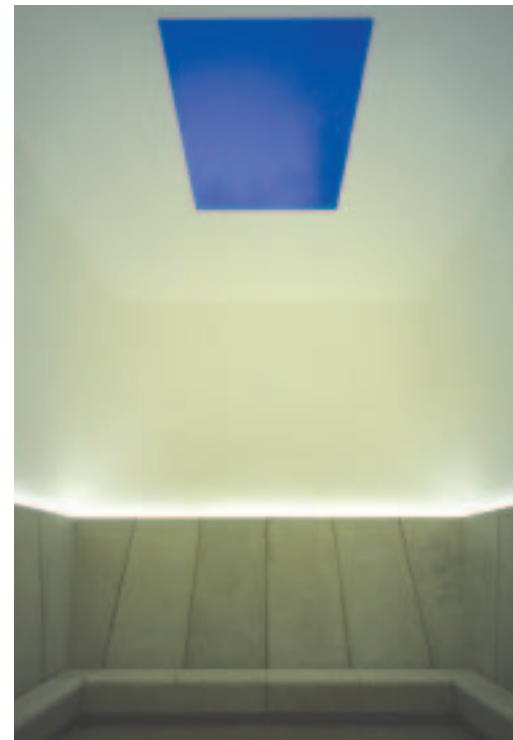
Note, however, that in *Belgium* registration taxes on lifetime gifts (made by deed) and inheritance taxes (at reduced rates) are payable even on transfers to cultural institutions, although the often used "manual gift" procedure can be used to avoid tax on lifetime gifts provided that the donor does not die within three years of the gift.

Droit de suite

Note that in relation to sales as opposed to gifts of contemporary works of art, the "droit de suite" introduced by the Resale Rights Directive applies in the EU. Broadly, this provides for artists' resale royalties to be paid to artists who are nationals of member states of the EU or of the European Economic Area (or their heirs) for the period of 70 years after the artist's death on a proportion of the sale price, up to a maximum of 12,500 Euros. However, these royalties are not applicable where an individual (who is not a professional art dealer) sells the work of art to a museum that is open to the public.

3. What is the position if I want to lend or gift a work of art to a museum in another jurisdiction?

James Turrell
The Deer Shelter 2006
Yorkshire Sculpture Park
ArtFunded 2006



Can I get equivalent privileges for gifts to foreign cultural institutions?

In general, donations to foreign charities do not qualify for the same tax benefits as donations to domestic charities. In some states, tax benefits for gifts to foreign charities are available in particular circumstances. For example, in Italy, donations to foreign cultural institutions such as public or private museums are exempt from gift and inheritance taxes on mutual terms (i.e. only if the same treatment is provided for Italian museums in the relevant country); and in the US, the income tax deduction is available for contributions to charities in three countries with which it has concluded tax treaties conferring reciprocal income tax benefits for charitable giving, and estate tax deductions are available in respect of transfers to certain kinds of foreign charities. By contrast, the UK tax regime only confers tax benefits in relation to gifts to UK charities.

The European Court of Justice's decision in the *Walter Stauffer* case of September 2006 confirmed that different treatment of domestic charities and similar charities established in other member states offends the principle of freedom of movement of capital. The case dealt specifically with the availability of an exemption from German tax of rental

Comparison of Tax Incentives

income earned by an Italian charity, but, going forward, EU states will have to look very carefully at whether they can justify discriminating between gifts to domestic and foreign charities. For example, the *Netherlands* is implementing legislation in January 2008 which will allow charities established in other member states of the EU to register in the Netherlands. *Belgium* (and its regional states) has adjusted its legislation by extending the reduced rates of gift and inheritance taxes to transfers to charitable organisations to entities established in a member state of the EU or EEA (provided certain conditions of substance are met) and has acknowledged that it is required to extend the income tax incentives. It is, however, conceivable that, in the context of art collections, the public interest in retaining national treasures within the jurisdiction may be relied upon to justify different treatment in certain cases.

What about import taxes?

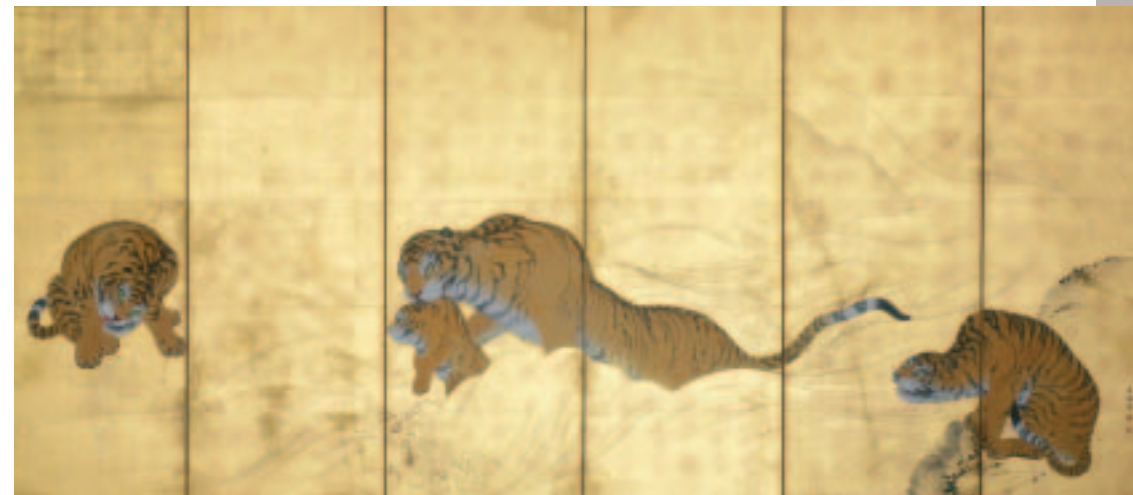
It is also worth mentioning that there are generally reduced rates for or exemptions from import taxes for works of art which are not intended for sale. In the EU, these provisions rely on a harmonised European definition of "works of art". The European Court of Justice has been asked to clarify the meaning on several occasions, usually because of problems with the definition, particularly in the field of contemporary items. For example, in a dispute on paperweights, the Court decided that sculptures which are commercial in character, and in particular works of craftsmanship, do not qualify as art under the definition even if it is recognised as being of an artistic nature and possibly placed in a museum. In this case, the Court set the following criterion: works of art are entirely personal creations through which artists express an aesthetic ideal and they do not compete economically either with each other or with other articles.

Case Study

Isabella is an Italian national living in London. Isabella purchases a painting which was hanging in her flat in New York. She subsequently lends it to MOMA for an exhibition. While it is on exhibition she dies. As the painting was not brought into the US solely for purposes of the exhibition it will have a US situs and chargeable to US estate tax.

Note that in this example, if Isabella had brought the painting to the US solely for the purposes of exhibiting this at MOMA, no estate tax would be due upon her death. A similar exemption from UK inheritance tax for items brought to the UK for the purposes of exhibition in a public gallery exists by way of extra statutory concession, although it should be noted that this was introduced as recently as 2003 in response to representations from Allen & Overy in relation to an overseas client who wished to lend a work of art to the National Gallery.

Maruyama Okyo and pupils
Tigers Crossing a River, c 1781-2
British Museum, London
ArtFunded 2006



Case Study

Ms Jansen, a Dutch resident living in Amsterdam, intends to give ?100,000 to the Victoria and Albert museum (V&A) in London. She asks what the Dutch fiscal consequences of such gift are for her and the museum. This depends mainly on the year she wants to donate the ?100,000. We would advise her to wait at least until 2008. The reason for this is that under the current legislation she will not be able to claim gift deduction for the gift and the museum will have to pay ?47,384 Dutch gift tax. Both Ms Jansen and the museum could file an appeal arguing that, based on the Walter Stauffer case of the European Court of Justice, such tax is not allowed, but the court procedure would cost time and money. As of 1 January 2008 cultural institutions (and other charities) resident in other EU member states can ask for a Dutch charity registration. After they have been granted such registration, the Dutch tax incentives for charitable gifts also apply to gifts to these EU charities. The V&A should therefore apply for registration in the Netherlands, a registration which would probably be granted.

Once the V&A is a Dutch registered charity, it can receive gifts from Dutch residents free of Dutch gift tax (the V&A will also be exempt from Dutch inheritance tax). Furthermore, Ms Jansen can deduct the gift to the registered V&A from her income. She would be able to get a full deduction for the gift if she agrees - in a notarial deed - to give a yearly donation of ?20,000 over 5 years, starting in 2008. If she donates the full amount in 2008, she would only be able to deduct the gift insofar as the total amount of her gifts exceed 1% of her income and her deduction would be capped at 10% of her income.

Case Study

1. Marquis Birago is the descendant of an old family of the Italian town of Ferrara. His ancestors have collected during the 19th and 20th century a vast number of renaissance and baroque paintings that are still displayed in the family palace in the town centre. Upon the Marquis' death, the heirs are faced with inheritance tax on the estate which includes the family palace, the paintings, land and other properties. Some major paintings in the collection and the palace are "notified" for their cultural importance. A number of other paintings are not notified. The heirs are thinking of offering to the State the non-notified paintings in satisfaction of inheritance tax as they think that the State may be interested in acquiring the ensemble (which is representative of the schools of Emilia Romagna and, in particular of Ferrara) for the local public gallery.

While the heirs' offer will suspend the payment of the inheritance tax until the procedure is completed, it is advisable that they heirs consider carefully the market value of the paintings because, should this result in a higher sum than the tax due, they

would not be entitled to a refund by the State. In addition, they should consider that no inheritance tax may be due on the "notified" palace and paintings (if all applicable conditions are fulfilled) so that the total tax bill may be lower than they expect.

2. Ms Solaro is the owner of two paintings, one by Fontana and one by Manzoni. She is thinking of offering them to the State in satisfaction of her income tax liability. She may do so notwithstanding that the paintings are less than 50 years old (and, therefore, according to Italian law, cannot be "notified" for their cultural importance) provided that the State is interested in acquiring the paintings (as, for example, it plans to display them in a modern art gallery in Italy). In contrast to the case of Marquis Birago's heirs, the filing of Ms. Solaro's offer will not suspend the term for the payment of her income tax. Once the transfer has taken place, she will be entitled to obtain the return of the sum paid in the period between the filing of the request and the actual transfer, or she may use the tax credit resulting from the transfer for the payment of income taxes that will become due after the transfer.

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This paper is intended only to give an overview of
the general situation. For detailed information,
consult your professional adviser.