Investing in Fine Art for the Future

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Edvard Munch's impressionist masterpiece, *The Scream*, was sold for $119 million at auction.

Pictures are not only worth a thousand words. They are worth thousands and sometime even millions of dollars, making them a most logical, safe and lucrative investment indeed, with the art market volume in the US alone surpassing US$40 billion per year.

The interest for investing in fine art has significantly grown over the last few years. Some do it out of passion and love for the art, others for investment purposes, while others do it for both of these reasons.

Given the current risky and volatile stock market environment and with interest rates at their lowest in decades, investors are now considering alternative investment opportunities such as fine art, antiques or even vintage wine.

In addition to the aesthetic and other qualitative values that fine art offers, there is also the profit reward potential of an outstanding price appreciation.

Recently there has also been an increased interest for participating in Art Funds through which a number of investors pool funds together to invest in scarcer and much more expensive art pieces, which of course can have a much higher value appreciation potential.

Furthermore, investment advisors worldwide have been encouraging their clients to consider diversifying their portfolios into alternative asset classes such as fine art.

When the money involved becomes significant, important considerations come into play as to how to effect such investments.

Each person has different circumstances, needs and intentions. These should never be ignored. Furthermore, high financial returns can result in high taxes. Valuable assets, whether of a monetary or sentimental value, can be lost following a potential legal action against the owner.

The issue of succession and transfer of assets to the next generation or whoever else in a tax efficient manner is also another important consideration. Tax, estate and succession planning as well as asset protection are now factors to consider very carefully.

Taking into account these considerations, investing in fine art can be structured through a number of ways, such as:

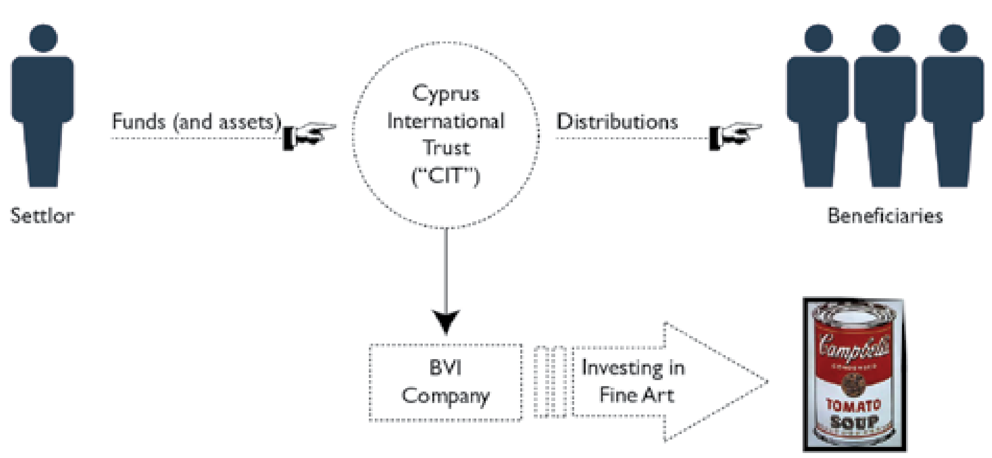
(a) Directly as an individual
(b) Through a company
(c) Through a Trust

Directly as an individual
This is the most common and convenient way as it is simple and retains full control and enjoyment of the art pieces. But is it really the most efficient way when owning a very significant art collection?

As a frequent buyer and seller of art pieces, the profit made on such transactions will probably be subject to tax, depending on the tax laws of the country of residence of the individual. There is the risk of losing the art collection against creditors or other potential lawsuits.

There is also a tax exposure on the value of the art collection transferred upon death in case inheritance tax exists in the country where the involved persons reside.

Through a company
By effecting art investments through a company can result in corporate taxes accordingly. This may not be a bad thing on its own provided it is structured carefully through a low-tax country (e.g. Cyprus which imposes a uniform corporate tax rate of 10%, being one of the lowest in Europe). Alternatively, it could be considered to use an offshore company like British Virgin Islands ("BVI").



Outline depiction of the use of a CIT combined with an underlying BVI company

If the way that such BVI company operates is structured carefully then transactions in fine art and other assets could result in no taxes at all until a dividend is distributed to its shareholder. In such case the recipient would need to declare the dividend in his country of residence accordingly. But the profits, instead of being distributed, could be re-invested in new art pieces again in a tax free manner.

When it comes to asset protection, estate and succession planning, the mere use of a company does not help. This is because the company shares belong to the individual in the same way as any other asset owned.

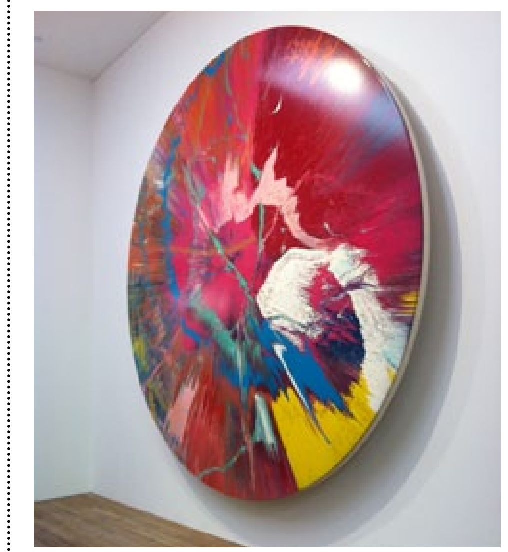
Through a Trust
Through the establishment of a Trust, the control and enjoyment of the art collection can still be retained if structured carefully. There is the potential of no taxes involved. Furthermore, the legal ownership of the art collection (or any other asset within of the Trust property) is not with the individual investor but rather with the trustees of the Trust. This concept can fully resolve the asset protection, estate planning and succession considerations in a very tax efficient and safe manner.

The choice of Trust jurisdiction is equally important. Cyprus offers a well regulated, globally acclaimed and tax efficient Trust regime through a Cyprus International Trust ("CIT").

In the same time, a Trust could set up an underlying company through which the art collection can be owned and managed. The existence of an underlying company could add various dynamics and practical efficiencies depending on the circumstances of each case.

How does a Trust Work?

- A trust is established by the settlor who settles (gifts) funds and other assets to the trust as trust property. The trustee(s) acquire legal ownership, management and control of the trust property for the benefit of the trust beneficiaries. The settlor can be one of the beneficiaries. Various levels of protection and retaining of certain control is possible.
- Upon their establishment, CITs are applicable to non-Cyprus residents. However, recent amendments to the CIT law now constitute CITs more flexible and attractive, whereby the settlor or beneficiaries can subsequently become Cyprus residents without this affecting the CIT status.
- Local or offshore Trusts are available for Cyprus residents.
- Qualifying CITs are not subject to any Cyprus tax to the extent that the beneficiaries are non-Cyprus tax residents.
- Local trusts are tax transparent for Cyprus tax residents.
- The trust can set up an underlying BVI or other company through which the art related investments are carried out.
- There could be more than one underlying company if other investing activities need to be made separately (e.g. trading in shares, investing in real estate). For certain types of investments, a Cyprus company can also be used in a very tax efficient manner (sometimes more efficient than an offshore company).
- The trust can make monetary or any type of asset distributions to its beneficiaries. Such distributions may be tax exempt in the hands of the beneficiaries depending on the local tax laws of the country of residence of each beneficiary and the manner in which the whole structure is set up and operated.
- Use of trusts offers a very high level of confidentiality where needed.



Damien Hirst, Beautiful, amore, gasp, eyes going into the top of the head and fluttering painting, 1997

Conclusion
The re-emergence of the Fine Art market is upon us. Under the current global economic climate, investments in fine art and other collectibles is an alternative that may offer a safer and better investment performance. At the same time, it offers the aesthetic pleasure and pride of owning certain objects that can be passed down to the family chain for generations to come.

There are various aspects that need to be considered in order to determine the most efficient and practical manner of effecting these investments. Each structure needs to planned and implemented very carefully in order to be customized to the relevant circumstances of each case and to address the local tax issues of the involved persons.

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