

Spencer's Art Law Journal

Edited by Ronald D. Spencer

Editor's Note

This is Volume 1, Issue No. 2 of Spencer's Art Law Journal. This issue contains two essays, which will become available by posting on ARTNET, September through November 2010.

As noted in Issue No. 1 of this Journal, art market custom and practice remain much as they were in the 19th and early 20th century. The legal structure we call art law (an amalgam of personal property law, contract, estate, tax and intellectual property law) supporting the acquisition, retention and disposition of fine art, often fits uneasily with archaic custom and practice. The result is that 21st century art market participants are frequently unsure of their legal rights and obligations.

The goal of this Journal is to promote discussion of art law legal issues for lawyers and nonlawyers alike, so as to provide greater transparency, stability and predictability.

The two essays in this Fall issue continue to deal with two core issues for the ownership of visual art -- authenticity and title (who created it and who owns it?). The first essay addresses the U.S. income tax deductibility of a loss resulting from the purchase of fake or misattributed art. The second essay deals with due diligence by the art buyer to limit the risk of post-purchase third party claims.

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Three times a year future issues of this Journal will address legal issues of practical significance to collectors, dealers, scholars and the general art-minded public, such as appropriate due diligence on the part of the buyer when provenance is incomplete or unclear, and the relevance of catalogues raisonnés for due diligence.

--- RDS

FAKES, MISTAKES, AND INCOME TAX DEDUCTIONS¹

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Elizabeth Kessenides

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This essay is about a collector's mistake (or plain bad luck) wherein a collector ends up with a fake or misattributed work and a substantial financial loss. Can the collector claim a tax deduction for the loss? Maybe. - RDS

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In the 1940s a wealthy art collector reportedly bought a Picasso painting for 10,000 pounds—at the time, a very large sum.² But the collector had one small problem—the painting was not signed. She told her art dealer about the issue, and the next time Picasso was in town the dealer asked Picasso if he could sign the work. Picasso was happy to oblige. Once he saw the painting, however, Picasso informed the dealer that it was not his. “How good a client is the owner?”, Picasso reportedly then asked. One of the very best clients, the dealer replied. “In that case, the painting is by me” Picasso said, and signed the painting.³

Tales of swindles and forgeries in the art world make for fascinating ruminations about human nature, commerce and the intrinsic value of art. But for the buyer of a misattributed or forged work, the resulting economic losses can be staggering. Recently, an art dealer in California admitted to selling a client a forged Picasso pastel for \$2 million.⁴ The dealer ultimately agreed to make restitution to the buyer, but most of the time collectors are not as fortunate. Normally, by the time a collector learns that she purchased a fake or a misattributed work, the dealer has long-since disappeared or gone bankrupt, making recovery of the purchase price or any form of direct restitution impossible.

The topic of tax law can have a soporific effect on many art collectors. But it is a topic that becomes more interesting when a collector believes she's been swindled and paid for more than what she got. Typically, when this occurs, the collector assumes that a tax deduction can be claimed. What she generally fails to realize, however, is that unless one can prove fraudulent or criminal intent on the part of the person who sold her the work, a tax deduction will not be available. In other words, a loss in value does not always equal a tax deduction—particularly where that loss relates to a collectible.

The most basic point to note at the outset is that losses relating to personal property are generally not deductible. Individuals are entitled to claim a deduction for losses only in limited circumstances: (1) where the losses are incurred in connection with a trade or business, (2) where the losses are incurred in a transaction entered into for profit, or (3) in the case of casualty or theft losses.⁵ Collecting activities tend to have a strong element of personal use, and collectors normally buy art in order to display it in their home—not as a trade or business asset, nor as an asset that is acquired principally for the purpose of realizing profit (where a work of art has been displayed in one's home, the collector will rarely be able to establish that she acquired the work in connection with a trade or business or profit-motivated transaction).⁶ This will mean that the loss resulting from her collecting activity cannot be deducted unless a theft has taken place.⁷

The discussion that follows addresses two scenarios: one, where the collector buys a misattributed work (the “Mistake”) and another, where a collector buys a forged work (the “Forgery”). The discussion assumes that the art in question is personal use property. While collectors (as well as their advisors) might expect the tax law to draw a meaningful distinction between a case involving an actual forgery and one involving a “mistake” or simple

misattribution, in actuality the end result will turn on the intentions of other people with whom the collector has dealt—principally, the person who sold the work to the collector.⁸

“The Mistake”-- aka, the Misattributed Work.

A collector buys an unsigned drawing from an art dealer attributed (by the dealer) to the Italian Renaissance artist Botticelli, paying \$500,000. Years after buying the work, the collector learns that the work is not a Botticelli, and indeed that it does not even date to the same period but to a much later time. The work turns out not to be worth very much; by the time this fact is discovered, the dealer has passed away.

As noted in the introduction to this essay, losses attributable to personal property are not deductible. Cases involving “theft” are the one exception; individuals can claim a theft loss “without regard to whether the losses arise in connection with the taxpayer’s profit-seeking activities.”⁹ In order to claim a theft loss for tax purposes, however, an individual must prove three things: (1) that a theft actually occurred under the law of the jurisdiction in which the act took place; (2) the amount of the loss; and (3) the date the loss was discovered.¹⁰ Further, any allowable deduction will be deferred if there is a reasonable prospect of recovery, whether by virtue of a civil lawsuit or otherwise, until there is a final resolution establishing the extent of the loss.¹¹

Fundamentally, *it takes a thief* in order to claim a theft loss. “Theft” is not a technical term defined by federal law or tax law; it is a term defined by reference to local law of the state where the relevant event occurred.¹² In general, a theft requires a fraudulent intention to deprive another person of his or her property. For example, the New York Penal Code defines larceny as “intent to deprive another of property”, and includes a taking by “trick ... or false pretenses.”¹³ It is not enough to show that some sort of criminal act took place—the applicable authorities require the taxpayer to prove “criminal intent”, some degree of “guilty knowledge” on the part of the perpetrator.¹⁴

A case decided in the 1980s addressed a situation almost identical to that of the Mistake. *Krahmer v. United States*¹⁵ involved a collector who acquired a painting wrongly attributed to Nicholas Poussin. The painting did not have a signature on it. Years after buying the painting, Krahmer tried to sell it on several occasions, unsuccessfully. He then went to Sotheby’s hoping to have the work authenticated, but the head of Sotheby’s old masters department concluded that the painting was not a work of Nicholas Poussin’s. Krahmer tried, unsuccessfully, to donate the work to a museum. Finally, he ended up selling the work for less than ten percent of what he had paid for it and claimed a theft loss (and a tax refund), which were denied by the IRS on audit.

By the time Krahmer realized that his painting was not a Poussin, the dealer who had sold Krahmer the work had passed away. The dealer’s intentions and character were evaluated by the Court based on circumstantial evidence. Indeed, the trial Court went so far as to note that *only seven* of the 50 works the dealer had sold to this collector turned out to have been wrongly attributed—surprisingly, a fact that the Court viewed as speaking *in favor* of the dealer’s character. “It is not at all clear”, the Court stated, “that misattribution of seven paintings out of a total of 50 is not within the range of what may reasonably be expected of an individual dealer in old paintings, many of which are not signed and have been restored by others.”¹⁶ Krahmer was out of luck with respect to his loss on the purported Poussin.

The Collector in *The Mistake* would similarly find herself unable to claim a loss with respect to the misattributed work, and would not be able to recoup her loss to any extent by virtue of a tax deduction, if she cannot prove (through direct or circumstantial evidence) criminal or fraudulent intent on the part of the dealer. A mere mistake in the attribution of the work (even a negligent one) will not be a sufficient basis for claiming a loss for tax purposes.

“The Forgery”

A collector buys a painting from a dealer, who acquired the work from a major auction house a few years earlier. The dealer paid \$250,000 for the work, which had been attributed in the auction catalogue to the artist “Mr. Art Star”, recently deceased. The work has a signature on it. The collector pays the dealer \$500,000.

A number of years later, the collector attempts to re-sell the painting through a prominent auction house and is informed that the work is a fake. She consults other art experts, as well as the authentication committee for Mr. Art Star's work. Everyone agrees the painting was not created by Mr. Art Star, that it is a forgery. She sells the work for only \$1,000, and hopes to claim a theft loss of \$499,000 on her tax return for the year in which the forgery is discovered.

The *Forgery* raises interesting practical and philosophical issues from a tax law standpoint. The first being, must a person be a direct victim of fraud, or of a theft, in order to claim that their loss "arises" from theft? Or, is it enough to prove that one's loss resulted from some fraudulent act that occurred somewhere along the ownership chain? In other words, if a forgery was sold by Mr. Dealer to a buyer ("B"), who later sells the work to a collector ("C"), without any knowledge of the fact that it was a fake, can C claim a theft loss despite B's innocence of the fraud? What if the forgery happened so long ago that C cannot prove who the original forger was, or what his intentions might have been? Must one identify the perpetrator of the crime, in order to claim a theft loss deduction?

Assume that the dealer who sold the collector the work in *The Forgery* was unaware that the work was a fake-- a safe assumption, since he himself paid \$250,000 for the work at auction. This means there would not be any evidence of bad faith or intent to defraud on the dealer's part; yet, the work contains a forged signature. Does this fact speak for itself and establish that the collector's loss arises from a "theft"? The one case that has considered the tax implications of this question has ruled unfavorably on it, from the collector's point of view.

In *Krahmer*,¹⁷ the case discussed above, Wolf Krahmer had also acquired (from the very same dealer) another work in addition to the so-called Poussin. This second work was attributed, in part based on a forged signature, to the artist William Merritt Chase. Krahmer had been told by the dealer that the work was by Chase and that the woman in the painting was Mrs. Chase (the invoice for the sale referred to the work as "Portrait of Mrs. Chase in Spanish Dress").¹⁸ Years after the purchase, Krahmer had the painting evaluated by an expert on the works of Chase, who determined that the painting was a fake. Having originally paid \$5,000 for the work, Krahmer was able to sell it for only \$300. Krahmer claimed a theft loss deduction for the loss on the "Chase" painting. His claim was upheld at trial, on grounds that the forged painting could be analogized to the receipt of counterfeit money, which the court stated would constitute a theft by false pretenses.¹⁹ On appeal, however, the Circuit Court disagreed and reversed--the presence of a forged signature alone, according to the Federal Circuit Court, did not mean that the dealer "stole" from Krahmer, because the dealer could have made an innocent mistake himself. The Circuit Court described its analysis as follows:

"In its analysis of the proper treatment for the loss suffered by taxpayer on the Chase painting, the Claims Court did not consider any evidence that Mitscherlich [the dealer] defrauded taxpayer. Instead, it relied solely on the existence of the forged signature on the painting, concluding that anyone who suffered a loss on purchase in the belief that the painting was by William Merritt Chase was the victim of a theft by false pretenses. The court analogized the sale of the painting with the forged signature to the passing of counterfeit money...The court held that, by showing the forgery to be the cause of the loss, taxpayer had satisfied his burden....[But, t]he court cannot presume a theft occurred based solely on the presence of a forged signature on the painting. The taxpayer must prove that the seller defrauded him by knowingly and intentionally misattributing the painting to the artist."²⁰

Section 165 of the Code does not refer to the taxpayer being a victim of a theft, but to a loss which "arises" as a result of a theft. Shortly before the *Krahmer* case was decided, another case involving a sale of land rights permitted subsequent buyers of the land rights, who were not *direct* victims of theft, to claim a theft loss (in this case, *Boothe v. Commissioner*, there was clear evidence of fraud by a prior owner in the ownership chain, who was shown to have sold the same land rights to two different buyers).²¹ The lower court in *Krahmer* cited to *Boothe* in its opinion, analogizing the sale of a forged painting to the passing of counterfeit funds. The Circuit Court, on the other hand, did not refer to *Boothe* in ruling that the presence of a forged signature, without further proof of fraud or deceit on the part of the dealer, did not support the claim of theft or a theft loss deduction.

Admittedly, it is difficult to imagine a scenario where a forged signature is placed on a ‘copied’ work of art (particularly one that later found its way to the secondary art market) without deception or fraudulent intent being involved. But, a meaningful distinction exists between *Krahmer* and *Boothe*; in *Boothe*, the perpetrator of the “theft” was identifiable (and *identified*). It is consistent with the logic of allowing a deduction for “theft loss” to require the taxpayer, at a minimum, to point to the perpetrator of the theft. This is particularly appropriate given the unique character of theft losses. Theft losses can offset ordinary income and are not limited in the same way as capital losses (which can only offset capital gains and are not eligible to be carried back to prior years). One cannot, therefore, fault the logic of the Circuit Court’s conclusion in *Krahmer*. The collector in *The Forgery* is out of luck. If she cannot identify a perpetrator *and* prove criminal intent, she will be unable to claim a theft loss.²²

Conclusion

With the dramatic rise in art prices through 2007, and more people (including art dealers) using art as collateral for loans, it is not surprising that allegations of embezzlement and fraud have been on the rise. Difficult questions of proof are inevitable in any case involving a misattributed or forged work of art, and these matters are even more challenging when dealing with works that may date back fifty years or more, in some cases hundreds of years. The *Krahmer* decision reflects the high burden of proof that is placed on the collector. It also establishes that one cannot presume “theft” simply because they unwittingly purchase a fake. Significant time and effort, therefore, must be devoted to evaluating the precise facts, circumstantial evidence, and the dealer’s (and perhaps, any prior seller’s) state of mind. The court in *Krahmer* took a certain view of whether a sale of seven or eight misattributed works, out of a total of 50, established a level of deception that might reflect intent to defraud. That case, however, dealt with works of old masters; another court may not give a dealer the same benefit of the doubt in a situation involving more recent, or contemporary, works of art.

It is interesting to consider that the tax law—while seemingly unsympathetic to the defrauded collector—holds true to the realities of the art market and the vagaries of “authenticity.” A recent exhibition (2010) in the National Gallery, London, entitled “Close Examination: Fakes, Mistakes and Discoveries”, exhibits works whose provenance has been questioned, some outright fakes, and others whose claim to legitimacy has changed over the years. In one case, a painting that was purchased by the National Gallery as a work of Botticelli’s was later determined to almost certainly be a fake; for years, it was kept in storage. Today, the painting is believed to be an authentic work of a Renaissance painter, perhaps even a Botticelli. What becomes apparent when considering the premise of this exhibition, and other similar accounts involving disputes over authenticity²³ is how very subjective the question of “value” can be; and, importantly, how changeable decisions about authenticity often are. Matters of proper attribution are challenging even for the best museums and art experts, sometimes resulting in drawn out lawsuits.

In drawing a line, therefore, between when a taxpayer can claim a tax deduction and when one cannot, the answer cannot ultimately rest only upon whether a work is signed, forged, or copied. The tax law demands a more objective process. As Michael Kimmelman, in his review of the National Gallery exhibit, reflected on “The Allegory” (the work that has gone from being considered a certain fake to almost certainly being considered a legitimate Renaissance work), at the end of the day “*It’s a picture. And the picture is the same whether it is said to be old or new, genuine or fake, an original or a copy.*”²⁴ The tax law is not the proper place to draw judgments based on authenticity and claims of reduced value. It must strive for a more objective determination, and so it does. The question is not, therefore, one of “dubious connoisseurship”,²⁵ to adopt Kimmelman’s phrase, but beyond that, and more simply, “was there a thief” or con man?²⁶

To ensure compliance with requirements imposed by United States Treasury Circular 230, we inform you that any U.S. federal tax advice or commentary contained in this essay is not intended to be used, and cannot be used, to avoid penalties under the Internal Revenue Code or to promote, market or recommend to another party any transaction or matter addressed herein.

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¹ The title to this essay was inspired by the title of a recent exhibition at the National Gallery in London, “*Close Examination: Fakes, Mistakes and Discoveries.*”

² This anecdote, reported in an article that appeared in *The Guardian* in 2005, was shared by an art dealer named Ronnie Anderson. See, *Alex Wade, Master’s Criminals*, *The Guardian*, May 24, 2005. The article addressed the widespread problem of forgery in the world of art.

³ Id. In describing this account, the article went on to state that the painting in question ultimately was authenticated as a genuine Picasso.

⁴ See My-Thuan Tran, *L.A. Art Dealer accused of selling a phony Picasso*, *Los Angeles Times*, January 9, 2010.

⁵ See Section 165 of the Internal Revenue Code of 1986, as amended (the “Code”). All Section references herein are, unless otherwise indicated, to the Code.

⁶ This discussion assumes a collector who engages in the ‘activity’ of collecting works, buying from time to time, and perhaps occasionally selling work.

A discussion of the relevant factors that apply under applicable tax law and Treasury Regulations to determine whether an activity is engaged in “for profit”, or is part of a trade or business, is beyond the scope of this essay. In very general terms the authorities look to whether the activity is conducted in a business-like manner, record-keeping methods, time devoted to the activity, assets devoted to the activity, whether there is any degree of personal use, and whether the activity has generated profit in any past years. This essay assumes an art collector is purely buying works of art for pleasure, displaying the works in her home.

⁷ If a collector’s art collecting amounts to an “activity”, gains and losses from the same activity may be eligible to offset each other. See Section 183. However, any net loss would not be deductible except if it is proven to be a “theft loss”.

⁸ In reading the following essay, it should be kept in mind that a proper analysis of tax consequences always must be based upon an examination of the specific facts of a particular case and an application of the law to those facts. The precise course of dealing between the parties will largely determine the ultimate tax outcome; a close examination of that course of dealing, as well as other relevant facts, will be crucial to reaching a proper understanding of tax obligations in any case.

⁹ *Boothe v. Commissioner*, 82 TC 804 (1984), at 813 Hamblen, J. dissenting.

¹⁰ See Treasury Regulation Section 1.165-8; See also *Vincetini v. Commissioner*, 98 T.C.M. (CCH) 427 (2009). Section 165(a) of the Code authorizes a deduction for a loss sustained during the year and not compensated for by insurance or otherwise. Section 165(e) provides that a deduction for “any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers the loss or theft.”

¹¹ Treas. Reg. Section 165-1(d)(2). If a taxpayer initiates a lawsuit against a party, this alone might establish that some reasonable prospect of recovery exists, requiring the taxpayer to wait to take an otherwise allowable deduction. See *Estate of Scofield Est. V. Commissioner*, 266 F. 2d 154 (6th Cir., 1959). Thus, one must consider whether there are settlement offers or other facts indicating some real prospect of recovery. Furthermore, a theft loss can be claimed only to the extent the loss exceeds 10% of an individual’s adjusted gross income. Section 165(h)(2)(A)(ii).

¹² See *Monteleone v. Comm’r*, 34 T.C. 688, 692 (1960); *Edwards v. Bromberg*, 232 F. 2d 107 (5th Cir., 1956).

¹³ State laws generally define a theft by reference to whether a person knowingly obtains, by deception, control over the owner's property. The Penal Code in New York State defines larceny as follows: "A person steals property and commits larceny when with intent to deprive another of property or to appropriate the same to himself or a third person, he wrongfully takes, obtains, or withholds such property from an owner thereof... Larceny includes a wrongful taking by trick or... by false pretenses." New York Penal Code Section 155.05 [McKinney, 2010].

¹⁴ See. Rev. Rul. 72-112, 1972-1 C.B. 60; *Bellis v. Commissioner*, 61 T.C. 354 (1973), aff'd 540 F. 2d. 448 (9th Cir., 1974). "Without evidence of guilty knowledge, there is no theft." *Bellis*, 61 T.C. 354 at 357.

¹⁵ 9 Ct. Cl. 49 (Claims Court, 1985), aff'd in part and rev'd in part 810 F. 2d 1145 (Fed. Cir., 1987).

¹⁶ 9 Ct. Cl. 49 (1985), at 55.

¹⁷ *Supra*, note 15.

¹⁸ See *supra*, note 16 at 49.

¹⁹ In the case of the passing of counterfeit bills, it should be easier to establish that a crime occurred since the creation of the counterfeit bills is a federal crime. It is not certain whether the receipt of such counterfeit bills, if passed to a person innocently and without any criminal or fraudulent intent, would itself authorize a recipient of the bills to claim a theft loss deduction, given the focus on guilty knowledge in the applicable authorities addressing the definition of "theft" for purposes of Section 165.

²⁰ *Krahmer*, 810 F. 2d at 1146.

²¹ *Boothe v. Commissioner*, 768 F. 2d 1140 (9th Cir., 1985), rev'g 82 T.C. 804. The Tax Court's decision, which the Court of Appeals overturned, reflected a major split between the judges.

²² Even where a taxpayer is able meet the requisite burden of proof for "theft" (under the law of the relevant jurisdiction) a tax deduction for a theft loss is allowed only for a loss that is sustained as evidenced by a "closed and completed transaction" and fixed by identifiable events. Treas. Reg. Section 1.165-(1)(d)(1). Thus, the mere discovery of a forged signature alone would not be enough, and the taxpayer might need to dispose of the work in order to "fix" the amount of the loss—in *Krahmer*, the taxpayer had sold both works, thus fixing the amount of his loss. The overall facts of each case will need to be examined to determine whether a taxpayer can establish the requisite 'closed and completed' transaction and fixed measurement of the loss.

²³ See David Grann, "The Mark of a Masterpiece", *The New Yorker*, July 12 & 19, 2010, p.50.

²⁴ Michael Kimmelman, "Old Masters and Modern Science", *The New York Times*, July 12, 2010, p. C1.

²⁵ *Id.*

²⁶ I would like to thank Alan Johnson, Mitchell Kane, Kathleen Ferrell and Ronald Spencer for their thoughtful comments and suggestions in reviewing this essay. Their collegiality is deeply appreciated.

ART BUYER'S DUE DILIGENCE. DO YOU OWN IT FREE AND CLEAR?

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Gary D. Sesser and Kenneth S. Levine

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This essay concerns actions and promises by prior art owners which result in claims against the new owner. — RDS

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Buyers of art commonly worry that the work being purchased is not authentic, and scrutinize carefully the evidence about its history and authenticity. But since buyers of art often do not know the identity of the true seller — sellers of art typically consign their works to art dealers, and buyers interact only with those dealers — other problems also can arise. Behind every transaction is a risk that the undisclosed seller is withholding information, or did something before the sale that could raise problems later on. For instance, if the work had been stolen at some point, or wrongly appropriated during war time, even an innocent purchaser cannot obtain good title.¹ The seller also could have used the art as collateral for a loan and failed to disclose it to the dealer. Or, in more prosperous times, the seller may have promised to transfer the art to a museum, university, or other worthy institution, but neglected to tell the cultural institution or the art dealer about the change of plans. The charitable institution will not be happy to learn that the art work once destined to support its worthy cause has now been sold, and may take action against the seller and purchaser. A pledge for a loan or promised gift by the former owner of a piece of art is like a latent defect that can rise up long after the ink on the purchase agreement has dried.

Buyers typically pay little attention to these concerns, relying, not unreasonably, on their dealers to rule out these potential defects. Art dealers, in turn, typically pass title to the work to the buyer, and represent and warrant to the buyer that the art is free and clear of all liens. If problems should arise with the transaction, the buyer would look to the art dealer for a refund or other compensation, not to the ultimate seller.

But buyers of art should also understand that merely purchasing art through a dealer will not necessarily protect them from a lawsuit, even if the buyer and dealer are unaware of some defect or the seller's pre-sale actions or promises.² Therefore, before purchasing a significant work of art, buyers should at least consider what would happen in case of any problems with the transaction. Since the buyer relies almost entirely on the dealer, how confident is the buyer that the dealer has checked for potential claims, and will still be solvent and in business in a few years in case problems arise?

This essay offers suggestions for ways buyers may protect themselves in art transactions.³ Buyers should consider adopting some or all of these procedures, or consult with their dealers on these procedures, depending upon their level of comfort with the dealer and the transaction itself.

Avoiding Pitfalls

First, before making a major purchase, buyers should make sure that either they or their art dealer search the Art Loss Register⁴ to make sure that the work has not been reported stolen, and the Uniform Commercial Code ("UCC") databases in states where the current owner resides or does business, to make sure that no liens were placed on the current owner and the work of art.⁵ Many dealers do not conduct these searches and, instead, rely on the seller for the promise of good title and that the art has not been pledged for a loan by the seller or the seller's predecessor in ownership. But, even against an innocent purchaser, if the work has been stolen the sale

does not convey good title, or if a party has a perfected security interest against the owner rather than the dealer, then title can be transferred but the sale may still be subject to the secured creditor's claim. Conducting these quick and inexpensive searches is the best way to screen for the most likely claims from prior owners or secured lenders.

Second, since the searches would not likely reveal potential claims from museums that have received only a promise of the art, buyers should make sure that the language in their purchase agreement explicitly rules out the possibility that the art has been transferred or promised to an institution. In the purchase agreement, the dealer should represent and warrant the following:

- the dealer has authority to sell the art;
- the art is *currently free* from any claim, lien, security interest, pledge or encumbrance;
- if the transaction will be completed at a later time, then, during the entire term of the agreement, the art will *remain free* from any claim, lien, security interest, pledge or encumbrance;
- no interest in the art has been promised or transferred to a museum or other third party;
- the dealer agrees to indemnify the buyer from any claims and expenses, including legal fees, that the buyer incurs in case of a breach of any of the preceding warranties;
- if the transaction is rescinded for any reason and the artwork is returned, the buyer shall receive the higher of the original purchase price or the current fair market value of the work.

Third, before completing the transaction, a buyer should have the art dealer conduct a "Google" internet search on the current art owner and specific piece of art, to see if any news items appear regarding a promise to an institution that may include the specific artwork. If there is any suggestion that the art has already been promised, a buyer should insist on additional information and, if necessary, a release from the promisee before purchasing.

Fourth, if the art dealer does not physically possess the art at the time of sale, the party who possesses the art must be notified prior to the completion of the sale. The buyer should also obtain written assurances from the party with possession that it does not object to the transfer. This is important as both a practical and legal matter, since the party holding the art is much more likely to sue if it feels it has legal interests in the art and the art needs to come off its walls.

Litigating Claims

Even when some or all of these steps have been followed, institutions or secured parties may still assert claims against the new owner when they discover that the art promised or pledged to them is now in new hands. The strength of the specific claims inevitably involves a close examination of the facts, including when and how the art was promised, pledged, encumbered, or sold, and what the buyer knew or should have known, as well as an evaluation of what jurisdiction's law will apply. However, the disputes generally boil down to one or both of the two following key principles of law.

First, an owner's *promise* to donate art in the future is not the same as an actual, present transfer of ownership. The key question is whether or not title to the art has actually passed from one holder to the next. The answer is sometimes difficult to discern, but evidence of a transfer of title may include a change in possession of the art, treatment of the transaction in tax returns, the language of other contemporaneous paperwork such as a deed of gift, and a change in the terms of insurance.⁶ If the prior owner only promised to give the art to a museum in the future, but did not actually effect a present transfer of ownership, then the innocent purchaser will retain title to the work as against the museum. The museum may have a claim for breach of contract against its putative donor, but not against the innocent purchaser.

Second, the "good faith" innocent purchaser of art must be truly acting in "good faith." A buyer cannot look the other way past suspicious details or open questions. If a buyer actually knows about an agreement between the

seller and an institution, then the buyer can, potentially, be sued for interfering with that agreement (although the buyer would still retain title to the purchased art). The key question is whether the buyer was actually aware or should have been aware of the agreement.⁷

In sum, every work of art may have lurking beneath its captivating exterior, a claim that it has already been given or promised to another. Because there is no official registry to record title to art, buyers should be mindful that the art being purchased may be expected elsewhere, and they should think through how best to protect themselves in case someone else comes calling for the piece.

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NOTES

¹ See *Solomon R. Guggenheim Foundation v. Lubell*, 77 N.Y.2d 311, 317 (1991) (“New York case law has long protected the right of the owner whose property has been stolen to recover that property, even if it is in the possession of a good-faith purchaser for value.”).

² The Uniform Commercial Code (“UCC”) recognizes that buyers in the ordinary course who purchase through a dealer in a typical arm’s length transaction would be expected to take the purchased item free and clear of any liens. See New York UCC §9-320(a); New York UCC §2-403(2); James J. White & Robert S. Summers, *Uniform Commercial Code* 4, §33-8 (6th ed. 2010), p. 359 (noting that a consumer buying a refrigerator in the ordinary course would be expected to purchase it free and clear, and not expected to conduct a search before the purchase to see if the refrigerator was encumbered). However, precisely because artwork is not a household appliance, and its distribution pattern is therefore often more complex and circuitous than industrial goods, this general rule may not apply to a given fact pattern. See New York UCC §9-201(a). Many facts would sway the outcome of the specific case, including the nature of the security interest and the dealer’s relationship with the secured party.

³ The same general concerns, and suggested protections, apply in cases where art is being used as collateral for loans. In those cases, the lenders will want to make sure that the art has not already been transferred or promised to an institution or pledged as collateral for a loan.

⁴ <http://www.artloss.com/>. While the Art Loss Register is the most prominent database for stolen art, there is no designated central authority for such a list. Several other public and private institutions have databases of stolen art that can be checked, such as the Federal Bureau of Investigation’s Art Theft program, <http://www.fbi.gov/hq/cid/arttheft/arttheft.htm>, and Interpol’s art theft database, <http://www.interpol.int/Public/WorkOfArt/Default.asp>. Buyers should also make sure that the art was not seized from Jewish owners by Nazis during the Second World War or otherwise looted. Again, there is no central database for such a search, but the following are two prominent databases that buyers should check: <http://www.lostart.de/Webs/EN/Start/Index.html>, and <http://www.lootedart.com/>. Many countries also maintain their own databases for the identification and return of looted or stolen Jewish property, links to which are provided here: <http://icom.museum/spoliation.html>.

⁵ See <http://www.coordinatedlegal.com/SecretaryOfState.html> (providing links to UCC search databases in each state). Private service companies such as Article 9 Agents, www.A9A.com, will also conduct the searches for a nominal fee.

⁶ Under New York law, an owner can transfer title to a work of art, but keep possession of it for his or her lifetime. In *Gruen v. Gruen*, 68 N.Y.2d 48 (1986), a father wrote letters to his son stating that he gave to his son, as a birthday present, a

painting by Gustav Klimt, but was keeping the painting in his home for the remainder of his life. The court found that the present gift, with a reservation of a life estate, was valid, reasoning that the letters had sufficient formality to convey the transfer. *See id.* at 55 (“As long as the evidence establishes an intent to make a present and irrevocable transfer of title or the right of ownership, there is a present transfer of some interest and the gift is effective immediately”). Ideally, the son should have filed a UCC financing statement so that his father could not attempt to sell or pledge the Klimt to anyone else, and to buttress his own claims of ownership.

⁷ In one case we litigated, an individual (“debtor”) promised a valuable art collection to a museum, but then arranged for the same art collection to serve as collateral for a debt owed to a third party without disclosing this fact to the museum. The debtor defaulted on his debt, and the third party creditor sought to seize the collateral. The museum sued the creditor, claiming that the creditor was interfering with its gift agreement with the debtor, and that the creditor was aware or should have been aware of the gift agreement because an article published in *The New York Times* referenced the debtor’s donation. Ultimately, the case settled before a court could rule on the legal question of whether the newspaper article provided sufficient notice of the gift to the creditor.

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