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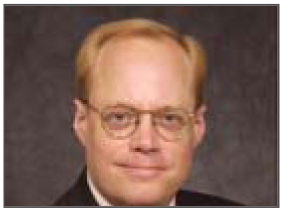

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THE TAX LAWYER

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Found Nazi Art Valued At $1B Is Worth How Much After Tax?

Tax authorities in Munich were searching the home of Cornelius Gurlitt, a suspected tax cheat. They surely hoped to find something implicating him in chiseling the tax system. Since Gurlitt is the reclusive son of a Munich art dealer, perhaps the tax authorities thought they might find some art in addition to evidence of tax evasion.

Chagall's Parents (Photo credit: Wikipedia)

However, they surely didn't expect to stumble across an astounding 1,500 paintings by masters like Matisse, Picasso and Chagall. The treasure trove of priceless art vanished during the Nazi regime and is valued at $1 billion. The bizarre story first appeared in the German language magazine Focus, though the BBC has a summary in English.

The BBC noted that the U.S. Holocaust Memorial Museum estimates that the Nazis seized approximately 16,000 artworks during the 1930s and 1940s. Of the 1,500 works recovered in the Munich tax search, 200 of them are reportedly the subject of international warrants.

German Customs calls it a true treasure trove, a term that has a particular meaning to the IRS. And while the Germans have the collection in a warehouse sorting it out, it's worth asking if the IRS can get a piece. Sound far-fetched? Not really.

The IRS likes "treasure trove," a term that actually appears in the tax law. It is just one example of the astounding breadth of the U.S. concept of what's income for tax purposes. The most famous case on treasure trove is *Cesarini v. United States, 296 F. Supp. 3 – 1969*. Mr. Cesarini bought a used piano for $15 and found nearly $5,000 in cash inside.

Imagine his surprise and delight over such good luck! But then the IRS said it was taxable income. Mr. Cesarini went to court over it, but the court agreed with the IRS. Mr. Cesarini appealed, but the 6th Circuit Court of Appeals agreed too. See *Cesarini v. United States, 428 F. 2d 812 – 1970*.

But does this mean the recovered art will be taxed? It depends. If you get something back that was yours, it generally shouldn't be income. However, there's an important exception if you claimed a loss deduction.

Under the tax benefit rule, since you claimed a tax benefit, you must take the item back into income when you recover it. But aren't there special rules about art? Yes and no. Most tax cases about art deal with valuation, either for purposes of charitable contributions or estate tax.

For charitable contributions, you want a high appraisal to support a big deduction. In estate tax matters, you want a low appraisal so you don't pay too much estate tax. The IRS knows this. For that reason—and given the subjective and specialized nature of expensive art—the IRS has a special Art Advisory Panel.

But that doesn't mean all art matters are gentlemanly. A good example is discussed in this Forbes report about the fight over the value of a Robert Rauschenberg collage. It was owned by Ileana Sonnabend, who died in 2007.

The Sonnabend estate tax return said her total worth on death was $876 million. Notably, it valued Rauschenberg's "Canyon" at zero? Yes, zero. The collage could not legally be sold since it included an endangered species, a stuffed Bald Eagle. Not so fast, said the IRS. The IRS valued it at $65 million and demanded $29 million in tax and an $11.7 million penalty. See The IRS Art Advisory Panel Has Its Head In The Clouds.

With the passage of nearly 70 years since World War II, it will be some time before the Germans sort out claims on the treasure trove of art. Before one can think about taxes, one must consider who owns what and the source of the claims. Still, tax collectors have the memory of an elephant.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.