

ART AND THE ESTATE PART II – NONRESIDENTS

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A prior article in this series discussed the way U.S. estate tax is imposed on the transfer of artwork at the time of death. For U.S. art collectors,¹ that tax liability can prove to be quite high, depending on the value of the asset and the overall estate. But what are the estate and gift tax liabilities for non-U.S. persons?

This article will address the tax consequences for nonresident, non-citizen individuals not domiciled in the U.S., as well as new developments affecting art collectors who buy or sell artwork from New York State.

U.S. ESTATE TAX

Application to Nonresidents

In the U.S., estate tax is imposed on the fair market value of a U.S. person's estate at the time of death. The Federal estate and gift tax regime is not limited to U.S. persons² but also applies to nonresident, non-citizen individuals who own U.S. situs assets. The regime applies to tangible property, including art, jewelry, gold coins, cash in a safe deposit box, and furniture. Therefore a nonresident alien owns artwork located in the U.S. at the time of death, his or her estate will face U.S. estate tax consequences.³

Exemptions

A nonresident decedent does not receive the relatively generous lifetime gift exclusion applicable to U.S. persons – \$5.45 million exemption for 2017 and \$5.60 million for 2018. Instead, foreign estates are entitled to a mere \$60,000 exemption.⁴ Generally, the effective tax rate is approximately 40%.⁵

The estate tax exemption may be increased through application of an estate tax treaty. A treaty between the U.S. and the nonresident, non-citizen individual's home country may provide for more generous rules, effectively overriding the U.S. situs rules.

¹ See “Art and the Estate: Why Planning is Important, Part I – U.S. Taxpayers.” *Insights* 10 (2017).

² Code §7701(a)(30).

³ Treas. Reg. §20.2104-1(a)(2).

⁴ Code §§2102(a),(b).

⁵ The tax is imposed at graduated rates amounting to \$345,000 for the first \$1.0 million in excess of the \$60,000 exemption.

If at the time of death, a nonresident alien owns artwork located in the U.S., his or her estate will face U.S. estate tax.⁶

Owning artwork through an entity (such as a foreign corporation or irrevocable trust for the benefits of others) may also provide for estate tax protection. However, consideration should be given to state and local tax consequences. New York, for example, imposes an alternative tax on a corporation subject to tax on business capital allocated to New York. This could occur, for example, if a corporation owns both rental real property and art and furnishings associated with the rental real estate.

There is an exception for some artwork located in the U.S. at the time of death. Artwork owned by a nonresident is exempt from U.S. estate tax if it is

- imported into the U.S. solely for exhibition purposes,
- loaned for those purposes to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and
- at the time of the death of the owner, on exhibition or enroute to or from an exhibition in such a public gallery or museum.⁷

The I.R.S. tends to view some of these conditions more strictly than others. For example, the I.R.S. did not require the work to be imported when it was purchased in the U.S. and immediately loaned for exhibition.⁸ However, it is important that the art is loaned to a public gallery or museum that meets the description under the regulations. Otherwise, there is a substantial risk that the artwork will be included in the owner's gross estate.

STATE ESTATE TAX

In addition to Federal estate tax, most of states impose their own estate and gift taxes. States such as Alabama, California, Florida, Georgia, Louisiana, Michigan, New Hampshire, South Dakota, Texas, Virginia, and Wyoming are among the exceptions.

New York imposes an estate tax on residents, as well as on nonresidents. The top N.Y. estate tax rate is 16%. New York provides a basic exclusion amount ("B.E.A."), which is currently \$5,250,000 but will increase to the level of the Federal estate tax exemption starting January 1, 2019. Unlike residents, nonresidents are only taxed on real or tangible property that is located in the New York. At first glance, the B.E.A. may seem generous, but it is not quite so. If the entire estate is more than 5% higher than the B.E.A., the B.E.A. is ignored and the entire estate will be taxed.

OTHER CONCERNS

Estate tax is not the only concern for nonresidents dealing with tangible property in New York. In addition to estate and gift tax concerns, nonresident art collectors may

⁶ Treas. Reg. §20.2104-1(a)(2).

⁷ Code §2105(c); Treas. Reg. §§20.2105-1(b), 20.2104-1(a)(2).

⁸ PLR 199922038; PLR 9141014.

be affected by a recent change to the New York sales and use tax regime.

Generally, New York State imposes a 4% sales and use tax on the gross amount paid for tangible personal property. This is further increased by tax imposed at the local level. If the collector is located in New York City, for example, the overall sale or use tax is 8.875%.



In New York, sales tax is a destination-based tax that applies to artwork that is delivered to the state, while use tax applies to artwork purchased outside the state and brought into the state to be used there. New York gives full credit for sales tax paid in other states.

Both sales and use taxes apply to individuals that are N.Y. residents. In this context, N.Y. resident has a broader meaning than it does for income tax purposes. For income tax purposes, an individual is a resident if he or she maintains a “permanent place of abode,” and spends at least 183 days a year in the state. But for sales and use tax purposes, an individual is a resident of New York if he or she maintains a permanent place of abode, irrespective of how much time is spend there. A permanent place of abode is construed broadly and may include any of the following dwelling places: (i) a home, apartment, or room at a residence hall; (ii) armed forces housing; or (iii) a trailer, mobile home, or houseboat. For sales and use tax purposes, it is possible to be a resident of more than one jurisdiction. In addition, a domestic or foreign estate or trust that carries on a business, trade, or profession or employment in New York is a resident for sales and use tax purposes. A corporation engaged in business in in New York is also treated as a resident.

Prior to a recent change of law, many holding companies could escape use tax as they were seen passive companies not doing business in New York. However, this is no longer the case.

Use tax is generally not due on taxable property or services purchased by a non-resident business. However, N.Y. tax law was amended effective April 10, 2017, to narrow this exclusion. Use tax is now imposed when a nonresident business brings tangible personal property or taxable services into New York for use here, unless the nonresident business has been doing business outside of New York for at least six months prior to the date the property or service is brought into the state.

The state offers this example:

XYZ Corporation is a resident of New York. On May 1, 2017, XYZ Corporation forms PQR, Inc., a Delaware corporation wholly owned by XYZ Corporation. On June 1, 2017, PQR, Inc., purchases a large sculpture for installation in the lobby of XYZ Corporation’s New York City offices. PQR, Inc., conducts no other business activity, and has no employees or offices. On February 1, 2018, PQR, Inc., brings the sculpture into New York and delivers it to the installation site. Even though PQR, Inc., was in existence for more than six months when it brought the sculpture into New York (May 1, 2017 - February 1, 2018), PQR, Inc., was never doing business as required by the statute. Therefore, PQR, Inc., will owe use tax on the sculpture when it is brought into New York.⁹

⁹ Tax Bulletin ST-910 (TB-ST-910) August 17, 2017.

CONCLUSION

Foreign persons owning or using artwork in the U.S. must be mindful of the special income, estate, and gift taxes associated with that ownership. If you are a nonresident alien and own artwork located in the U.S., your estate will face U.S. estate tax consequences, and you must not overlook the application of state and local sales and use taxes on purchases, acquisitions, or ownership of artwork.

“If you are a nonresident alien and own artwork located in the U.S., your estate will face U.S. estate tax consequences”

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