

Family Art Foundations: Preserving & Protecting Family Art Collections for the Next Generation

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Introduction

Today, the private art collections of wealthy families can rival those of major art institutions. Private foundations are being created at an astounding rate and for many wealthy families art collecting has become synonymous with art investing. Equally important, art collectors are moving toward an increased focus on using their wealth to realise what they define as a richer life and to achieve a greater sense of fulfilment for themselves and for their community by leaving a lasting legacy with their collection.

Having created or inherited a collection, many families will wish to ensure it is preserved both during their lifetime and for future generations. Planning how to transfer a family collection to the next generation can be one of the most critical aspects of building and maintaining a successful financial plan. Deciding where the collection may reside be it with a foundation, a family member, or a museum also is a key consideration. In light of the potential tax and other financial liabilities, deciding on the best strategy early on can be of critical importance.

In recent years a growing number of collecting families are choosing to create their own private foundation rather than to donate works art to existing institutions. While there are a number of factors driving the growth of foundations globally, the desire to preserve and protect the family collection is a major consideration. Equally

important, once a collection has passed a certain threshold, a wide range of financial planning considerations come into play.

Ownership through a foundation structure can offer significant advantages over direct ownership, in terms of preservation of the collection generally and, in particular, in relation to the owner. The very wide range of foundation formats available and the huge flexibility which careful drafting can incorporate into foundation instruments allows structures to be tailored to the needs of the particular client and collection.

Why Families Set up Private Art Foundations

The Family Art Foundation is a vehicle which aims to help families organise their collection for the purpose of transmitting the art to the next generation. Its object is to manage and administer art assets in favour of one or more beneficiaries, or in favour of one or more aims, which are different than those dedicated to non-profit foundations.

Creating the right financial plan for an art collection requires a personal touch, taking into account the unique financial needs, interest in providing for heirs and other beneficiaries and the nature of the assets involved to chart a creative and sound financial course that serves the family effectively over time.

Questions concerning whether children will have the organisational and financial resources to care for a collection and whether there will be sufficient wealth to bequeath an inheritance outside of the collection itself may have to be worked out. Regardless of whether the children have an interest in a family collection, decisions about its disposal can be quite emotional.

Individuals and wealthy families may use the Family Art Foundation for many reasons, which may include any of the following:

Desire to leave a lasting legacy

A private art collection is often built on emotions and passion. It is only natural that collecting families who devote great care to cultivating their collections should also wish for it to leave a lasting legacy. Moreover, the value of this familial patrimony will increase over time and it is important that the collection remain intact and continue to evolve over time. Families may wish to maintain control over the collections and to ensure the art is properly cared for. The foundation can also be used as an instrument to prevent the dispersal of the art after death.

Preserve the original vision of the founder

Ultimately, collectors considering the creation of a foundation feel a responsibility towards their art and want it cared for and preserved. By creating a Family Art Foundation the founder ensures that his or her vision continues long after they are gone. Another consideration is the shape that their foundation will take – do they intend to build a permanent memorial or an evolving institution? Ideally, this should be decided early in the collecting process as it helps define the collection's scope. Any collection could potentially survive as either, but collectors should assess the unique benefits and setbacks of each model. A permanent memorial will serve the purpose of immortalising the founder while allowing the public to experience art as the collector intended.

Succession planning and a Family's Cultural Heritage

Collecting families need to make provisions for the preservation of their collections and transmission to succeeding generations. Family collections can provide essential clues to a family's past and can hold vital and unique information regarding the history of a family. Creating a Family Art Foundation gives the possibility to choose how and by whom the collection will be managed in order to secure the family's heritage. Moreover, the foundation allows the separation of economic ownership of family property and the management of the family business. This is particularly useful when the founder has no children or if he considers some of the heirs may not be suitable to oversee the collection.

Taxation in Luxembourg

Unlike other vehicles for private wealth management, the Family Art Foundation in Luxembourg has an opaque "company form" from a Luxembourg tax perspective and is considered as fully liable to Luxembourg income tax (corporate income tax and municipal corporate tax). However, the Private Foundation is tax exempt on:

- 1- Capital gain on artworks - Capital gains realised on any movable asset held by the Foundation is also tax exempt, if the foundation has held the said asset for more than 6 months.
- 2- Income derived from renting the artworks – The rents received by the Foundation might be taxable but holding the artworks will not suffer any wealth tax. Receiving income from renting the art collection may be taxable but will often be offset against the costs of holding, maintaining, insuring, and protecting the collection. The Private Foundation will be exempt from wealth tax.
- 3- Certificates issued by the Foundation – A Foundation can also issue certificates which are linked to one particular group of assets like an art collection or in

tracking the income realised by the Foundation on a particular piece of art. Income including rental income or capital gains which are generated by the Foundation then becomes directly due to the holder of such certificate. The income received by the Foundation enters into its taxable base but the payment made to the holder of the certificate is then considered as an interest which then offsets the income derived by the Foundation. Thus no taxation will be applicable at the level of the Foundation. This deemed interest income paid by the Foundation on the certificate does not suffer any withholding tax at source, being payable to a third party, resident or non-resident, being a company, a fund or a HNWI.

Moreover the other incomes like income derived from the wealth management of a portfolio of securities held by the private Foundation will also be tax exempt (dividends and interests received from securities as well as capital gains on such securities). This feature gives a tax advantage to the founder and the beneficiaries; the art of work and the family financial assets can be grouped into the Private Foundation and be managed jointly in a tax efficient manner.

The Foundation won't be subject to net wealth tax. The Private Foundation can also hold some rights, shares, real estate and life insurance contract which may also benefit from some tax advantages.

The "beneficiaries" of the Foundation, if they are non-resident will not be taxed in Luxembourg upon distribution paid by the Foundation.

Likewise no inheritance tax will be applicable upon transfer of assets by the Foundation to the beneficiaries (or to the founder if he is one of the beneficiaries), except if the assets are real estates situated in Luxembourg.

Chart 1.

Incomes	Tax advantage
Capital gain on Artworks	Tax exemption, if assets are held at least 6 months
Income derived from artworks	No income tax, no wealth tax
Certificates issued by the Foundation	No taxation at the Foundation level Rental income or capital gains are due to the Certificate holder No withholding tax at source on the interest income
Income derived from wealth management of a portfolio of securities	Tax exemption
Other incomes	Tax exemption subject to conditions

Philanthropy

It is a fine gesture for families with exceptional art wealth to share their passion by enriching a museum's collection with works of art, or to give them on loan to an exhibition in order to share their enjoyment with others. However, the primary aim of a family art foundation is to manage and administer a family's private art assets in favour of one or more beneficiaries, or in favour of one or more aims. There are also non-profit foundations dedicated purely to philanthropic endeavors. Nevertheless, it is not prohibited for a private foundation to have incidental charitable and non-profit activities, but they should not be incorporated with a goal in mind that is normally reserved for non-profit foundations.

Confidentiality

The protection of privacy is an important part of a Family Art Foundation. With many museum collections going online, it begs the question should private collectors not do likewise and in doing so how do they protect their property and privacy. A foundation can meet the legitimate needs of wealthy families to limit the visibility of their art assets to ensure their safety. This privacy is reflected in the fact that while the creation of such a foundation must be advertised in certain publications, it is not required that the publication mentions the identity of the founder and the beneficiaries or even the amounts contributed. Equally, although the foundation must prepare annual accounts, these accounts do not need to be published. Furthermore, the appointment of an auditor is only required if the foundation has more than 5 beneficiaries or assets exceeding 20 million euros.

The Benefits of Art Foundations over other Art Holding Structures

Quasi corporate in nature

A Private Art Foundation in Luxembourg is defined as an instrument reserved for individuals or wealth structuring entities whose purpose is to administer and manage art assets. It cannot be used to exercise a commercial, industrial, agricultural or professional activity. Based on corporate law, this instrument resembles a commercial company with a separate legal personality. The main difference is that the foundation is an orphan structure which has no shareholders, partners or members.

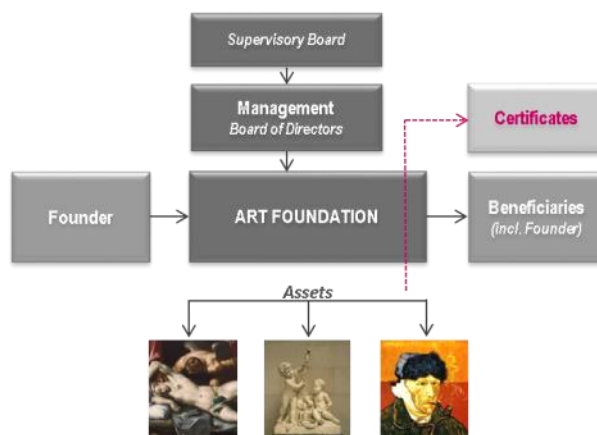
It is also easier to create a foundation in Luxembourg. It simply requires its constitution document to be filed and registered:

- The foundation must have a registered office in Luxembourg;
- The minimum contribution is EUR 50.000

•The foundation can only be used by individuals or by wealth management entities who administer the assets of individuals

•A notarised deed must be drawn up. The deed contains the Charter of Constitution.

Chart 2.



Family members, advisers and professional fiduciary can be appointed as Councilors

A Foundation implies a tripartite organisation, involving the founders, the beneficiaries and the management. The Founder can be one or several private individuals (family members or not), advisors or professional fiduciary that administer assets of individuals, like a Trust. The Founder has a large amount of freedom and can reserve the right to amend the articles of incorporation of the Foundation, including its lifetime and liquidation, the designation of the beneficiaries, and also change the legal by-laws.

A Foundation can have one or more beneficiaries whereby the founder is given the possibility to appoint as well as to revoke beneficial interests and to determine the criteria for the selection of beneficiaries. The patrimonial foundation is administered by a director, or by a board of directors, composed of natural or legal persons (including the founders and beneficiaries who may combine these functions) that undertake all action necessary for the accomplishment of the Foundation's purpose. In some cases, the foundation may have a supervisory board. It is only mandatory if there are more than 5 beneficiaries or if assets exceed 20 million euros. Resolutions by the foundation's management and supervisory bodies will be approved by simple majority and a quorum is not required.

Enjoys separate legal personality and will own assets itself

It's separate legal personality allows foundations to own an art collection directly.

Beneficiaries have no rights over the assets

Assets placed into a Foundation become the property of the Foundation itself both legally and beneficially and will be managed by the foundation itself for the benefit of one or more beneficiaries. However, the law allows that Foundations can issue certificates of entitlement providing beneficiaries with a clear title which represents an asset or a part of the estate of the Foundation.

No shares are issued

As no one individual owns a foundation, it is fully autonomous. Accordingly, the foundation does not have shares, unlike a corporate structure. As seen above, the Foundation may issue registered certificates linked to assets it owns and representing rights defined in the incorporation act or other documents, to any individual or patrimonial entity acting in the scope of wealth management of one or more individuals. A certificate holder has the right to receive income deriving from the underlying Foundation's assets.

Attractive to clients from civil law jurisdictions

Foundations are clearly governed by the law in the jurisdiction where they are established. Foundations are based on civil law and clients from civil law jurisdictions have more familiarity with such law.

How an Art Foundation can provide for Heirs and other Beneficiaries

An Art Foundation can help to decide on a strategy for an art collection early on:

- The foundation can be created during the lifetime of the Founder or on death.
- The foundation can be created for a limited duration and can be revoked.
- The founder can exercise control over the use of the assets and retain certain powers.
- The foundation foresees the supervision by outside administrators.
- The foundation is created for asset protection and succession planning.

Help to maintain family harmony

A private foundation can be used as an instrument to prevent the dispersal of assets in the event of death of a member of the family. As the decision on how the assets would be managed was taken before the death of the Founder, and according to the Founder's will, the family is not able to intervene independently in the management of

the collection. Risks of differences of opinion within a family will be minimal and the family harmony thus kept.

Includes family members in the decision making process

Family members and heirs can take on several roles in the Art Foundations: Founders, Beneficiaries and / or members of the Board of Directors, according to the Founder's decision. They could then be involved in during the stage of reflection prior to the decision -which will finally be drafted in the Constitution Charter- or during the implementation phase of the will (as being a member of the Board of Directors). Including the family member in this process will help to obtain a better acceptance of decisions.

Preserves the collection during their lifetime and for future generations

The Management of assets by a Board of Directors will be able family and heirs not to have to continually consider the most appropriate choices in order to preserve the collection. The strategy is already decided and risks of error are thus reduced.

Structuring a Family Art Foundation – Case Studies from Crestrust

Case Study 1

A collector owned a collection consisting of thousands of antique objects of art. He was married twice and has three children from his first marriage and two others from his second marriage. His objective was to ensure that his collection would remain intact and not dispersed among his heirs in order to achieve the best valuation while also maintain the possibility of receiving a periodic income from the collection.

Crestrust helped the client to structure a Foundation to whom he donated the entire collection and the objects of art are now the property of the Foundation. While the donation is irrevocable, the client is able to remain very involved in the management of the Foundation and is a member of the Supervisory Board. This entity allowed him to nominate beneficiaries as well as modify the beneficiaries list and statutes of the Foundation during his lifetime. As Managing Director of the Foundation the client was able to oversee the management of the Foundation enabling the collection to continue to benefit from his extensive experience.

Any gains realised by the Foundation from the collection will be distributed to the beneficiaries in order to generate an income for them during their lifetime, while also providing for an orderly succession and nomination of members to the Supervisory Board. Existing members

included the client, two independent experts, a lawyer and an art advisor.

Case Study 2

A family with a child who was an emerging young artist, wished to provide sufficient capital to allow the child to:

- develop his art;
- create and build a collection; and
- organise an art exhibition to launch his career. While wishing to fund the child's artistic development, the family wanted to ensure the funds were not misused and to protect the young artist from misappropriation by third parties.

Creitrust helped the family to structure the funding arrangement through a Foundation in order to ensure the aim intended by the family was upheld. The family structured the Foundation in such a way that a Board of Directors was named and a clear road map established, in order to achieve the young artist's support without the capital being used for other purposes. The Foundation designated a Supervisory Board made up of family members to ensure that the Board of Directors' mandate was correctly realised and a rule of succession for the Supervisory Board was predetermined.

Case Study 3

A client owned a major share (30%) of the works of an artist who had reached the age of 75 years. The client wished to ensure that the collection would not be subject to a forced sale by the artist's family at time of death, thereby significantly impacting the value of the artist's work. The client required a tax efficient structure which would allow both the client and the artist to jointly manage the collection until his death, while ensuring the artist's family would benefit from best execution in the ultimate disposal of the collection.

Creitrust helped the client to create a Foundation which brought together the artist's entire collection plus a securities portfolio pledged by the client. In return, the artist would receive a lifetime annuity from the securities paid quarterly by the Foundation until death. The Foundation issued certificates backed in part by the assets in the Foundation (e.g. the art collection) which could only be realised at time of sale. The Foundation was established in such a way that the artist had the option to oversee the management of the collection in the Foundation. However, upon the death of the artist, the client would remain the only member of the Supervisory Board. The client's family was designated as the beneficiary of the gains realised from Foundation whereas the artist's family receive gains realised from the certificates.

Resources Required to Care for the Collection in a Foundation

Caring for and managing a collection held in a family foundation requires efficient access to dependable resources and trustworthy experts. Appropriate industry credentials combined with years of experience are critical for serving the complex needs of the family.

Assistance in matters of shipping, insurance, storage, and restoration will be required to guide the family through the minefield of official documents and export licenses which may be required for the transfer of the art into a foundation. Experts should be internationally recognised leaders in their field and any services they perform should be carried out with due skill and care in accordance with international standards of best practice.

Since most family collections are unique and irreplaceable, proper documentation is crucial and can ultimately decide whether a painting has a lower or higher value. Over the past several years, provenance, or the history of ownership for a particular work, has become increasingly important. Provenance can help determine the authenticity of a work, establish the work's historical importance, and trace the work's legitimacy.

Deciding whether an object is authentic is one of the most important factors in establishing its value. Authenticity is a concept which changes constantly, both from the point of view of how one defines what is an authentic piece and from the viewpoint of who is best qualified to determine whether a piece is authentic or not. Attributions of works to certain artists can and does change and adequate research and regular review ought to be conducted to identify any issues in this regard.

Framework for Art Governance

A Family Art Foundation requires explicit governance practices in the same way as a family business. One key to making sure a collection doesn't damage family harmony is to work toward open communication and look for creative ways to include family members in the decision-making process. A sound governance system for a Family art foundation should comprise both structure and discipline.

In order to agree shared values for a Family Art Foundation the process of creating governance-related documents such as a family collection policy and mission statement can be truly valuable.

A common complaint within families that fail to have a rules-guided, transparent system in place for their

collection is that most decisions are made, or appear to be made, ad hoc. The problem with such a decision is that it is susceptible to challenge on one or several grounds including it was not consultative or it was too emotionally driven. By contrast, if a decision is made pursuant to a rule directed and transparent process, it will be, by definition, consultative. Moreover, it's much more difficult to attack a decision that results from such a process as being motivated by personal emotion.

The Role of an Art Foundation in Art Philanthropy

In recent years a growing number of wealthy collectors are choosing to build their own museums, through a foundation rather than donate works directly to existing institutions. While there are a number of factors driving the growth of private museums globally, a lack of public exhibition space has played a major part. For many collecting families, they simply want their art works to be seen. Though still relatively rare, private museums opened by wealthy collectors are increasing in both number and size globally.

Apart from the psychological motivations, the decision to build a private museum is often prompted by the desire to keep artworks exposed and available to the public. Collectors must also consider the extent to which they can provide financially for the preservation of their collections. A private museum is not only expensive to build, but requires a large endowment to preserve it for the future.

Conclusion

The future looks bright for private collectors interested in creating their own Family Art Foundations. An art collection requires the same strategic planning as other financial investments and with the help of skilled advice can become an effective working asset for the family. However, the potential problems and pitfalls of creating a Family Art Foundation are numerous and require careful consideration. It is certainly well worth any family wishing to put their collection into a foundation spending some time and money on ensuring that all issues are addressed at the outset. Solutions to most concerns are available, it is just a question of seeking them out.

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About Fine Art Wealth Management

Fine Art Wealth Management (FAWM) is the first wealth management consultancy dedicated exclusively to art, collectibles and other investments of passion as an alternative asset class and the disciplines required to analyse this complex field of investment. We are wealth structuring specialists in art assets and a leading provider of intelligence on financial planning for private collections to wealth managers, private banks, family offices and professional advisors.

About Creatrust

Creatrust is a leading independent trust and corporate services firms in Luxembourg providing family, fund and corporate services for Wealth Managers, High Net Worth Individuals, Family Offices, Corporates and Fund Promoters. As a member of the Luxembourg Council of Chartered Accountants, we offer one-stop-shop solutions based on our expertise in accounting, tax, legal, administration and financial matters. Our range of services includes creation of companies, fund set up services, and establishment and management of trusts and foundations for family offices. Our international clients recognise Creatrust as a partner of choice thanks to our working model and our in-depth understanding of the Luxembourg and international legal, regulatory and fiscal environment.

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