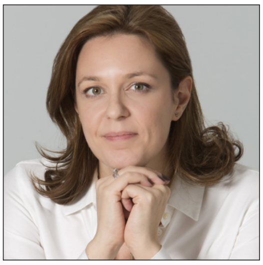
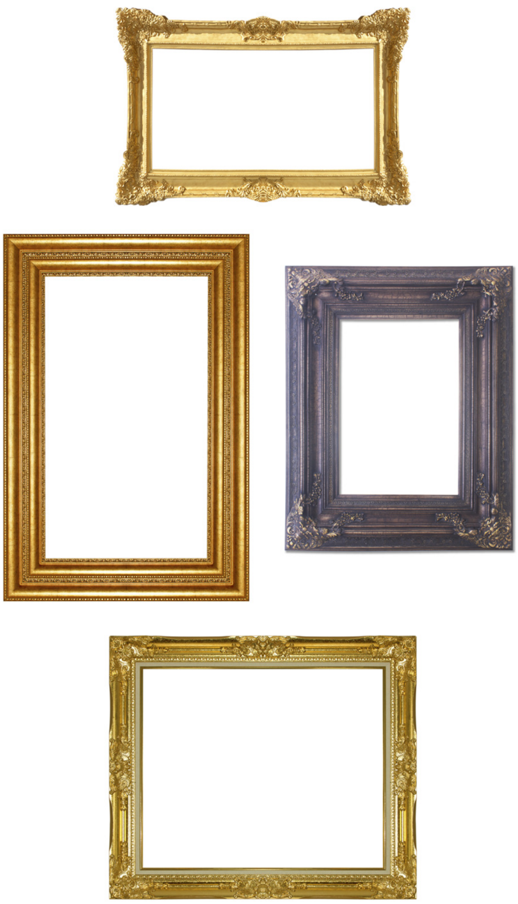
Philanthropy, Succession Planning and the Nation's Heritage

Clarissa Vallat *(www.sothebys.com)*

Having spent a lifetime painstakingly assembling an art collection, it is hardly surprising that many collectors give careful thought to what will happen to their collections after they die. Some would like to ensure their collections remain intact, if possible; others are more concerned simply to maximize the benefit to their legatees whether that involves dispersing the items in the collection or not.



Clarissa Vallat



The tax implications of gifts and succession planning can have a significant impact on a collector's approach. Whether they are made on death or during a UK taxpayer's lifetime, gifts of objects such as works of art will usually be subject to Capital Gains Tax (CGT) or Inheritance Tax (IHT) or both. In contrast, gifts to charities are tax-free. As well as this general incentive towards charitable giving, certain additional tax incentives exist with the object of bringing important works of art and cultural property into public ownership (or at least public display), protecting them and sharing them for the long-term benefit of the nation. The incentives are available to UK taxpayers whose philanthropy takes the form of gifts, loans or public display of works of art which are sufficiently important to be considered part of the UK's national heritage.

What sort of object can count as heritage property? Recent examples range from paintings to a 17th-century buff coat, Chelsea porcelain plates, busts and other works of art. The test for heritage property is whether it can be considered 'pre-eminent' because of its close association with our history and national life, because of its artistic or art-historical importance, its importance for scholarship, or because it is closely associated with a particular historic setting.

Cultural Gift Scheme

So far, five objects have been accepted under the CGS and are now on public display, including paintings, Beatles lyrics and letters written by John Lennon and a group of political posters.

For lifetime gifts, the CGS can offer the donor an Income Tax/CGT reduction of 30% of the value of a gift of a pre-eminent work of art to a qualifying UK institution (or 20% of the value of the object for companies setting their tax reduction against Corporation Tax). The purpose of the CGS is to encourage philanthropy, so the gift must be for the benefit of the public: the tax reduction is not intended to compensate the donor fully for the value of the object.

From the donor's point of view the CGS has the great advantage that the gift can be accepted by an institution and put on display during the donor's lifetime, providing certainty and satisfaction unavailable to those who bequeath works of art hoping that they will be eligible under the Acceptance in Lieu scheme.

Acceptance in Lieu

The AIL scheme allows UK taxpayers to transfer important works of art and heritage property into public ownership while offsetting the value of the object against an IHT liability. To be accepted in lieu of tax the object must be pre-eminent, and the value of the offer will be given as a tax credit against the tax bill. This will be its likely hammer price (i.e. its open market value) and can include an amount to represent the buyer's premium which would be charged were the object bought at auction, which can increase the value of the offer by up to 25% depending on its value.

The way the tax credit (often referred to as the Special Price) is calculated is by deducting from the offer value of the object in question the tax that would normally be payable in respect of that object (e.g. if passing on death, 40% IHT), and then adding back to the net of tax figure the douceur worth 25% of that tax.

Example:

Offer value		100,000
Deduct notional IHT		40,000
		60,000
Add douceur	(25% of £40,000)	10,000
Special Price		**70,000**

The tax credit can then be used to deal with IHT liabilities on the remainder of the estate – the object offered is of course not itself subject to tax.

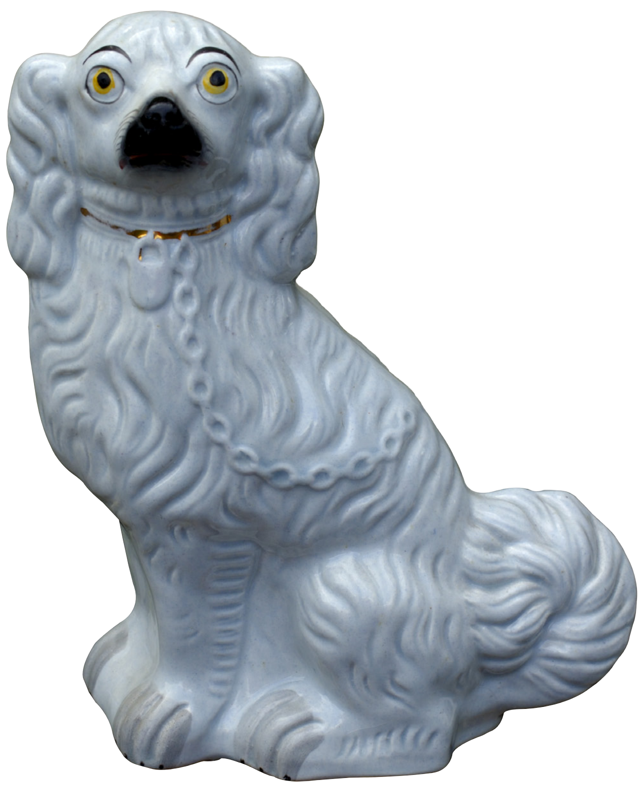
When an object is accepted under the scheme, an IHT credit is given and ownership of the object passes to the appropriate institution. It is sometimes possible to negotiate an 'in situ' arrangement where the object in question can be loaned back by the acquiring museum to the offeror, for display to the public in its original setting.

Private Treaty Sales

Pre-eminent objects and items which have been granted conditional exemption from capital taxation (IHT or CGT) can be purchased by private treaty by certain bodies including most UK public museums, galleries and archives, at a price which is beneficial to both the public purchaser and private vendor. These sales are known as Private Treaty Sales.

Private Treaty Sales benefit from the *douceur* arrangement in the same way as items accepted under the AIL scheme. For example, when a £100,000 item which has been conditionally exempted from IHT at 40% is sold on the open market, the net sale proceeds after payment of IHT will be £60,000. If the same object is sold to a qualifying body by Private Treaty Sale however, the purchasing body will usually therefore acquire it for about 70% of its agreed open market value, so an item valued at £100,000 can be acquired for £70,000. As with the AIL scheme, with Private Treaty Sales the higher the tax liability which would arise on an open market sale, the greater the benefit of the douceur.

A practical difference between an AIL and a Private Treaty Sale is that to negotiate a sale to a museum, the donor must identify a buyer and agree the price with it, and the buyer will have to raise funds to pay for the object. This of course can be quite a hurdle. In contrast, it is not necessary to find an institution to purchase an object which is accepted under the AIL scheme: the object will be allocated to a museum without the need for fundraising on its part.



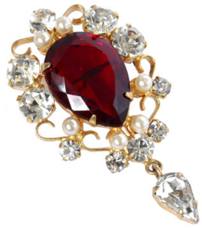
Conditional Exemption

The most common of the tax incentives intended to encourage heritage property in the UK to become available to everyone is Conditional Exemption (CE). CE is an exemption from the IHT which would otherwise be due when an object is transferred, either on death or on a chargeable lifetime gift. When CE is granted, IHT is not payable on the transfer of the object so long as its owner promises to keep it in the UK, preserve it, and advertise and allow public access to it. In this way art which is held privately comes to benefit everyone, and collections can remain intact when otherwise it might be necessary to disperse them to meet IHT bills as the collections pass down the generations.

Works of art which are on display to the public in this way are listed on HMRC's database of tax-exempt heritage assets to enable us all to visit exempt art works, buildings and land.

Reduced IHT Rate

The heritage tax exemptions outlined above are specifically intended to implement the government policy of promoting and protecting the UK's cultural and artistic heritage to make the nation's cultural heritage accessible to all. However, when considering philanthropic strategy and succession planning the tax relief with the greatest overall effect may well be one not designed especially for art or cultural property, but one which encompasses any charitable gift, namely the 36% rate of IHT which can apply to estates in which the deceased has left at least 10% of his or her property to charity.



The effect of the reduced IHT rate can be dramatic, even increasing the amount inherited by other, non-charitable, legatees. From the testator's point of view if the reduced IHT rate applies, in an estate of £1.325 million (i.e. a net estate of £1m after the Nil Rate Band) it could have the effect of reducing the 'cost' to the testator of a £100,000 legacy to a mere £24,000. This is because the legacy, if not given to charity, would be subject to IHT at 40% making the real 'cost' to the testator of the gift to charity only £60,000. In addition, because the gift pushes the charitable giving within the estate to the point where the 36% IHT rate applies, 4% of the remaining estate of £900,000 will be tax-free as a consequence of the gift. 4% of £900,000 is £36,000. This tax saving is attributed to the charitable gift, so the gift represents a cost to the testator of £100,000 less £40,000 saved IHT on the gift itself, less the £36,000 which has been saved in the rest of the estate as result of the gift. £100,000-£40,000-£36,000 = £24,000.

In the end, each individual's circumstances and wishes are different, and each art collection is unique. There are clearly many factors which can influence a collector's strategy for philanthropy and succession planning, and the tax implications alone cannot - and should not - dictate it. However we can hope that the tax incentives touched on here serve to encourage philanthropy and that we will all benefit from it.

	40% IT RATE LIFETIME GIFT	45% IT RATE LIFETIME GIFT	40% IHT RATE BEQUEST	36% IHT RATE BEQUEST
CHARITY RECEIVES	100,000	100,000	100,000	100,000
COST TO DONOR	60,000	55,000	60,000	24,000
% OF CHARITABLE GIFT PAID BY DONOR	60%	55%	60%	24%

Ms Vallat joined Sotheby's Tax and Heritage Department in 2012 and works with clients and their professional advisers on the UK tax and valuation issues which arise through the acquisition, ownership and sale of art. Her work for Sotheby's clients ranges from advising on heritage taxation matters including the Cultural Gift Scheme and the Acceptance in Lieu scheme, the export of works of cultural significance, private treaty sales to UK institutions, heritage exemptions and valuations for tax purposes, to the negotiation of leases of personal possessions. She regularly speaks at a variety of events on heritage and taxation issues.
Before joining Sotheby's Ms Vallat was a solicitor in the private client department of a London law firm and she has also worked in law firms in France and Spain.