

ART & ADVOCACY



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A Primer on Art Loans

By Lawrence M. Kaye & Yael Weitz

There are many reasons a private collector would want to loan a work of art to a museum. Museum loans present a philanthropic opportunity for lenders to share their works with the general public in a controlled and safe environment. Additionally, the borrowing museum may provide new scholarly information about the works. Inclusion in a museum exhibition could also bolster an artwork's provenance, potentially increasing the work's monetary value through public exposure.¹ Many museums, however, frown upon the sale of a loaned work shortly after an exhibition. These museums often include a provision in their loan agreements that prohibits a sale within a specified period after the close of the exhibition. These periods can range from as short as three months to as long as two years after the conclusion of the loan.

Before loaning a work of art, a potential lender must first consider whether it is appropriate to lend a particular work, taking into account safety and damage concerns. Once these issues are addressed, the potential lender must then determine what should be included in the loan agreement once a work is approved for exhibition.

Preliminary Considerations

As a starting point, a potential lender should determine whether an artwork is sufficiently robust to withstand the stress of travel. Even objects that are stable while not in transit may become vulnerable to damage when moved, and this risk should be carefully assessed. Once travel is deemed safe for a particular work, a conservator should prepare a detailed condition report before the artwork leaves the lender's possession. That way, both the lender and the borrower can determine if the work was damaged while in transit.

The next issue to consider is security, both while the work is on exhibit and while in storage. For example, a lender may want to examine the security cases and/or the location of the objects during the exhibition in relation to the viewing public. It is also a good idea to become familiar with the security systems and protocols in place at the borrowing museum.

Owners should also consider if the loan creates a use tax liability. This tax applies on account of a property's use within a taxing jurisdiction (in contrast to the sales tax, which applies on account of a property's sale within a taxing jurisdiction). For example, if a painting is purchased in State A, and five years later is loaned to a museum in State B, the use of that painting in State B (i.e., its exhibition at a State B museum) may subject it to a use tax. Generally, sales tax paid on a property will be credited against the owner's use tax liabilities, if any. The challenge, therefore, is mainly for works that were protected from sales tax, whether on account of happenstance or creative tax

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A Primer on Art Loans (continued from page 1)

planning. The circumstances that create a sales tax exemption or discount tend to vary from state to state, and a work that has not been subject to sales tax might become subject to use tax on account of a loan to a museum situated in an inhospitable taxing jurisdiction. In those circumstances, a lender may face a use tax that is prohibitively expensive.

Another preliminary issue for the lender to consider is whether there are any provenance questions regarding the artwork. If there are competing claims to a work, these may open the artwork to the risk of judicial seizure. Countries that currently have a law on immunity from seizure include the United States, Canada (at provincial level), the United Kingdom, France, Switzerland, Belgium, Austria, Germany, Israel, Australia, and Japan.

In the United States, the Immunity from Judicial Seizure statute, 22 U.S.C. § 2459, protects certain objects from seizure by the U.S. Government. Pursuant to the federal statute, any not-for-profit museum, cultural, or educational institution may apply to the U.S. Department of State for a determination that art to be

loaned from abroad for exhibition is culturally significant and that the exhibition is in the national interest. If the application is granted, the art is immunized from judicial seizure by the federal government. At the state level, New York, Rhode Island, Tennessee, and Texas have anti-seizure laws for cultural objects. These statutes have provisions similar to those in the federal Immunity from Judicial Seizure statute, but only protect such objects from seizure by state, as opposed to federal, government authorities.

Unlike with individual collectors, where the lender is a cultural institution owned by a foreign state, there are added issues to consider. Under the Foreign Sovereign Immunities Act (FSIA), a foreign state and its agencies and instrumentalities are immune from suit in U.S. courts unless certain exceptions apply. See 23 U.S.C. §§ 1602, *et seq.* Nevertheless, an artwork's presence in the U.S. may become the basis for jurisdiction even where the object is immune from seizure. This was the case in *Malewicz v. City of Amsterdam*, in which the heirs of Kazimir Malevich brought a restitution claim to recover 14 Malevich works that were on loan in the U.S. from the Stedelijk

Museum in Amsterdam. Prior to the loan of the artworks to the U.S. museums, the museums secured immunity from seizure from the U.S. State Department. Nonetheless, the heirs were able to establish jurisdiction under the FSIA based on one of the statute's enumerated exceptions. *Id.*, 362 F. Supp. 2d 298 (D.D.C. 2005); *Malewicz v. City of Amsterdam*, 517 F. Supp. 2d 322 (D.D.C. 2007).

Following this decision, in 2012, federal legislation was introduced in the U.S. House of Representatives to overrule *Malewicz* and essentially provide for immunity from lawsuits for foreign states that obtain immunity from seizure for artworks on loan to the U.S. The legislation, called the "Foreign Cultural Exchange Jurisdictional Immunity Clarification Act," passed the House, but the Congressional session ended while it was pending in the Senate. The bill was reintroduced in March 2014, but it again failed to pass the Senate. The bill has now been reintroduced a third time and is currently pending.²



"Tahitians on the Riverbank" by Paul Gauguin is on long-term anonymous loan to the Honolulu Museum of Art.

The Loan Agreement

Collectors lending to museums should also carefully

consider the loan agreement with the museum. Although art loans raise legal concerns that touch on a variety of issues, the forms provided by the borrowing museum are often quite short and inadequate for purposes of the lender. To maximize protection, lenders should not hesitate to negotiate and add any terms reasonably necessary to protect their interests to the loan agreement. A few key areas to focus on include:

- a. Insurance:** The agreement should describe the insurance coverage for the artwork, including the work's insurance value. The lender typically provides this number. International loan agreements should also take into account whether any government insurance will be provided. For example, the UK has a Government Indemnity Scheme, as does the U.S. In the U.S., if the exhibition is insured through the Arts and Artifacts Indemnity Act of 1975, the U.S. Government will pay insurance claims in addition to the insurance coverage provided by the borrowing museum. This insurance applies to artworks loaned to U.S. exhibitions, where the artworks are of educational, cultural, or scientific value, and are certified by the Secretary of



State as being in the national interest.

b. Taxes: For international loans, the loan agreement should take into account any tax considerations that are specific to the host country. For example, in the U.S., the Internal Revenue Code, Section 2105(c), provides that artworks loaned to a public gallery or museum in the U.S. will not be subject to estate taxes, if such works remain on loan at the time of the owner's death, as long as the owner is a non-resident who is not a U.S. citizen.

c. Copyright: The loan agreement may need to include copyright provisions. If the borrowing institution plans to photograph the artwork for publicity materials or commercial purposes, and the artwork is under an existing copyright, the borrower will have to obtain permission from both the owner and the copyright holder.

d. Force Majeure: The agreement should address the lender's concerns about circumstances beyond the parties'

control, including war, natural disaster, and political unrest. Many loan agreements excuse performance of certain provisions where events of this kind make performance of the contract dangerous.

Art loans will never be risk-free. But for every loan, there is a cost-benefit analysis that must be made. It is up to the lenders and borrowers to assess the risk and, if they decide to go forward with the loan, to ensure that steps are taken to maximize the safety and security of the artwork.

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- 1 See generally Traditional Fine Arts Organization, "A TFAO Report: Lending Art to Museums for Special Exhibitions," <http://www.tfaoi.com/aa/7aa/7aa993.htm>; Chubb Group of Insurance Companies, "Loaning Art to Museums and Cultural Institutions," https://www.chubb.com/cpiebcontent/cpihomepage/pdf/02010424_LoaningtoMuseums.pdf.
 - 2 See generally <https://www.congress.gov/bill/114th-congress/house-bill/889>.



Tax Benefits and Pitfalls of Private Museums¹

By Jason Kleinman & Michelle Bergeron Spell

Collectors who have run out of space to store or display their art at their homes inevitably confront the question of what to do with their spare art. Collectors who are considering their estate planning options might also question how their art figures into their legacy. The options typically considered are to sell, bequeath, or donate the art. This article describes a twist on the third of these options: the donation of one's art to a museum located on or near one's property, where the museum remains largely controlled by the donor and might be thought of as an extension of the donor's personal residence.

The choice between selling, bequeathing, or donating one's art is sometimes influenced by tax considerations. To illustrate how these considerations play out in real life, let's assume we have a collector who paid \$10 over the years to amass a collection that today is valued at \$100. Let's further assume that our collector's net worth (excluding art) exceeds the threshold for estate, gift, and generation-skipping taxes (i.e., for a married couple, \$10 million plus upward adjustments for inflation), so we can be reasonably sure that a 40% tax will be levied on the fair market value of any art that our collector bequeaths or gives to a child.² Our collector's options then appear to be:

1. Sell the art for \$100 and pay tax on the gain. At the federal level, the long-term capital gains tax rate of 28% plus a 3.8% surcharge for the so called "Medicare Tax" should apply, for a cumulative federal tax liability of \$28.62 on the \$90 of gain.³ This leaves the collector with a net return of \$71.38. Assuming this \$71.38 is eventually given or bequeathed to the collector's children, an additional 40% gift or estate tax would apply, leaving the collector's children with \$42.83.
2. Give the art to her children and pay gift tax on the \$100. This should trigger a gift tax liability of \$40, which the donor would be required to pay. The children would receive the art with a "carryover basis," meaning that the children would be liable for a capital gains tax and Medicare Tax in the cumulative amount of \$28.62 upon their sale of the art, as described in the preceding example. This results in a \$40 liability for the donor and a transfer of \$100 to \$71.38 of value to the donor's children, depending on when and whether this capital gains tax is incurred.
3. Donate the art to a museum and claim a \$100 charitable deduction. As we can assume the donor is taxable at the federal level at a 39.6% rate plus a 3.8% Medicare Tax, this



deduction can result in a tax savings of as much as \$43.40. Assuming this \$43.30 of tax savings is eventually given or bequeathed to the collector's children, a 40% gift or estate tax would apply, leaving the collector's children with \$26.04.

The examples above provide a rough illustration for the idea that, after tax consequences are taken into account, selling and donating art can yield roughly the same amount of financial value. This is even more likely to be the case if state and local income taxes are figured in, as these additional taxes increase the cost of selling and, conversely, increase the savings to be had from donating one's art to a museum.

For those collectors who would like to partake in the charitable giving described above, but are reluctant to cede control over their collections to a wholly unrelated museum, the idea of establishing their own museum, with curators of their choosing, might be a welcome one. Some of these collectors might even prefer for such a museum to be located on or near their personal residence, or for the museum to display its art within their homes. The challenge for such an arrangement is in determining when a donor's control over a museum renders the museum ineligible for tax-exempt status. The applicable restriction is found in the Treasury Regulations on charities, which state, in relevant part, that "it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."⁴

There are only a handful of authorities describing how this restriction is applied to a museum. Private Letter Ruling 8824001 appears to provide the most relevant guidance to persons considering this strategy. The donors described in this ruling were the sole contributors to a charity they had created, and the charity displayed sculptures on the donors' property. Some of the sculptures were viewable from the road, but most were obscured by a privacy hedge or fence. The donors permitted members of the public to tour the grounds upon request. The donors notified various art museums and schools of the

opportunity to tour the grounds. The museum had almost 300 visitors per year.

The IRS ruled that this charity did not qualify for tax-exempt status because it ran afoul of the prohibition against operating for private interests. In arriving at this ruling, the IRS noted:

1. The absence of a sign to advise passersby of the museum's location;
2. That most of the sculptures were clustered near the donors' home and pool, as opposed to more remote and less personal portions of the donors' grounds; and
3. The fact that no effort was made to advise the general public of the opportunity for touring the grounds.

From the foregoing, we may infer that a museum located on or near one's property might qualify for tax-exempt status if it is well publicized, physically separated from the donor's personal living spaces, and is identified by signage.

Many donors, however, would be reluctant to create a museum on or near their residence if in doing so they must advertise the museum's location and invite members of

the general public to visit. This option is likely to appeal only to donors with estates that are large enough to permit a remote portion to be set aside for a museum, at a distance from their personal residence that is sufficient to permit a measure of privacy. This appears to be the price one has to pay to qualify for a charitable tax deduction for art contributed to one's own museum, where the donor can manage the charity and, to a degree, appear to retain the work by keeping it close to home.



The Musée de l'Éventail, a private museum in Paris.

1 IRS Circular 230 Disclosure: To ensure compliance with Treasury Department regulations, we inform you that any U.S. federal tax advice contained in this document (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code of 1986, as amended (I.R.C.) or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

2 I.R.C. §§ 2001 and 2010.

3 The long-term capital gains tax rate from the sale of collectibles, including art, is 28%, whereas the long-term capital gains tax rate from the sale of stock is only 20%. I.R.C. § 1(h).

4 Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii)



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Art Law Events

Recent Events Involving Herrick's Art Law Group

June 4, 2015

Jason Kleinman spoke on a panel entitled "Death, Debt and Divorce: What Appraisers Need To Know" hosted by the Appraisers Association. The event was held at Herrick, Feinstein's offices in New York City.

June 9, 2015

Darlene Fairman participated in a fireside chat entitled "Managing Collectibles: Establishing Policies to Protect and Preserve Art, Wine, Cars and Other Valuables" at the annual SFO Wealth Operations & Performance Conference that was held at the Princeton Club in New York City.

June 17, 2015

Stephen Brodie spoke on a panel entitled "Managing Risk in Art Transactions" with Laura Patten of the Art Crime Program at the FBI; Judy Pearson, President of ARIS Title; Dina Friedman of JPMorgan; and Annelien Bruins, Chief Operating Officer of Tang Art Advisory, held at Herrick, Feinstein's offices in New York City.

June 25, 2015

Darlene Fairman spoke on a panel entitled "Art Authentication Issues" hosted by Herrick, Feinstein and *The Art Newspaper*. Anna Somers Cocks, Founding Editor and CEO of *The Art Newspaper*, moderated the panel held at Herrick, Feinstein's offices in New York City.

June 26, 2015

Howard Spiegler was co-organizer of the Institute of Art and Law, UIA and the British Library's first rare book conference entitled "The Written Heritage of Mankind in Peril: Theft, Retrieval, Sale and Restitution of Rare Books, Maps and Manuscripts." Howard also moderated one of the panels at the event entitled "The Legal Framework for Retrieving Stolen Books: An International Case Study." The event was held at the British Library in London.

Upcoming Events Involving Herrick's Art Law Group

August 1, 2015

Lawrence Kaye will give a lecture entitled "The History Behind Gustav Klimt's Portrait of Adele Bloch-Bauer – The Lady in Gold and his other works" at Congregation Shirat HaYam in Nantucket.

September 30, 2015

Herrick, Feinstein and *The Art Newspaper* will host "Challenges of Loaning Works of Art" a panel that will be moderated by Jane Morris, Editor of *The Art Newspaper*. The event will be held at Herrick, Feinstein's offices in New York City.

October 28, 2015

Howard Spiegler will moderate a panel at the Annual Congress of the Union Internationale de Avocats (UIA) entitled "Posthumous Casts: What Is an Original and What Is a Legitimate Reproduction: a Mock Case Study" and will speak on a separate panel entitled "To Authenticate or not to Authenticate? The Artists' Foundations' Dilemma." Howard is the Vice President of the UIA's Art Law Commission. The event will be held in Valencia, Spain.

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