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NEW APPLICATION OF ANTI-MONEY LAUNDERING RULES TO ART TRANSACTIONS

Art dealers and intermediaries are about to face new transparency regulations in several European nations. Art brokers and dealers involved in any cross-border transactions with people in E.U. nations should pay careful attention to the new rules as they roll out over the next year.

I. NEW EUROPEAN UNION RULES

A recent European Council Directive will likely have a significant impact on European art and antiquities transactions by requiring brokers and dealers to identify buyers and sellers in most transactions. The Directive, intended to increase transparency in the art market, aims to make it harder to launder money through anonymous art sales.

This Directive builds on more broadly applicable European Council directives designed to prevent abuse in financial transactions. (Council Directive 2015/849, art. 2 (EU) ("Fourth EU Money Laundering Directive")). The Fourth EU Money Laundering Directive targets both money laundering, i.e., the transfer, concealment, or acquisition of property derived from criminal activity, as well as terrorist financing, i.e., providing funds that may be used to carry out terrorist activities. (Fourth EU Money Laundering Directive, art. 1).

The recent Fifth EU Money Laundering Directive expands the scope of these rules to art dealers and brokers, specifically:

> persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more; and
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> persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more.

(Council Directive 2018/843, art. 1 (EU) ("Fifth EU Money Laundering Directive")).

Under the new Fifth Directive, art gallerists, auction houses, brokers and dealers must conform to due diligence requirements designed to increase transparency, including:

> …identifying the customer and verifying the customer's identity…
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> identifying the beneficial owner and taking reasonable measures to verify that person's identity…

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> verify[ing] that any person purporting to act on behalf of [a] customer is so authorised and identify[ing] and verify[ing] the identity of that person…

(Fourth EU Money Laundering Directive, art. 13).

The Fifth EU Money Laundering Directive will have a significant impact on legitimate art transactions. Those involved in such transactions will need to take appropriate steps to determine the real parties in interest in the art transaction. This requirement runs counter to the industry practice in many transactions, where agents and intermediaries sometimes control information about the ultimate buyer.

The Fifth EU Money Laundering Directive became operative on July 9, 2018 but has no force until adopted in the national law of EU Member states. States have until January 2020 to adopt the provision into their national laws. Electronic copies of the Directives may be found here and here.

II. NEW RULES IN THE U.S.

U.S.-based art dealers, brokers, gallerists and auction houses should carefully consider how the Fifth Directive will apply to them if they are involved in art transactions occurring at least in part in E.U. Member states that have implemented the Directive in their national law. As with other E.U. rules, such as the E.U. General Data Protection Regulation, the applicability of E.U. law to U.S. entities is not always straightforward.

Here in the U.S., legislators have proposed similar rules, but none have yet been acted on. In the last session of Congress, a bipartisan House bill was introduced to amend the Bank Secrecy Act (31 U.S.C. §§ 5311 et seq) to include "dealers in art or antiquities." (115 H.R. 5886). Like the E.U. Fourth Directive, the Bank Secrecy Act aims to prevent money laundering and terrorist financing, in part through recordkeeping standards and mandated reports of possible criminal activity. If the Act were amended to include those involved in art transactions, art dealers would be subject to the same requirements.

Electronic copies of the proposed bill (now expired) can be found here, and the Bank Secrecy Act can be found here.

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This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.

value of the residence minus the value of the grantor's right to live in the residence, as determined by a calculation involving the applicable interest rate, the grantor's age, the value of the property, and the length of the QPRT term. A high interest rate environment means a lower present value, a lower gift value, and lower gift and estate taxes. Note, however, that in order to remove the value of the residence from the grantor's estate for estate tax purposes, the grantor must outlive the QPRT term. Additionally, the taxable gift resulting from the transfer of the property into the QPRT will reduce the grantor's unified exemption from estate and gift tax.

Charitable Remainder Annuity Trusts ("CRAT")

A CRAT is the reverse of the previously mentioned CLAT, insofar as the annuity from the trust is payable to a noncharitable beneficiary and the remainder is payable to a charitable beneficiary. The noncharitable beneficiary receiving the annuity can be anyone, but if it is not the grantor or the grantor's spouse, the present value of the annuity—which must be between 5% and 50% of the initial value of the assets—is considered a taxable gift when the CRAT is created. The present value of the remainder that will pass to the charity—which must be at least 10% of the value of the transferred assets as determined using the 7520 rate—is deductible as a charitable contribution for income tax purposes.

As with installment sales to grantor trusts, transferring highly appreciated assets to a CRAT will make it most effective, since a CRAT's tax status will allow the deferral of capital gain recognition. However, unlike installment sales, higher interest rates are preferable since they result in a higher annuity payout to the noncharitable beneficiary.

Grantor Retained Income Trusts ("GRIT")

A GRIT is an irrevocable trust to which the grantor transfers assets and retains an interest in all of the net income of the trust for a set term of years. When the term of years ends, or upon the death of the grantor, the remaining assets in the trust pass to the remainder beneficiaries. The value of the grantor's retained interest in the trust reduces the value of the trust for gift tax purposes, but only if the beneficiaries are not members of the grantor's family. However, "members of the grantor's family" include only the grantor's spouse and lineal descendants of the grantor or grantor's spouse and any sibling of the grantor or the grantor's spouse. Therefore, a GRIT is effective for gifts to nieces, nephews, distant relatives, friends, or others that do not fit into the definition of "members of the grantor's family." As the 7520 Rate increases, the value of the remainder interest conversely decreases and the value of the taxable gift decreases as well.

If you have questions about gifting strategies in various interest rate environments, please contact your Wiggin and Dana attorney.