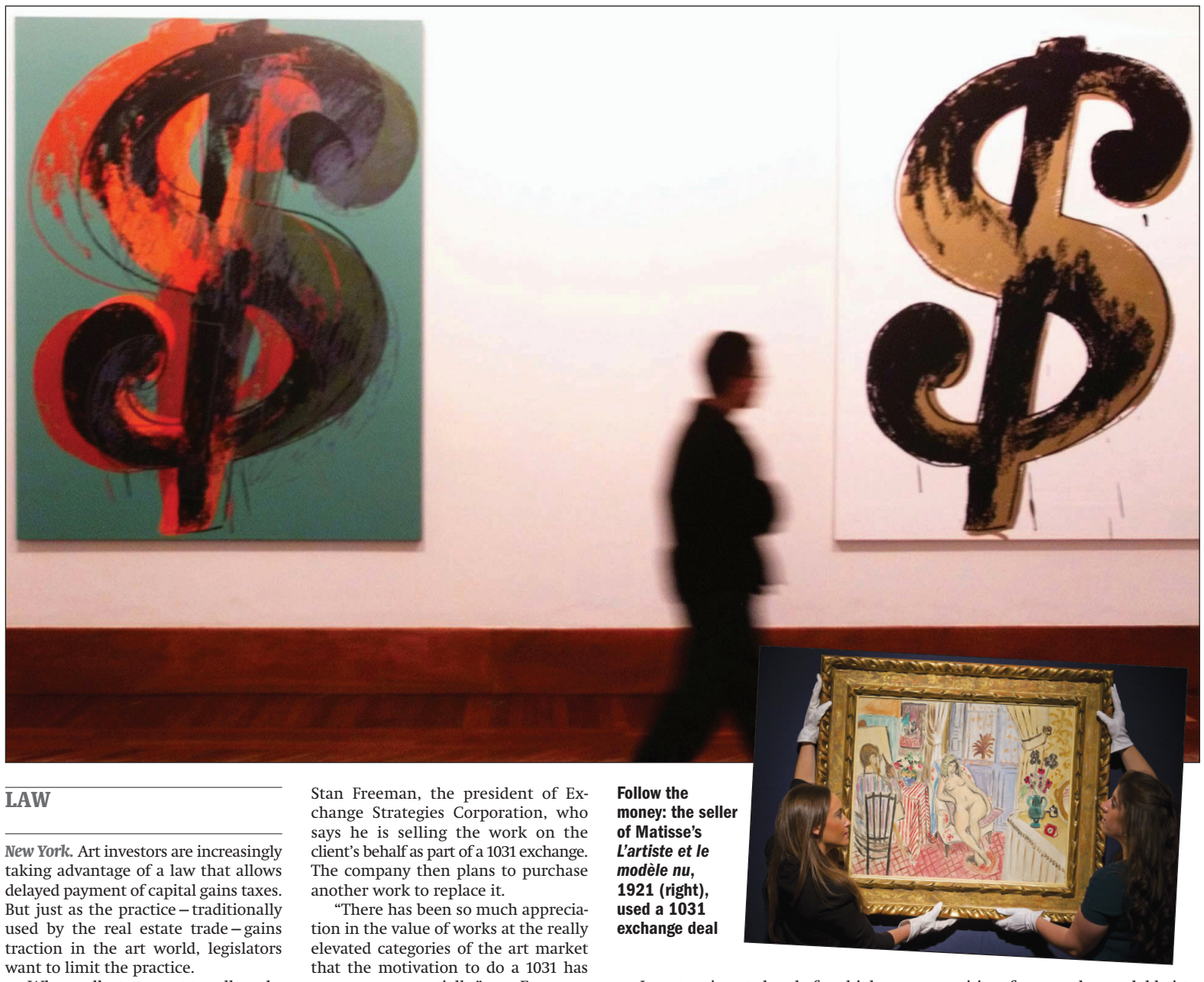
ART MARKET
US & Americas

Swap art to save on taxes

Collectors are making use of "like-kind" exchanges, but the US government wants to clamp down



Follow the money: the seller of Matisse's *L'artiste et le modèle nu*, 1921 (right), used a 1031 exchange deal

LAW

New York. Art investors are increasingly taking advantage of a law that allows delayed payment of capital gains taxes. But just as the practice – traditionally used by the real estate trade – gains traction in the art world, legislators want to limit the practice.

When collectors want to sell works of art that have appreciated in value, they can avoid paying taxes on the profits indefinitely if they continue reinvesting the proceeds in other works. This kind of transaction, known as a 1031 or "like-kind" exchange, must meet a complex set of criteria, but "if it's done right, it's a wonderful tax strategy", says Diana Wierbicki, an art lawyer with Withers Worldwide.

> *"If you've made a profit and want to buy more art, why wouldn't you do an exchange?"*

A recent example involves Henri Matisse's *L'artiste et le modèle nu*, 1921, which sold at Christie's, London, for £6.8m (est £7m-£10m), on 24 June. The seller originally bought the painting at Sotheby's, New York, in 1985 for just $1.2m, and so would ordinarily have faced a $2.9m capital gains bill on an outright sale. Instead, he hired Stan Freeman, the president of Exchange Strategies Corporation, who says he is selling the work on the client's behalf as part of a 1031 exchange. The company then plans to purchase another work to replace it.

"There has been so much appreciation in the value of works at the really elevated categories of the art market that the motivation to do a 1031 has gone up exponentially," says Freeman, whose company is just one of several 1031 specialists – known as "qualifying intermediaries" – that have begun marketing their services to the art world in recent years.

"If you've made a profit on something you've been sitting on for ten years and want to buy more art, why wouldn't you do an exchange?" says the New York-based art adviser Lisa Schiff.

How does it work?

To qualify for a 1031 exchange:

- The seller must name the "replacement" work within 45 days of selling the "relinquished" work, and purchase it within 180 days.
- The traded works must be in the same medium.
- The exception applies to investors who routinely flip works for profit, rather than collectors who may buy works solely to live with.

Investors in art already face higher costs than those in other categories. As well as shipping, storage and insurance fees, art is taxed at a 28% federal capital gains rate – nearly twice that of many other assets. In addition, the 2013 tax code added a 3.8% Medicare tax on the sale of art.

But the costs of hiring a third party to enact a 1031 exchange "isn't really worth it on anything less than gains of $500,000", says the art collector Stefan Simchowitz. The exception is not relevant to him, he says, because he deals "with younger art, which is not that expensive, even when it appreciates a lot".

Closing the loophole

Congress is currently trying to restrict the practice. In November, the Senate Finance Committee proposed eliminating the exception for all personal property, including art. And the House Committee on Ways and Means is calling for a repeal of 1031 exchanges altogether in its Tax Reform Act of 2014.

But the government faces strong opposition from exchange lobbyists. The Federation of Exchange Accommodators (FEA), a trade association for practitioners of 1031 exchanges, is currently hiring independent economists to write a study on the impact of its elimination on the economy.

"These troublesome proposals are based on myths that 1031 is an unfair loophole or a tax avoidance scheme for the rich," says the FEA coordinator Suzanne Baker. "But it doesn't matter if it's a farmer exchanging tractors or an art investor exchanging paintings – if you don't have the tax benefit, a lot of these transactions would be delayed or foregone, which equates to fewer jobs in those industries."

In the meantime, art investors might do well to proceed with caution. Since the practice is still relatively new to the art trade, the Internal Revenue Service has yet to publish clear guidelines governing these exchanges – "so there's always a risk that it could be contested", Schiff says. "It can be a fantastic mechanism, but it's still very grey."

Rachel Corbett

New York moves

Leila Heller expands in midtown

The Leila Heller Gallery has expanded with the opening of an 18,000 sq. ft space in midtown Manhattan. The six-floor gallery at West 57th Street and 6th Avenue includes a 60-seat auditorium as well as a project space where invited curators and artists will stage exhibitions. Thomas Arnold, formerly a director at Mary Boone Gallery, is running the new space, which will mainly focus on Modern and classic contemporary art. Meanwhile, the Leila Heller gallery on 25th Street in Chelsea will show work by emerging and mid-career artists. Both spaces were given over to a survey show of portraiture, "Look at Me: Portraiture from Manet to the Present" (until 14 August in Chelsea; until 29 August in midtown), organised by the collector Beth Rudin DeWoody and Paul Morris, a founding director of the Armory Show who is now acting as a "curatorial consultant" to the gallery, according to press materials. *C.B.*

Lisson to open under the High Line

Lisson Gallery is opening an 8,500 sq. ft space (below) under the High Line in Chelsea, New York. Lisson has signed a 15-year lease on a space between 23rd and 24th Streets. The new gallery, scheduled to open

in early 2015, will be Lisson's fourth—it has a space in Milan and two in London, where it was founded in 1967. For more information, visit www.theartnewspaper.com/fairs *C.B.*

Alexander Gray grows in Chelsea

Alexander Gray Associates is adding a 1,000 sq. ft ground-floor space, designed by David Kirschenbaum of Design AIDD Architecture, to its 4,000 sq. ft first-floor gallery on 26th Street. The space was formerly occupied by the Harris Lieberman gallery, which closed last year after nearly eight years of business. *E.R.*

Casey Kaplan heads to Flower District

The dealer Casey Kaplan (below) will leave Chelsea after ten years and move to the Flower District in early 2015. The Casey Kaplan gallery has taken a ten-year lease on a 10,000 sq. ft space at West 27th Street, between Sixth and Seventh Avenues. "It's an exciting neighbourhood that is in transition," Kaplan says. *C.B.*

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