

WHY DO I OWE TAX ON ART I DON'T OWN?

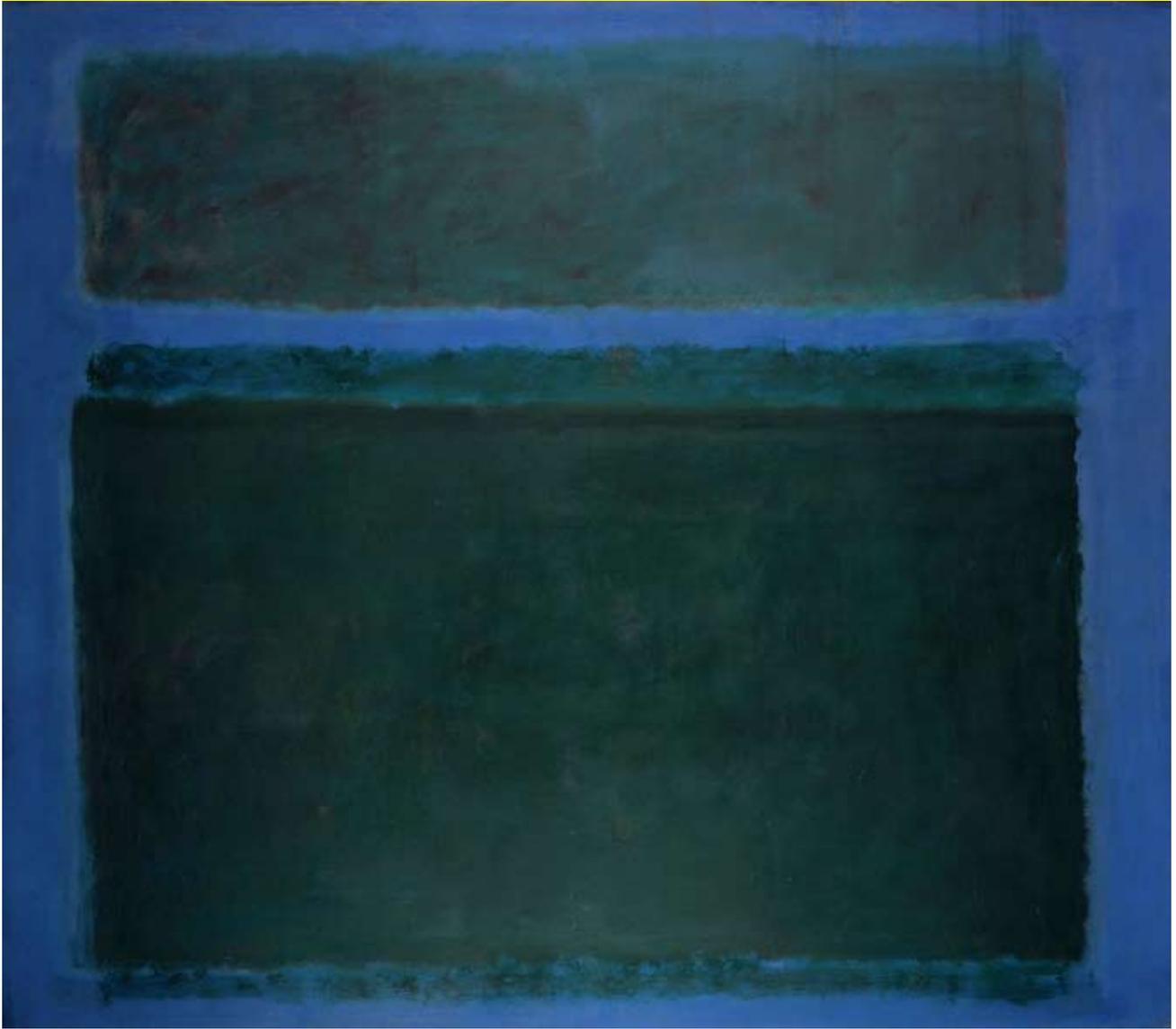
BY JUDITH L. PEARSON



TAXPAYERS SPEND a lot of money creating tax-efficient plans for their real estate investments, business interests, and stocks and bonds, yet they often ignore the future when it comes to their art and other important pieces. The paramount risk in the art world today is the risk of a defective legal title, i.e., a situation in which the client does not actually own the work of art or other important piece in their possession. The resulting financial loss to art owners, their families, and third-party beneficiaries due to the failure of tax, trust, estate, and other philanthropic plans can be substantial.

Two recent court cases show the tension between the Internal Revenue Service (IRS) policy to tax personal property without regard to related questions of marketability or the lack of a clear legal title (or ownership) and the Uniform Standards of Professional Appraisal Practice (USPAP), which requires appraisers to identify assumptions and hypothetical conditions regarding possible liens, encumbrances, or other factors that can affect clear legal title (or ownership) behind their reports on valuation.

An important case is that of the Ileana Sonnenbend estate and a Robert Rauschenberg work entitled *Canyon*, which three appraisers using USPAP standards valued at \$0 and which the IRS valued at \$65 million. The late art dealer Ileana Sonnenbend purchased *Canyon* in 1970, a collage that includes a stuffed bald eagle. After the sale, the U.S. Fish and Wildlife Service made it illegal to own, possess, sell, or exhibit anything containing bald eagles. But in 1982,



This page: It is important for taxpayers to understand the legislation that surrounds their artwork (pictured, Mark Rothko's Untitled, circa 1957). Opposite page: Judith L. Pearson, President of ARIS Title Insurance Corporation.

Sonnebend obtained a special permit to retain *Canyon* and lend it for use in exhibitions at museums. The work is now on view at the Metropolitan Museum of Art, but with arguably no marketability. Therefore, the taxpayer is unable to claim any value for estate tax purposes.

Another important case is that of the daughter of the late rare coin dealer Israel Swift, who found a safe deposit box once owned by her father containing 20 Double Eagle gold coins from 1933 with an estimated value of \$80 million. The U.S. government proceeded to allege that the coins had been stolen in 1933, and succeeded at trial in seizing the coins from the Swift family. In the court documents, it came to light that the gold coins at issue were not disclosed for IRS estate tax purposes when the executors probated the Israel Swift estate in 1985 and 1990. Although there has yet to

be a claim by the IRS or a dispute in the public domain about the family's estate tax obligations related to this non-disclosure, the case begs the vexing question of whether a taxpayer who has dominion and control but, according to judicial ruling, no legal title to the property is the owner for estate tax purposes. If so, can the asset be taxed at full market value despite the lack of legal title?

These two cases are examples of ownership defects with substantial financial consequences, highlighting how critical it is for collectors and their professional advisors to understand the impact that art ownership has on tax and estate strategies and the two related issues still in flux: What is the value of an estate tax liability for art and related assets for which a taxpayer does not have clear legal title (as in the Swift case)? And what is an owner to do if an asset has no marketable

value assuming a right to dominion and control but clearly has a defective legal title (as in the Sonnebend example)?

Collectors should proactively raise these issues and know the authoritative legal state of title of their art and collectibles for tax planning. And so should their professional advisors, whose role it is to protect their clients and their clients' trusts, estates, and beneficiaries from the foreseeable risk of loss resulting from ownership-related issues with their fine art and other important collectibles.*

**To the extent that this article discusses tax matters, it is not intended to act as law. Taxpayers should seek advice from independent tax attorneys or accountants based on circumstances. See circular 230.*

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