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# International Art Collecting — Investment and Succession Strategies

By Marla Wasser, Tammy Anklewicz, and David Kerzner

As any art collector understands, buying art is deeply personal and can be a rewarding venture on many levels. As with any important investment, there are also responsibilities. Unfortunately, it is beyond the scope of this short article to enumerate all of the pertinent acquisition, tax, and succession issues that may arise in connection with each family's unique relationship with their collection. Knowing this, we have put together a few thoughts that we hope you will find interesting and will stimulate you to pursue your own research as you collect. This article touches on three subject areas: acquisitions; dispositions on death; and cross border tax planning.

## I. ACQUISITIONS

With the growing number of specialized art websites (including galleries, auction houses, art pricing sites and more), the art market is now truly a global affair, which makes collecting more exciting, but also more daunting. Buying art can be a serious investment, similar to investing in real estate or equities. Art collectors are now adding art advisors to their inner circle of specialized lawyers and financial advisors, recognizing their value within the complex process of acquiring and investing in art.

### *Research*

Get to know the artists or genre that you want to collect, and educate yourself by subscribing to websites (e.g. Blouin ArtInfo at www.artinfo.com), reading art-related books, speaking with experts, and going to gallery and museum exhibitions. Consider using travel as an opportunity to visit new galleries and educate yourself on up-and-coming artists.

### *Condition*

Never buy a piece of art unless you or someone you trust in the art industry has personally inspected the work. The condition of the artwork is the

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**Volume 6, Issue 1 – February 2013**
**Editors: Martin Rochwerg, Miller Thomson;
David W. Chodikoff, Miller Thomson;
Hellen Kerr, Thomson Reuters**

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underlying foundation of any proposed purchase, and should be your first and most important criterion.

### Value

Always purchase from reputable galleries which are members of professional associations (Art Dealers Association of America – www.artdealers.org). In order to understand the correct value of a work, visit art value websites or obtain auction history to validate the asking price. There can be up to a 10% discount available, so don't be afraid to negotiate.

### Provenance

Before you decide to purchase a work of art, obtain the provenance as well as a history of where the piece has been reproduced in literature and exhibited. The object here is to ensure that the work is neither stolen nor a fake. Unfortunately, the closing of Authentication Boards for artists (including Andy Warhol and Jean-Michel Basquiat) has put a higher level of responsibility on the purchaser to do proper due diligence.

### Document and Insure

Photograph and document the work, and have a professional appraisal by a member of the American Society of Appraisers (www.appraisers.org) – a multi-discipline non-profit international organization of professional appraisers. Use this appraisal to properly insure the work.

### Hidden Costs when Buying Outside of Canada

Beware – When you are buying outside of Canada, you are dealing with foreign currencies, so make sure that you know the value in Canadian dollars. Canadians are also responsible for the HST on all goods being brought into Canada, so set aside an extra 13% to be added to the cost of purchasing any art outside of Canada. Additionally, Fine Art shipping can be costly but is worth the expense for securing safe transportation of valuable works.

### Exit Strategy

Before purchasing a piece of art, consider what your options might be if you decide to re-sell the work in the future. Is there a secondary market that is easily accessible and already established? Depending on the size of the investment, the exit strategy will determine the level of risk on your investment.

## II. DISPOSITION ON DEATH

For many an art lover, what will happen to one's collection after one's death is a very serious consideration which should not be over-looked.

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### *Spousal Transfer*

If you and your spouse acquired such art together, you may jointly own it. Accordingly, if you die first, your surviving spouse will solely own the entire collection. You will have no ability to direct to whom such works will pass, either upon your own death or anytime thereafter. If you alone own your collection, you may choose to leave your works of art, outright, to your spouse in your Will. Again, if your spouse survives you, you will have no control over that collection once he or she receives it. While you may be in agreement as to how to pass on those works of art to your children or others, it is possible that you may not be. Would you be prepared to leave that determination to your spouse if he or she survives you? Consider, as well, if you are in a second marriage — do you wish to allow your surviving spouse the enjoyment of your works of art but not the ability to direct who will receive them upon his or her death? If so, you may consider granting your spouse, if he or she survives you, a "life interest" in such works of art and thereafter, upon his or her death, such works will pass to such persons and/or institutions as you determine. You should put your mind, as well, to whose obligation it will be to insure your collection if you give your spouse a right to enjoy the art during his or her lifetime, rather than providing for an outright gift. Should your estate bear such cost or should same be borne by your spouse?

### *Transfer to Children*

If you are not survived by a spouse or if you wish to bypass your spouse and leave your collection (or part thereof) to your children — are any or all of such children interested in your works of art or would they rather have same sold and receive the net proceeds? Have they expressed and will you consider any preferences they may have for certain pieces over others? What if two or more of the children prefer the same item(s)? Until the collection is actually transferred to them, what arrangements will be made for securing, storing and insuring same? Who will bear the cost of transport if, for example, the artwork is in Toronto but the beneficiary child is in Los Angeles? Aside from any specific pieces that you may choose to earmark for specific children, how will the collection otherwise be divided amongst your children? If they are all adult and capable, will you leave it to them to divide same equitably amongst themselves? Will you allow them to draw lots to determine who selects first, second and so on? Alternatively, will you specify the order of selection? Or, will you leave it to your executor(s) to create packages of equal value and, if same is not possible, equalize amongst your children with cash? If any or all of your children are minors, what provision will you make to store and insure their bequests and at what age do you think they should receive them?

### *Transfer to Others*

Apart from your spouse and children, are there other people to whom you might wish to leave specific works of your art? Are there any cultural institutions and/or charities that you might wish to benefit? Have you communicated with such persons, institutions and/or charities during your lifetime to confirm that they actually wish to receive same?

### *Multi-Jurisdictional Issues*

If your works of art may be found in another country, you should ensure that you and/or your advisors have some familiarity with the laws of such jurisdiction. Will it recognize a Canadian Will? Further, will such jurisdiction potentially have special rules of its own governing the distribution of property located within that jurisdiction?

### *Tax Issues*

Have you considered the tax consequences on death, both Canadian and foreign, if applicable? If the artworks can be classified as Canadian cultural property, have you considered the benefits associated with the gift of same?

While it is prudent to regularly review your Will and your estate plan to ensure that they continue to meet with your wishes and desires, it is suggested that you revisit same, giving ample consideration to the disposition of your works of art upon your death. In the meantime, take pleasure in and enjoy them!

## III. CROSS BORDER TAX PLANNING

### *U.S. Estate & Gift Taxation on Works of Art in the USA Owned by Canadians*

While many Canadian residents and their advisors are aware of the U.S. estate tax exposure they may face in connection with their ownership of vacation real property in the U.S., fewer are cognizant of their exposure to U.S. estate tax on other investments, like securities or works of art.

To illustrate, let's say you purchased one of Christopher Wool's "Word" paintings for US$400,000 at Christies back in 1999. A similar painting sold in 2010 for US$4.4 million, and then a painting from this same body of work sold in 2012 for 5.2 million Euros. Assume the value in 2013 is US$5.4 million, and the

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work is in your home in Palm Beach, Florida. The work is jointly owned by you and your spouse. Assume that you or your spouse dies in 2013. For U.S. estate tax purposes, generally, the result is that the entire value of the work may be subject to a 40% estate tax (more than $2 million). An additional U.S. gift tax may also apply at death due to the highly complex and often unfavourable U.S. tax consequences arising from the horrendous joint ownership (transfer tax) rules that can plague Canadians owning property in the U.S. (or Americans owning property in Canada).

While an entire chapter is devoted to the subject in *The Tax Advisor's Guide to the Canada-U.S. Tax Treaty*, briefly stated here, the residents of Canada are generally subject to the same estate tax rules applicable to U.S. citizens (and domiciles); however, the gross estate, and therefore the taxable estate, only includes property deemed situated within the U.S.. For purposes of the U.S. estate tax, the value of the gross estate for a Canadian resident decedent includes the value at death of all of his or her property, real or personal, tangible or intangible, situated in the United States. Such property generally includes works of art (other than art on loan for exhibition).

Therefore, Canadians contemplating buying art for enjoyment in their second home in the U.S. should investigate the cross border income and estate/gift tax consequences regarding their plans surrounding the art (ownership, investment, charitable gift, succession). Canadians should also seek timely Canadian and U.S. tax counsel in advance of gifting any of their works of art (e.g., to a family member) situated in the U.S. as this can trigger a tax of 40% of the fair market value of the art.

### *Asymmetrical Tax Treatment at Death in Canada and the U.S.*

When a decedent passes away in Toronto owning art in Florida, the consequences may be different under the Canadian and U.S. tax rules. A rollover may prevent a deemed disposition at death in Canada, but trigger U.S. estate tax in the U.S. at the federal and possibly state level as well. Moreover, where art has devalued in time, it can potentially generate a capital loss in Canada at death and may be claimed by the representative of the deceased in postmortem planning to offset certain other eligible gains. But the same piece of art can still trigger an enormous U.S. estate tax because the U.S. estate tax (unlike the deemed sale at death rules in Canada) applies to the market value of the asset, and not its appreciation (or depreciation). Such a lopsided result is but one example of the many cross border tax horrors (the joint ownership of art in the illustration above is another) that can reduce a family's wealth in relation to their ownership of art.

### *Use of Strategies and the Treaty – Tax Suffering is Optional*

The good news is that there are various strategies that families can use to prevent such occurrences and which may involve repositioning and use of special purpose vehicles, and other solutions. Depending on the facts, the treaty between Canada and the U.S. may afford protection against the estate tax. However, treaty relief is dependent on prevailing facts which are subject to change such as the U.S. estate tax exemption, the U.S. estate tax rate, the value of a decedent's assets in the U.S., and the value of a decedent's worldwide estate. Moreover, treaty relief requires timely and professional action by a family in grief and which is receiving international tax advice. Having to address these cross border issues at death is not without professional costs and compliance fees. Moreover, for many high net worth families, relief under the treaty will be marginal and/ or impractical because of the size of their estates and the limitations on relief afforded under the treaty. To wit, a family with a home in Palm Beach with a piece of art that has a value in the US$5 million range, is unlikely to benefit greatly from the treaty. Hence, preventing the problem from arising before death is often the superior strategy. If U.S. estate tax does apply, a credit to offset applicable Canadian taxes at death may be available.

## IV. CONCLUSION

Involving art, estate planning, and tax advisors in your pursuit of art interests can help build strategies that can bring peace of mind and more enjoyment to you and your family while preserving family wealth.


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