

<http://www.wealthmanagement.com/art-auctions-antiques-report/freeports-art-world>

Recent headlines have depicted “freeports” as uber exclusive warehouses filled with billions of dollars of art, scandal and fraud. These headlines have left many to wonder, what exactly are freeports, how do they function, should they be used to store art and what type of art transactions occur in them?

What Are They?

“Freeports” are areas where goods may be handled with less intervention from taxing and customs authorities. These areas are generally located in seaports and airports worldwide to facilitate international trade. Freeports were originally intended to provide areas where goods could be fabricated, stored and quickly transported by ship or plane to buyers around the world. Storage companies have built manufacturing and storage warehouses in freeports to facilitate this activity. In any discussion about freeports, questions about “bonded warehouses” commonly arise. Generally, bonded warehouses are synonymous with freeports because freeports are merely clusters of bonded warehouses in one location; however, freeports may have different tax implications.

Historic and Current Use

Historically, freeports were used as spaces to store goods in temporary transit, free of taxes and customs duties until the goods reached their final destination. When goods are finally delivered to customers, they become subject to the taxes and customs duties

of the country of delivery. Not subjecting the goods to taxes and customs regulations until final delivery results in a quicker turnaround time for various stages of such international trades.

Today, freeports are still being used to facilitate international trade. Not only do companies with high volume international sales employ freeports, but also private individuals use them for personal trading. Storage and logistics companies have built even more sophisticated and highly secure storage facilities in freeports to adjust to their expanded use, which provide for long-term and even permanent storage of luxury goods, such as fine art, rare books, historical artifacts, classic cars, vintage wine, jewelry, precious coins, classic musical instruments, sports memorabilia, entertainment and pop culture collections and gold. Companies are renting storage space in these high tech facilities to private individuals who've purchased goods for investment purposes and want to keep those goods in a safe location.

There's no distinction in the treatment of goods being transported through or stored in the freeports—grains, cars and luxury goods all benefit from the tax suspension system in the freeports. There's also no restriction on who may use the freeports—a business entity and a Russian billionaire are both entitled to benefit from the tax suspension system in the freeports.

Given the evolution of the freeports' use, there's been criticism that the reduced level of oversight originally intended to quicken the turnaround time of international trade is making it easier for bad actors to hide illegally acquired property in freeports and launder money. In response to these concerns, many freeports now provide their local customs jurisdiction with access to their inventory and owner lists. Owner lists are available because several freeports require owners to present customs invoices that state the owner's name upon registration. Therefore, although customs duties don't apply, the disclosure requirements to customs authorities are increasing.

Security and Tax Benefits

Storing art in freeports has security and tax benefits. Freeports have evolved into areas with world-class state-of-the-art facilities that offer users both an immense security infrastructure and white-glove, museum-standard art amenities. The security infrastructure at freeports includes electronic monitoring and armed guards. The services offered generally include controlled temperature and humidity storage, museum-quality handling and packing, restoration, conservation, insurance, shipping, bespoke showrooms, private viewing rooms and office space. Thus, the storage facilities in freeports have become some of the safest places in the world to store art.

An added benefit, as previously discussed, is that freeports are tax suspension zones for certain, but not all, taxes. Sales taxes, value-added tax (VAT) and customs duties are due on final delivery to a destination outside of a freeport, and the laws of the country where the good is delivered govern the tax and customs process. The longer the art is stored in a freeport, the longer the obligation to pay such taxes and customs duties is delayed, and if the art never leaves a freeport, such taxes and customs duties will never be due.

If an individual purchased the art for purely investment purposes with no desire for personal use, there's no incentive to move the art to a final destination outside of a freeport because the art is often more secure inside a freeport than at any other facility, any future sales can take place at the warehouse where the art is located and if the art requires any kind of servicing, specialty companies are at a user's disposal.

Options Around the World

Although Swiss freeports most often make their way into the news headlines, there are actually many different freeports to choose from around the world, including locations in Asia and North America. The major difference among the freeports is their disclosure policies, which are more burdensome in some locations than others. For instance, the Luxembourg freeport requires the trustees of a trust storing art inside the freeport to disclose the identity of the trust's beneficiaries, while other freeports may not necessarily require that additional layer of disclosure.

An especially interesting Asian freeport is Hong Kong. It's unique from other freeports because its entire territory is essentially a "freeport" itself. In Hong Kong, art isn't a dutiable good for export and import purposes, and there's neither sales nor capital gains tax. Thus, in Hong Kong, artwork can be stored in private settings, outside of a warehouse, and still incur many of the benefits that traditional freeports and bonded warehouses offer. One of the newer Asian freeports is the ultra-modern Singapore freeport, located at Changi Airport. The Singapore freeport provides all major art services and, at over 22,500 square feet, is expansive. There are also plans to open a new, modern, freeport in Shanghai, and bonded warehouses have long existed in China.

In the United States, fine art storage facilities in Delaware have begun to brand themselves as the American freeports. **Fine art warehouses in Delaware can operate like freeports for two major reasons: (1) Delaware has no state sales tax on the sale of art, and (2) there's no federal customs duty levied on art imported into the United States.** These two elements permit fine art storage warehouses to function under a freeport-like suspension of the tax system within the United States. The Delaware freeports are a convenient resource for those U.S.-based collectors, dealers and galleries that don't feel comfortable with their art being stored abroad.

Most European countries have some form of bonded warehouses within their borders. These countries include France, Germany, Luxembourg and the United Kingdom. However, no country has been more prolific in defining itself as a freeport haven as Switzerland. Geneva and Zurich had the leading art freeports for more than a century, and billions of dollars of art are estimated to be held within them. Freeports are also located in Chiasso and Basel. Until recently, the Geneva freeport was an art market favorite because of its thorough and expert provision of highly sophisticated logistical art services. Shock waves reverberated through the art world last year when news broke that the owner of one of the largest Swiss freeport companies was accused of fraud and money laundering in one of his art deals. This news raised new questions regarding the ethics of freeport owners acting as art dealers, given their knowledge of confidential information, which one could view as a conflict of interest. It remains to be seen whether this case will affect private dealing inside the Swiss freeports.

Effect of Private Art Sales

The art market consists of two types of sale arrangements: public auctions and private sales. Live public auctions are traditionally popular with buyers and sellers who want more regulation of the art sale process and are less sensitive to privacy issues. Privacy issues arise in public auctions because the art and sale prices are released to the public, and the names of the buyers and sellers may be leaked during the intense press coverage. Buyers and sellers looking for confidentiality with respect to their transactions customarily use private sales because there's neither public disclosure nor press coverage in a private sale. Sales timing is another difference between public and private art sales. Typically, public art auctions for each art category occur, at most, twice a year in any one location. These public auction schedules don't affect private sales, which can take place at any time during the year and are thereby the more flexible option from a timing perspective.

As recently reported by *The New York Times*, “globalization, financial deregulation, and the lure of art as a tax-efficient alternative investment have encouraged people” to enter the art market.¹ Additionally, the rise of contemporary art values, the growth in the number of wealthy individuals in China, India and Russia and the performance of collectibles as compared to securities have all contributed to an increase in the number of global private art sales. The strength of the art market hasn’t only led to a greater demand for art, but also to a higher command of art prices. The increased demand has created interest in buying art at all times of the year, not just during public auction seasons, and the realization of higher prices has produced greater privacy concerns—perfect market conditions for an upswing in international private sale transactions.

The popularity of private sales has translated into a high demand for advisors capable of structuring sophisticated international private art transactions and facilities, such as the storage warehouses located in the freeports, capable of providing neutral, secure and private venues to facilitate such transactions. Private sales trigger complex tax planning considerations as buyers, sellers and their agents are based in different jurisdictions with dissimilar tax structures and reporting requirements. The intersection of various taxing regimes in an international private art transaction underscores the necessity of the freeports’ tax suspension zones, which are critical to assessing the tax implications of these trades.

Neutral Locations

With multiple jurisdictions in the mix, when structuring international art transactions, the sale location is a key consideration for purposes of tax compliance.

Tax compliance risks are minimal when art is sold at public auction because the auction houses inform buyers of the taxes that are owed and remit the appropriate tax amounts

to the government. The auction house's role as intermediary alleviates compliance risk for buyers because they don't have to research the tax laws in the jurisdiction where the auction saleroom is located to know how much tax is owed on an art purchase. Further, buyers don't have to be concerned about whether undisclosed sellers actually remit paid taxes to the government because the auction house provides that certainty.

Unlike public auction sales, tax compliance risks fall on the individual parties in private sales. The great advantage of the freeport tax suspension system is its ability to simulate the ease of auction sales because it eliminates the burden of tax collection. While art is inside a freeport, there are no import and customs duties, VAT or sales taxes levied on the art by the jurisdiction where the freeport is located. With none of these taxes imposed on the art sale, there's no tax due by the buyer and no tax that the seller would be required to withhold from the buyer.

It's important to note that freeports are only suspension zones: They don't eliminate taxes, and the tax suspension only applies to the taxes and duties mentioned above. The buyer may be required to pay such taxes and duties when moving art to a location outside a freeport. For example, if a buyer purchases art in a freeport and subsequently ships it to the United States, the state where the art is delivered may impose a use tax at the time of delivery.

Other taxes, such as income taxes, may still be applicable even though art is held in a freeport, and this tax is based on the country where the seller is domiciled or resides.

For example,

U.S. residents are taxed on their worldwide income, which includes any gains realized on the sale of art that takes place in a foreign freeport or bonded warehouse. Therefore, such gains must be reported to the Internal Revenue Service. Additionally, if an individual dies with art located in a freeport, estate tax may still be owed on the value of such art. For example, if a nonresident alien dies with art located in Delaware, the decedent's estate may owe estate tax in the United States on the value of the art.

Privacy Protection

If art is sold publicly, the sale will likely take place at an auction house. The auction house provides a neutral location that enables sellers and buyers to remain anonymous if they choose to do so. However, if art is sold privately, more consideration is given to the location of the sale for privacy protection reasons. Some private sales take place at the seller's location or the buyer's location, but most often buyers and sellers select a neutral location because the parties involved wish to remain anonymous. Freeports and bonded warehouses are generally considered neutral locations, because third parties can arrange for art viewings, inspections and shipments, while simultaneously keeping the identities of the seller and buyer undisclosed from one another.

Selecting Freeports

When selecting which freeport or bonded warehouse to use for an art transaction, sellers and buyers should consider the differences in the freeport locations as they relate to: (1) flexibility in movement; (2) privacy with respect to disclosure requirements; (3) the amenities and services offered; (4) security and access; and (5) the current location of the art and the selection of a convenient travel location to mitigate risk of loss or damage.

Selecting a freeport as the location of an international art transaction will ease several negotiation points. For example, each party will have the responsibility to separately conduct its own tax planning, arrange private viewings, perform any required restoration or conservation onsite and easily allocate transaction expenses.

Freeports have evolved to provide art market participants with convenient locations to conduct their international transactions, and the art market's use of freeports is in line with the original intended use of freeports to facilitate international trade. Without them, international art transactions would be much more difficult to structure, coordinate and execute.

Endnote