

Recent publicity has caused many in the art world to start asking questions.

Because of the uptick in activity and recent publicity, there has been a significant increase in questions and concerns with respect to transactions involving the art world. Inasmuch as art is an area unto itself and tax issues are fairly arcane, the following is presented as a guide to demystify the entire process.

A recent article in the New York Times suggested that sales tax could be avoided if art work was sent to a museum for a limited period of time immediately after the purchase. Is this correct?

The article buried a disclaimer so adeptly that it went virtually unnoticed. The correct answer is that there are a very small number of states that allow for a sales tax exemption based on placing the artwork in a non-taxable stream of commerce for a finite period of time (e.g., donating it to a museum out-of-state for a six month period). However New York is not one of these states!

How can a state like New York tax an item which I either purchased outside the state, or which I sent outside the state and did not bring into New York until months later?

This is at the heart of the distinction between sales tax and use tax. Sales tax generally applies to the sale of all items of tangible personal property (such as art). The tax is levied upon the transaction itself at the point of purchase, where delivery and control occur. Use tax is the flip side of sales taxation. It applies to instances where a purchaser brings or directs property either purchased or delivered elsewhere into the Empire State. Sales and use tax rules have been around for over 50 years and their constitutionality has been consistently upheld by the courts.

Is there a sales/use tax in New York City?

Almost all localities have their own tax, but all are administered by the State tax authority. Thus the combined New York State/New York City rate is over 8% and is included on a single filing.

Who is responsible for filing these returns and paying the tax?

Sales and use tax collection liability is joint and several, meaning both buyer and seller are on the hook. If the seller has presence within New York, then it normally is the primary filer. However if for some reason the seller fails to file and remit payment, the tax authorities can come after the purchaser.

Is there a statute of limitations?

Yes, there is a three-year statute. However this only applies where a tax return has been filed. Failure to file means the statute of limitations clock never runs and the tax exposure is unlimited. Note, there is a sales tax line on New York personal income tax returns. If this line is filled in stating the amount of sales tax paid to the state, even if wrong, it begins the clock for statute of limitations purposes.

I did not know of my filing obligations. Am I at risk and is there any recourse?

Unfortunately ignorance of the law is no excuse, although in some cases (including one published case involving the popular singer Roberta Flack) the receipt of erroneous professional advice can be grounds for penalty abatement. The risk for lapses in this area are the unlimited look-back for past liabilities, interest and penalties. There is a process, known in tax circles as VDA (voluntary disclosure administration) wherein taxpayers can of their own volition have their representative contact the state to make amends for prior failings. The benefits of VDA are a three-year look-back and penalty abatement.

I purchased art while out of the country. How will the State learn of this?

There are ways the auditors can discover these matters, such as through the information sharing with the United States customs authorities. Note, the State is scrutinizing these transactions.

I live outside New York and am purchasing art at a New York studio. Can I take possession and not pay tax as long as I leave the state immediately?

No. If you take possession on New York soil, the tax applies. However, there is a limited exemption where you can have the art delivered to the airline and delivery is made to you while on board the aircraft. Any delivery made outside New York is exempt even if not on an airline, unless it will be brought back into the state.

Are there any ways to purchase artwork in New York without sales or use taxation?

Yes, there are a number of planning techniques and exclusions that are available. These require some foresight and must be adapted to each individual's particular circumstances.

Can I escape taxation if I lease the artwork?

No, because the sales and use tax statute is worded to treat "sales" expansively. Leases, barter and the like are deemed to be sales for tax purposes.

Can I avoid the tax if I purchase through an entity that I control, such as an S Corporation or a trust?

No, there is a legal concept called piercing the corporate veil, wherein the discrete form of a controlled entity is disregarded and transactions imputed to the controlling individual. This applies in the sales tax area as well.

Do federal rules apply in the area of state taxation?

State tax codes are separate from the Internal Revenue Code, but virtually all states use federal law as their starting point. Thus federal principles apply unless the state statute explicitly states otherwise.

Most of these Q&A's have dealt with sales tax. Are other taxes involved?

Most issues are currently in the sales tax area, but there can be gift tax, estate tax and income tax implications. The next two Q&A's highlight one particular income tax area, for illustrative purposes.

What is a Sect. 1031 transaction?

This is a like-kind exchange and it derives from the section in the Internal Revenue Code treating it. Like-kind exchanges exist where one type of property is exchanged for another item of the same type of property. Such transactions do not generate taxable gain for income tax purposes, unless there is boot which means if some additional asset is exchanged such as cash, that is referred to as "boot" and the tax exclusion does not apply to the extent of boot.

Art is to be enjoyed and should never be the cause of sleepless nights, especially because of tax concerns. If you have any additional questions, please contact us or have your advisor contact us at:

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