

## Loss of Privacy Rights When Purchasing Art

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In late 2018, the European Union adopted the Fifth Anti-Money Laundering Directive. This Directive updates previous guidance with a focus on regulating the art market and terrorism financing. By January 10, 2020, all EU nations (including the United Kingdom) were required to enact regulations to implement the Fifth Directive. But what do art and terrorism have to do with one another? Just as the Nazis did in World War II, today's terrorist groups are stealing historical and cultural artifacts and selling them to fund their terrorist activities. In fact, art and antiquity sales are the second highest source of income for ISIS.<sup>1</sup>

In an effort to prevent sources of terrorist funding, all EU member states were required to enact regulations which increase the transparency of art purchase and sale transactions. The goal is to stop terrorism and locate looted artwork, but a necessary consequence of the Fifth Directive is that art dealers, collectors, and investors with no terrorist connections are more heavily regulated and scrutinized than ever before.

There are two main mechanisms that the Fifth Directive leans on to increase transparency in art transactions: (1) know your customer ("KYC") disclosures, and (2) increased due diligence requirements. Both these mechanisms are common and noncontroversial in the purchase and sale of a home or business (banks always require KYC disclosures); but the art market is different. Secrecy is a long tradition in the art market, and what makes the industry so intriguing to wealthy collectors and investors. Although auctions at Christie's and Sotheby's are publicized, most art exchanges still take place in storage facilities called freeports. A freeport is a tax-free holding zone that offers numerous tax and confidentiality benefits that are especially attractive to high value art sales, and innumerable pieces of art and antiquities are stored and sold in these freeports each year. These freeports are located throughout the world, with the "premiere" freeport located in Geneva, Switzerland. It is estimated that over 1.2 million works of art are stored in the Geneva Freeport, effectively never becoming subject to the tax laws of any state or country.<sup>2</sup>

The KYC disclosures require "obliged entities" to reveal the identities of buyers and sellers in an art transaction occurring in the EU or the UK. An "obliged entity" is any individual or business trading or acting as an intermediary in the sale of artwork (including galleries and auction houses), and anyone storing, trading, or acting as an intermediary in the sale of artwork in freeports.<sup>3</sup> If the value of the artwork or series of artworks being sold is €10,000 or more, the obliged entities must disclose personal information and conduct research confirming that the buyer and seller are who they actually say they are.<sup>4</sup> This means that all those private collectors hiding their assets tax-free in freeports will have to disclose their identities when they engage in art transactions. Suspicious

provenance or chain of ownership for an artwork, offshore companies or trusts, or a seller changing their story about how they came to own the work, are all red flags that have to be investigated before the art transaction can close.

Obligated entities must now: (1) identify all sellers and buyers and verify their identity, (2) identify all beneficial owners, and take reasonable measures so that they know who they are transacting with, (3) obtain information on the purpose and intended nature of the transaction, and (4) conduct systematic, ongoing monitoring of beneficial owners or existing customers and regularly update proof of registration of customers who are corporate or other legal entities.<sup>5</sup> And if a customer is from a high-risk country (e.g., Syria, Yemen, Afghanistan, Iraq, and other nations under attack), the obliged entity must inquire about the source of the funds and the wealth of the customer. For those collectors and investors purchasing art in the EU and the UK, the Fifth Directive is a major deterrent for art transactions.<sup>6</sup>

The nations of the EU are not the only nations supporting these types of regulations of the art market. On May 18, 2018, the United States House of Representatives introduced the Illicit Art and Antiquities Trafficking Prevention Act (H.R. 5886), which sought to incorporate art transactions into the existing regulations under the Bank Secrecy Act. H.R. 5886 had similar requirements as the Fifth Directive. H.R. 5886 died in the Senate, but the House passed a second bill in March 2019 known as the Counter Act (H.R. 2514) in hopes of enacting these regulations again. To date, the Senate has not passed H.R. 2514.<sup>7</sup>

Most criticisms of the European Fifth Directive and the American Counter Act focus on burdens placed on small to mid-market dealers who do not have the resources to conduct the thorough due diligence these regulations demand.<sup>8</sup> There is fear that smaller purchases will be less appealing because of the obligations of the parties involved in the transaction are not worth the investment. Furthermore, how will high-profile art fair transactions be handled? People travel from all over the world to purchase artwork at Art Basel, for example, an international art fair that only lasts for a few days. Given this type of time constraint, it is likely impossible for the obliged entities at art fairs such as this to comply with the Fifth Directive. There are also concerns that the illegitimate art transactions will simply take place outside of the EU and the UK to maintain secrecy, and the regulations will have no negative impact on terrorism funding but to force them deeper underground. It's too soon to determine what effect the Fifth Directive regulations will have on the art market, but the fears continue to mount.

In summary, if you are an obliged entity and purchasing or selling artwork in the EU or UK, you will need to comply with the applicable nation's version of the Fifth Directive. If you are a collector or investor and purchasing art working in the EU or UK, you will need to disclose much more information than before, and more than you are likely comfortable with. Additionally, failure to comply could result in heavy fines and up to two years in prison.

But even with these potentially difficult inconveniences, it is important to remember why they exist. The required disclosures may be intrusive, but the overall goal is to shut down a major source of income for terrorism and rogue

countries, and bring the art industry out into the open.

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5. *Id.*

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