

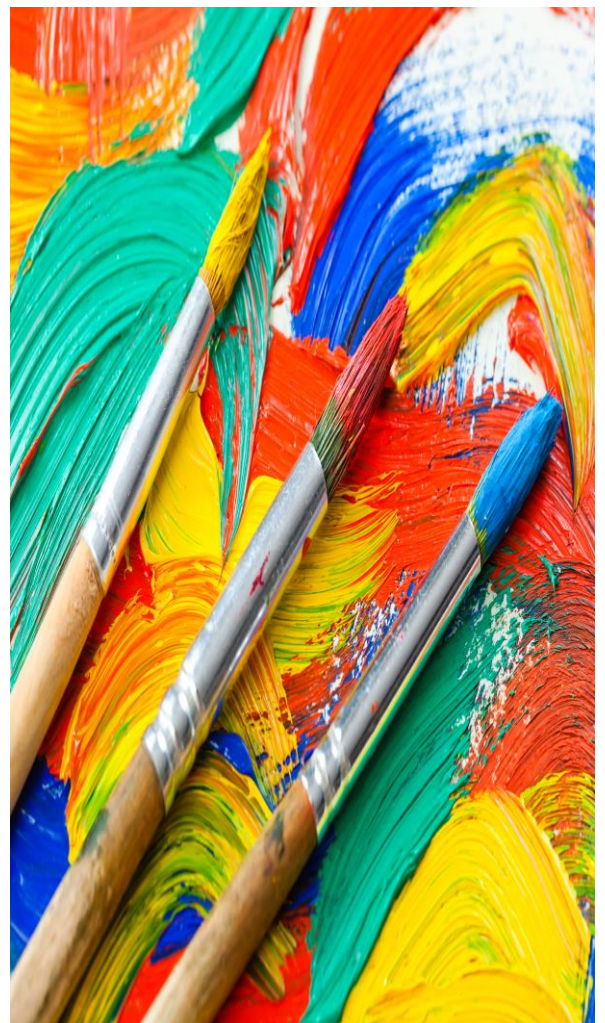


Art – is it worth considering structuring?

Should I hold an art collection in a trust? In a company? In my own name? Does it make a difference if it's hanging on my wall? Art and tax are not words that frequently come up in the same sentence, but they are worth considering together. This article discusses certain options for structuring art collections and their benefits and pitfalls from a UK tax perspective.

The questions above depend on the individual themselves ("X") – and not only their preferences and interest (if any) in trust or company structuring but also their personal circumstances. This article assumes that X is UK resident and non-UK domiciled or, in the alternative, UK resident and deemed domiciled in the UK where these types of questions often arise.

To provide some brief context, persons who are UK resident but do not have a domicile of origin in the UK (broadly meaning they were not born to UK parents) or a domicile of choice in the UK (broadly meaning they are not present in the UK with the intention to remain here permanently or indefinitely – in other words, they do not intend to end their days in the UK) will be non-UK domiciled. However, once an individual has been resident in the UK for 15 out of the previous 20 UK tax years they will be deemed domiciled in the UK. This is regardless of whether they are still non-UK domiciled or not.



Trust ownership

One option is to hold art in a trust structure. This could be, for instance, a non-UK discretionary trust settled by X or a non-UK discretionary trust settled by another where X is a beneficiary. The art may be held by the trustees of the trust, or by an underlying company to the trust.

The advantage of using a trust to hold art is the inheritance tax saving. Holding art in trust means it can fall outside of X's estate for inheritance tax purposes. Provided the trust is settled by X when they are non-UK domiciled and the art is kept outside of the UK, no inheritance tax charges will arise for X or for the trustees of the trust itself.

However, if the art will be enjoyed by X because it hangs on their wall in the UK (for example) and X is a beneficiary and the settlor of the trust or X added property to the trust which was settled by another then it is preferable from an inheritance tax perspective for the art to be held by a non-UK company owned by the trust (although bearing in mind the other UK tax issues associated with company ownership referred to below). This is to ensure no inheritance tax charges arise for X under the "gift with reservation of benefit" rules.

Another issue to bear in mind is whether the trust already holds other assets or has non-UK source income and/or gains that have arisen to the trust in the past.

If the trust contains non-UK source income and/or gains that have not been paid out of the trust or used to meet expenses (for example) in the UK tax year that they arise, that income and/or gains will be available to match against any benefit received from the trust. If X hangs the art on the wall of their UK home then they have received a benefit from the trust. The benefit would be matched, and an income or capital gains tax charge could arise for X. The amount of the benefit (and so the tax charge) would be based on HMRC's official rate of interest (currently 2.25%) multiplied by the acquisition cost of the art or, if it was not acquired in an arm's length transaction, its market value at the date of acquisition plus any expenditure incurred subsequently for the purpose of enhancing its value less any repair, insurance, storage costs or rent paid by X for use of the art.

However, if the trust holds no other assets and is "dry", in other words no non-UK source income or gains arise to the trust which are available to be matched, then it may be an efficient way of holding art and enjoying it in the UK. No UK tax would be

due unless and until there were funds available to be matched.

An alternative is for X to pay rent to the trustees of the trust for use of the art in the UK. However, this would mean adding UK source income to the trust which the trustees would have to report to HMRC and tax would be payable.

As a further point, if the art is sold whilst it is held by the trust then any gain that arises on the sale will be added to the pool of other gains (if any) within the trust. Those gains may be available to be matched against any prior untaxed benefits (where there were no income or gains in the trust until the sale of the art) and any future benefits that UK resident beneficiaries receive from the trust, resulting in a UK tax charge for those beneficiaries.

Company ownership

Another option is to hold an art collection through a company. This provides some protection from inheritance tax if the value of the shares in the company is less than the value of the art that it holds. The value of the shares in the company would be within X's estate for inheritance tax purposes (rather than the art itself). Taking this a step further, if the company is non-UK incorporated and X is non-UK domiciled and not deemed domiciled then X would not be subject to inheritance tax on the shares in the company (or the art it holds).

X needs to consider how the company is funded. If non-UK source income or gains are added to the company and used to purchase art and that art is brought to the UK, this can result in income and/or capital gains tax liabilities for X when the art is imported. This is the case if X is unable to or fails to claim the benefit of the "remittance basis" of taxation. The remittance basis can only be claimed by individuals who are non-UK domiciled and not yet deemed domiciled in the UK, and in essence provides that X will be subject to UK tax on non-UK source income or gains only if they (or certain persons connected to them) bring these to the UK.

The other consideration is "benefit in kind" charges, which can be punitive. If X is a director of the company (or the other directors of the company are accustomed to acting in accordance with X's wishes, so that X is a "shadow" director) and X benefits from the art as it hangs on their wall for example then these charges can arise. The charge is based on the cost to the company. One solution is for X to pay rent to the company for use of the art in order to avoid paying the benefit in kind charge, but again

this can give rise to UK source income for the company which would be subject to tax.

Where the art is later sold by the company in the UK and a gain arises, this gain would be subject to tax on X. However, if the art was taken out of the UK and then sold, a UK tax charge would only arise if X was deemed domiciled in the UK at the time or did not claim the benefit of the remittance basis or if X did claim the benefit of the remittance basis and either X or certain persons connected to X brought the proceeds back to the UK. Export restrictions would also need to be considered in that context.



Personal ownership

A third option is to hold the art collection personally. The first consideration is how the purchase of the art is funded. If the art was already purchased by X using non-UK income or gains outside of the UK and is subsequently brought to (i.e. remitted to) the UK, this can give rise to income or capital gains tax on the original funds used to purchase the art if those funds have not already been subject to UK tax or are not "clean capital". Clean capital includes inherited funds and income and gains that arose before X became UK resident. There are exemptions, however, where no remittance will occur. The exemptions include circumstances where the art is available for public access whilst it is in the UK through a museum, gallery or similar institution or the art is brought to the UK for repair or restoration. There is also an exemption for art that is brought into, received or used in the UK for 275 or fewer days. However, such exemptions are less useful where X wishes to enjoy the art themselves.

If, however, art is purchased in the UK using UK source income or gains (or clean capital) then no further UK tax charge on the purchase arises.

If a single work of art is sold in the UK and is worth more than £6,000, any gain in value would be liable to capital gains tax. However, if the art was taken out of and sold outside of the UK, a capital gains tax liability would only arise if X was deemed domiciled in the UK (or not claiming the benefit of the remittance basis of taxation at the time) or the proceeds of sale were later brought back to the UK.

If the art remains in X's estate on death and is located in the UK (or X is deemed domiciled), it will be subject to inheritance tax. However, it is possible to insure against that liability. There are also concessions available for inheritance tax on certain works of art, provided the art is pre-eminent and public access is given, maintained and preserved. The art must also be kept in the UK, and the concession does not remove the inheritance tax but defers it. As a result, if and when the art is sold the inheritance tax becomes payable.

Conclusion

To conclude, whether it is worth structuring art collections through a company, trust or combination of the two will depend on the particular circumstances of the individual, whether they have pre-existing trusts (in which case a trust structure may be more viable in terms of cost) and the value and extent of the art collection amongst other considerations. In many cases it may be simpler for X to hold art in their personal capacity, and a further factor is the extent to which UK taxes (or a particular UK tax, such as inheritance tax) are of concern to the individual.

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