

THE ART OF THE POSSIBLE ¹

PART I

GIVING YOUR ART COLLECTION AWAY BUT STILL ENJOYING IT – CHARITABLE OPTIONS

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1. Introduction

This article focuses on how high net worth individuals can donate their precious art collections and houses to charities in a tax efficient way – yet still, to a certain extent, retain possession of their property. Part one looks at charitable giving and Part two looks at non-charitable options and compares them to the suggestion made in Part one that a settlor could establish his own charity, transfer his art collection to it but continue to enjoy possession of the collection. Alternatively, the settlor could enter into an arrangement with existing charities such as museums and galleries on favourable conditions. Although the article's focus is on art it also necessarily covers situations where both art collections and the property housing the collection are vested in a charity. Some of the issues raised in the article are particularly topical because of the review of the register document released by the

¹ This paper first appeared in a European Association for Planned Giving "Give a Thought" booklet. For details contact www.plannedgiving.co.uk.

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Charity Commission called: 'Preservation and Conservation'³ which examines, inter alia, the charitable basis of heritage property and the level of public access required when heritage property is held by a charity and also the consultation document 'Museums and Galleries'⁴ which looks, inter alia, at the question of the quality of the art required.

2. A Settlor's Own Charity

Before looking at how a settlor having transferred ownership to the charity can continue to enjoy possession of his collection and the relevant tax reliefs it is necessary to set out the basic requirements of charitable status.

2.1 Charitable Basis of An Art Collection

The charitable basis of an art collection is usually to advance the education of the public or a sufficient section of the public⁵ but can also be simply to display for the benefit of the public or a sufficient section of the public works of art of recognised artistic importance.⁶ To be charitable in law there must be benefit to the public or a sufficient section of the public. There must also be sufficient educational value or artistic merit.

2.2 Educational or Artistic Value?

A charity established to display paintings of little or no educational value or artistic merit (in practice the two will amount to the same thing) would be unlikely to be considered to be charitable in law by either the Court or the Charity Commissioners.

In *Re Pinion*⁷ the testator gave his studio, paintings, old furniture, silver and other objects to his Trustees to offer to the National Trust. He left the rest of his estate as endowment to maintain the collection as a museum should the National Trust decline the gift (which it did). Expert witnesses agreed that the collection was of a low

3 RR9. See the Charity Commission's website www.charity-commission.gov.uk.

4 See the Charity Commission's website.

5 For the law relating to public benefit see Tudor 'Charities' (Sweet & Maxwell) 8th Edition and Picarda 'The Law and Practice Relating to Charities' (Butterworths) 3rd Edition.

6 See *Re Cranstoun* [1932] 1 Ch 537 and *Re Allsop* (1884) 1 TLL.4.

7 [1965] Ch 85.

quality and that it had no educational value. The Court of Appeal decided, on the basis of the experts' evidence, that the gift was not charitable because it lacked educational value. Lord Justice Harman commented as follows:

"I can conceive of no useful object to be served in foisting upon the public this mass of junk. It has neither public utility nor educational value".⁸

The traditional approach of the Charity Commissioners (following that of the Court) when looking at applications for charitable status is to take expert evidence on educational value or artistic merit when it is not obvious.⁹ This is confirmed by the recently issued review of the register document 'Museums and Art Galleries'.¹⁰ A case from practice, for example, involved a debate over the registration of a leading contemporary art charity until the matter was decided by expert evidence. The evidence of at least two experts is usually required by the Charity Commissioners. The initial decision as to whether educational value is sufficient or not is often subjective and only resolved by such expert evidence.

2.3 Public Access?

In order to be charitable there must be sufficient public access. Where charities are set up to house art collections they must be available to the public or a sufficient section of the public and not just exclusively enjoyed by the donor. For example, a private hobby which purely benefits the person collecting the art and is not available to the public is not charitable.

The Approach of the Charity Commissioners to Public Access

Public access usually means physical access but the Charity Commission is currently reviewing the register of charities and has published a review of the register document called 'Preservation and Conservation' which sets out their current position on public access and, in appropriate cases, they will allow computer simulations, videos and TV and radio coverage etc.

Traditionally the approach of the Charity Commissioners is as follows:

- If a work of art is of only scholastic interest then it may be restricted to visits by appointment by academics.

⁸ *Ibid* at 107.

⁹ Expert evidence was admitted in *Re Pinion* [1965] Ch 85.

¹⁰ RR.9.

- If the work of art is of exceptional quality and would be damaged if brought out of storage too often then restricted access may be permissible.
- Otherwise, reasonable public access can be by prior appointment. Reasonable public access by appointment means 7 days a week for 6 months a year (with reasonable exceptions) or exceptionally 3 months a year at 7 days a week (this is sometimes referred to as The National Trust criterion). The Charity Commission usually expects public access to be given at weekends and bank holidays to allow working members of the public the opportunity to visit.

2.4 A Settlor must Divest Himself of the Collection

The general rule is that the settlor (i.e. the person placing the paintings into charity) must fully divest himself of his gift. In other words he must transfer legal ownership of the paintings to the charity. That is not to say that the gift cannot remain in his physical possession and continue to be enjoyed by him.

2.5 Rule against Trustees Benefiting

The general rule is that a trustee cannot benefit from his/her office as a trustee without specific authorisation from the charity's governing instrument or the Charity Commissioners. The benefit in this context is private enjoyment of the paintings. Unless the Charity Commissioners specifically authorise a settlor or members of his/her family to act as Trustees, independent Trustees will need to be appointed. Having said that, where a settlor is providing the funds or property for the charity, such as an art collection, and provision is made in the governing instrument for the settlor as Trustee, or family member Trustees to receive benefits the Charity Commissioners have in the past had no objections to those arrangements so long as the overall public benefit of the gift is maintained. However, the 'Preservation and Conservation' review of the register document points out the need to avoid potential conflicts of interest through provisions in the charity's governing instrument which ensure that former family owners who remain in possession of charity property such as works of art or buildings only form a minority of the Trustees and absent themselves from meetings when they are in conflict.

3. Advantages for the Settlor

As mentioned above, the general rule is that charities exist for the public benefit rather than the private benefit of any individuals. If the paintings and property housing the paintings are made available to the public then any private benefit to the

settlor in terms of enjoying the paintings in his home for the rest of the time may be viewed by the Charity Commissioners as incidental to that public benefit and therefore acceptable.

3.1 Charges by the Settlor or the Charity?

3.2 Settlor

It is probably permissible for the settlor to charge the charity for security costs, lighting and maintenance on a pro rata basis.

3.3 Charity

It is probably also permissible for a charity to make a reasonable admission charge to the public which could assist in paying for the pro rata security costs, lighting and maintenance charge by the settlor and to restore the paintings.

However, should the benefits to the settlor, arising from the charges outlined above, outweigh the overall public benefit to the charity then registration as a charity may be provisionally rejected and if the charity is already on the register of charities then it could be investigated by the Charity Commissioners.

4. Reservation of benefit: Inheritance Tax Charge?

Usually, owners of paintings with charitable intentions might consider retaining the collection during their life and then bequeathing the paintings to a charity on their death. Such a disposal would be free of inheritance tax and capital gains tax.¹¹ However, some people prefer to dispose of their collection of paintings during their lifetime, perhaps for philanthropic reasons, perhaps to transfer the paintings to their own charity during their lifetime so that they have the opportunity to be involved in the charity.

From an inheritance tax point of view if the donor is deemed to have reserved a benefit over assets which he has given away then those assets will still be treated as part of his estate and therefore subject to tax. The charitable options discussed in this paper avoids the reservation of benefit problem arising.

4.1 Paying Rent Instead of Giving Public Access

A few years ago a story emerged in the national newspapers concerning Andrew

¹¹ See Inheritance Tax Act 1984 and Taxation of Chargeable Gains Act 1992.

Lloyd-Webber's charity. Lord Lloyd-Webber (as he now is), his wife and a business associate were Trustees of the charity. The press claimed that for almost half the time, when the charity's paintings were not on loan to public galleries, they were housed in Sir Andrew's home without public access. The main legal issue was whether there was a breach of the public access rule.

In this case the Charity Commissioners had authorised the arrangement between the charity and Lord Andrew so that Lord Andrew only had the paintings while they were not on loan to public galleries and he paid the charity a rental for their use during the period of time that they were in his possession. Therefore, in return for rental payments to the charity the Charity Commissioners agreed that public access could be denied. Lord Andrew had also purchased a painting from the charity but at a price above market value. Furthermore, even though the level of public access would normally be insufficient in this case the charity recovered the benefit of rental payments which could be used to purchase more paintings. There was no reservation of benefit for the purpose of inheritance tax because full consideration was given by Lord Andrew for the reservation of benefit.

4.2 Retention of the House and Collection

Property can either be held by a charity as functional property i.e. to house the art collection or alternatively as part and parcel of the charitable objects. If a charity is established to preserve and maintain a particular property for the benefit of the public then sufficient public access needs to be given (as described above) and the quality of the building needs to be sufficiently high. Quality could be established by either English Heritage listing of I (exceptional) or II (more than special interest) or through a connection with a particular person or historic event. The charitable basis would either be for the advancement of education or simply to preserve for the benefit of the public a house and art collection of sufficient historic or architectural significance.

A case from practice involved a world famous architect who conveyed his paintings and house to a charitable trust. In this case his wife was allowed to remain in sole occupation without public access to the house because she was elderly and her life expectancy was not long. In order to avoid inheritance tax she would have needed to pay a full market rent. This was said to be an exceptional case by the Charity Commissioners and the Inland Revenue and charitable status and inheritance tax relief was awarded on that basis.

An alternative arrangement could involve the settlor occupying part of the house and retaining part of the collection. This would usually be a separate compartment of the house, not open to the public, which is relatively unimportant and would not detract

from the overall public benefit. That part of the house could contain some paintings subject to agreement with the Charity Commissioners.

This would usually involve a lease by the occupant to the charity for a market rent with the obligation for the tenant/occupant to pay insurance and maintenance for part of the house that he or she occupies. There would be no inheritance tax to pay if a full market rent was given.

4.3 Gifts of shares to be sold and used to purchase paintings

It would not be possible for a donor to gift aid cash to the charity on the understanding that the charity would then use the cash to purchase because of anti-avoidance provisions.¹² However, there are no such anti-avoidance provisions in respect of the tax relief for donors of qualifying shares.¹³ This means that it is theoretically possible for a donor to donate such shares to a charity on the understanding that the trustees will sell the shares and use the proceeds to purchase paintings from his donor.

5. Conditional Gifts and Loans

5.1 Gift Subject to Conditions

A settlor may wish to attach particular conditions to his gift when transferring his paintings to either his own charity or an existing charitable institution such as a public gallery or museum.

As a matter of law when property, such as a painting, is donated to a charity subject to particular conditions then, depending on those conditions, a separate charity may be created. Those charities are often referred to as 'special charitable trusts'.

If paintings are given to an institution, such as a gallery, subject to a condition or conditions that those paintings shall be held by the institution on special charitable trusts, then legally (depending on the exact terms of the gift) the institution may act as a trustee of a separate charity. Institutions such as The Tate Gallery and the Victoria and Albert Museum hold collections of art and artefacts on special charitable trusts. A donor wishing to ensure that his collection was preserved for the benefit of the public might be comforted by the fact that his collection was held separate from a charity's general assets which could more easily be sold or made

¹² Finance Act 2000.

¹³ Finance Act 2000.

available to creditors if the charity became insolvent.

Sir Denis Mahon recently withdrew three old Masters from the Walker Art Gallery in Liverpool as a result of the decision by the National Museums & Galleries Commission on Merseyside to impose admission charges. The paintings were given to the Walker Art Gallery on the condition that they should be available for the public free of charge. His success in withdrawing the paintings further demonstrates the value to donors of making conditional gifts to institutions.

5.2 Ensuring That the Collection Is Not Sold by the Trustees

Often settlors will wish to ensure that once their collection of paintings are transferred to their charity that the Trustees do not then sell their paintings. This consideration is relevant, irrespective as to whether the settlor wishes to transfer his paintings to his own charity or an existing institution.

As a matter of law, if the objects of the charity are expressly for the public exhibition of paintings or a specific collection of paintings then subject to there being an express power in the charity's governing instrument to sell the paintings the Trustees may, if they consider it to be in the best interests of the charity, sell the paintings. However, on the other hand, if the charity has broad charitable objects and the settlor transfers paintings or a collection of paintings to the charity then arguably each painting or alternatively the collection of paintings as a whole are held on separate charitable trusts, with the effect that, in the absence of an express power of sale set out in the instrument of transfer, authority from the Charity Commissioners would be required by way of an order or a scheme.

In order to put the matter beyond doubt settlors would be wise to establish the charity with broad charitable objects and then transfer the paintings or collection subject to conditions that the paintings or collections are held *in specie* for retention in perpetuity as permanent endowment. This would have the effect of creating special trusts for the paintings or collections, making it clear that there was no express power of sale and in the case of the requirement that the paintings are held as permanent endowment that should the paintings ever be sold then the proceeds of the sale must be held as capital. The requirement that the paintings be held as a permanent endowment would deter the Trustees from seeking to sell the paintings and expend the funds generally.

The effectiveness of the special trust device as a deterrent on Trustees from selling works of art were shown by the attempt by the Royal Holloway and Bedford New

College to sell three minor works of art.¹⁴ The Charity Commissioners took the view that, although the paintings were held on special trust, the College held the paintings as an adjunct to its primary educational object for the adornment of the College and could therefore be sold. Significantly the paintings were not held for public display.

However, in stating that the case was not to be seen as a “green light” for other charities to sell their paintings the Charity Commissioners distinguished charities which had as their objects the display of works of art and other charities with educational objects which held the paintings on special trust for the decoration of the charity’s building. It should be noted that it took four years for the scheme to be sealed and come into effect.

5.3 Loans

A private charity can make loans to museums, galleries, universities and schools, all of which are open to the public or a sufficient section of the public for the purposes of charity law, without breaching the public access rules. Typically a loan agreement will be put in place providing that the borrower will pay the cost of insurance and other related costs.

6. Restoration

The objects of the private charity could include the restoration of the collection. It is doubtful whether a settlor or a close family trustee could gift aid funds to the charity, as the private benefit of having exclusive access to the paintings some of the time would disallow tax relief. However, there would appear to be no such problem with donations from members of the public whether or not made by gift aid. Under the new tax regime for charities introduced by the Finance Act 2000 it is now open to people paying an admission fee for themselves and their family to gift aid their admission fee thus enabling the charity to reclaim basic rate tax and also enabling the higher rate tax payer to obtain higher rate tax relief. In the context of this paper the charity will need to have as its main aim the preservation of the property. Clearly, this could include properties which also house paintings.

7. Dual-qualified UK/USA charity

Where a settlor is a non-domiciled US citizen resident in the UK with a collection of paintings and income in both the US and the UK then it might be wise to structure

¹⁴ See Decisions of the Charity Commissioners Vol. 1.

the charity as a dual-qualified UK/USA charity.¹⁵

This is a charity which is structured so that it qualifies as a charity in the UK and USA. In the UK only cash gifts given by gift aid and donations of certain kinds of shares can attract tax relief for the individual donor. In the UK gifts of works of art to a charity are treated on a no loss no gain basis and are exempt for inheritance tax purposes. However, in the USA a non-cash gift such as a work of art can be deducted against income tax up to the full value so long as it is used for the objects of the charity which would need to be related to the artwork. A dual-qualifying charity might therefore allow donors to give tax efficiently in both jurisdictions.

For example, if a non-domiciled US citizen is resident in the UK and has paintings in both the US and UK and wishes to donate some paintings to his US and UK charities this might be a useful tax planning device. If he donates his US paintings to his UK charity then he will face a significant US tax on the capital gain on the appreciation in the value of the painting. For US income tax purposes his basis in the paintings will be his purchase price since there will have been no step-up in the basis at the time of the gifts. In addition, he will not be able to deduct the value of the paintings against his income tax and may face a US gift tax liability.

If, on the other hand, he donates his UK paintings to his US charity then any appreciation in value since the date of purchase will result in a UK capital gains tax liability. An inheritance tax liability could arise in connection with the donation as well.

The use of a dual-qualified UK/US charity can eliminate these problems of taxation and offer the non-domiciled citizen resident in the UK the opportunity to deduct the value of his gift of paintings against his US income for tax purposes and to avoid tax on any gain. Essentially this will enable the US citizen resident in the UK to achieve the same tax results as his UK citizen counterpart.

¹⁵ See 'Transatlantic Charitable Gifts' by Richard Cassell, *Christie's Bulletin* Autumn Issue 1995 and updated article November 2000.