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Artful Imbalance

HOW THE US TAX CODE AND STATE TRUST LAWS ENABLE THE GROWTH OF INEQUALITY THROUGH HIGH-VALUE ART COLLECTIONS

*“[A]ll . . . should take a serious interest in money, its measurement, the facts surrounding it, and its history. Those who have a lot of it never fail to defend their interests.”*¹

INTRODUCTION

In the fall of 2021, the International Consortium of Investigative Journalists (ICIJ) released over eleven million documents under the name of the “Pandora Papers.”² Their reporting revealed how the United States shelters an enormous amount of wealth, primarily of non-US citizens.³ The revelations from the 2021 Pandora Papers firmly established the depth of this phenomenon and revealed how the world’s wealthiest individuals store their assets in the United States while paying little to no taxes. The popularity of the United States as a tax haven has ballooned to such an extent that the country “has become the premiere global destination for hidden wealth and kleptocratic capital.”⁴ For instance, one single trust company in South Dakota, the South Dakota Trust Co., has clients from fifty-four different countries.⁵ The breadth of this company’s international clientele demonstrates the desirability of South Dakota as a place to store wealth, based on its various tax structures and trust and estate laws that directly cater to

¹ THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* 753 (2013).

² David Pegg & Dominic Rushe, *Pandora Papers Reveal South Dakota’s Role as \$367bn Tax Haven*, *GUARDIAN* (Oct. 6, 2021 2:35 AM), <https://www.theguardian.com/news/2021/oct/04/pandora-papers-reveal-south-dakotas-role-as-367bn-tax-haven> [<https://perma.cc/3K8T-7T4J>].

³ *Id.*

⁴ Chuck Collins, *How Tax Haven States Enable Billionaires to Hide Trillions*, *NATION* (Apr. 1, 2021), <https://www.thenation.com/article/economy/tax-haven-delaware-south-dakota/> [<https://perma.cc/5RS3-ZLY9>].

⁵ See Debbie Cenziper et al., *Foreign Money Secretly Floods U.S. Tax Havens. Some of It Is Tainted.*, *WASH. POST* (Oct. 4, 2021), <https://www.washingtonpost.com/business/interactive/2021/booming-us-tax-haven-industry/> [<https://perma.cc/2Q43-W2GE>].

individuals seeking to pay the lowest possible tax rate with the least amount of scrutiny.⁶

The Pandora Papers also provided a glimpse into how the art market incentivizes tax evasion, tax avoidance, and money laundering. The Internal Revenue Service (IRS) defines tax evasion as “[t]he failure to pay or a deliberate underpayment of taxes,” whereas tax avoidance is “[a]n action taken to lessen tax liability and maximize after-tax income.”⁷ The IRS specifically states that tax avoidance is “perfectly legal” in contrast to tax evasion, an illegal activity.⁸ Tax avoidance may involve anything from writing off charitable donations to selecting a specific state to live in based on the income tax scheme.⁹ However, there is a legal gray area in which efforts to legally reduce one’s tax burden effectively runs counter to public policy and increases inequality.¹⁰

Some scholars argue that *any* form of tax avoidance in this grey area, even where legal, is immoral based on the rapid rise of global wealth and the corresponding burden placed on the middle class.¹¹ As Marina Walker Guevara, Deputy Director at the ICIJ, stated in an HBO documentary about the Paradise Papers:¹²

The main victim is the middle class. They are paying for the infrastructure, they are paying for the schools, they are paying for transportation. And the richest people in our society have found a way

⁶ *Id.*

⁷ IRS, WORKSHEET SOLUTIONS: THE DIFFERENCE BETWEEN TAX AVOIDANCE AND TAX EVASION 1, https://apps.irs.gov/app/understandingTaxes/whys/thm01/les03/media/ws_ans_thm01_les03.pdf [<https://perma.cc/8KS9-GUMF>].

⁸ *Id.*

⁹ Maryalene LaPonsie, *22 Legal Secrets to Reducing Your Taxes*, U.S. NEWS & WORLD REP. (Feb. 16, 2022, 11:03 AM), <https://money.usnews.com/money/personal-finance/articles/legal-secrets-to-reducing-your-taxes> [<https://perma.cc/Z9J2-JEWK>]; Janet Berry-Johnson & Rose Wheeler, *9 States With No Income Tax*, FORBES ADVISOR (Mar. 18, 2022, 7:00 AM), <https://www.forbes.com/advisor/taxes/states-with-no-income-tax/#:~:text=The%20benefit%20of%20moving%20to,levy%20income%20taxes%20on%20individuals> [<https://perma.cc/NW4R-8PD2>].

¹⁰ Zoe Prebble & John Prebble, *The Morality of Tax Avoidance*, 43 CREIGHTON L. REV. 693, 701 (2010).

¹¹ *Id.*; Andres Knobel, *Trusts: Weapons of Mass Injustice?*, TAX JUST. NETWORK (Feb. 13, 2017), <https://www.taxjustice.net/wp-content/uploads/2017/02/Trusts-Weapons-of-Mass-Injustice-Final-12-FEB-2017.pdf> [<https://perma.cc/8GY3-VVEK>].

¹² See *Paradise Papers: Everything You Need to Know About the Leak*, BBC NEWS (Nov. 10, 2017), <https://www.bbc.com/news/world-41880153> [<https://perma.cc/3625-EC6K>]. The Paradise Papers were a similar but smaller release of documents by ICIJ from 2017. Dean Starkman et al., *Frequently Asked Questions About the Pandora Papers and ICIJ*, ICIJ (Oct. 19, 2021), <https://www.icij.org/investigations/pandora-papers/frequently-asked-questions-about-the-pandora-papers-and-icij/#:~:text=In%20terms%20of%20raw%20size,compared%20to%20Pandora's%2011.9%20million> [<https://perma.cc/J5YW-TNXT>].

to skirt a whole bunch of taxes that the rest of the citizens cannot possibly avoid.¹³

Guevara's statement illustrates the argument that tax avoidance results in the middle class bearing more than its share of the cost of critical services enjoyed by the whole of our society.¹⁴

With the aid of lawyers and accountants adept at identifying loopholes in the tax code and trust laws, art collectors and dealers can largely "work with as much dirty money as they want," with few consequences and little scrutiny by the IRS.¹⁵ In one significant example, reporting from the Pandora Papers included an investigation into Douglas Latchford, an infamous British art dealer, and his rampant trafficking of looted antiquities, particularly from Cambodia.¹⁶ The investigation revealed how Latchford used offshore accounts to sell stolen artifacts and disguise their provenance.¹⁷ Because the vast majority of art sales are private, there are likely countless other significant, stolen pieces of art and cultural heritage that go undetected.¹⁸ The reporting on Latchford was possible because

¹³ *VICE News Tonight: The True Story Behind the Secret 9-month Paradise Papers Investigation* (HBO television broadcast Nov. 6, 2017).

¹⁴ *Id.*; see *Paradise Papers*, *supra* note 12.

¹⁵ Casey Michel, *The United States of Dirty Money*, ATLANTIC (Oct. 5, 2021), <https://www.theatlantic.com/ideas/archive/2021/10/how-south-dakota-became-haven-dirty-money/620298/> [<https://perma.cc/ED4M-HWVK>]. On October 5, 2023, the IRS issued a warning to taxpayers regarding "improper art donation deduction promotions." In the statement, the IRS claimed to be focused on increasing "compliance activity involving high-income and high-wealth areas," however, this warning was specifically targeted at a type of fraud unrelated to *actual* high-value artwork. Rather, the value of the artwork in these schemes is often inflated for the purpose of obtaining higher tax deductions. Furthermore, the focus of the warning was to *protect* taxpayers and art collectors. I.R.S. News Release IR-2023-185 (Oct. 5, 2023), <https://www.irs.gov/newsroom/irs-warns-taxpayers-of-improper-art-donation-deduction-promotions-highlights-common-red-flags> [<https://perma.cc/93Y2-ME36>].

¹⁶ Sarah Cascone, *The Pandora Papers Leak Reveals How the Late Dealer Douglas Latchford Used Offshore Accounts to Sell Looted Cambodian Antiquities*, ARTNET (Oct. 5, 2021), <https://news.artnet.com/art-world/pandora-papers-douglas-latchford-2017069> [<https://perma.cc/GW9Q-45RA>]. Since the ICIJ's release of the Pandora Papers, Douglas Latchford's estate settled a federal civil case related to looted antiquities for \$12 million and in December 2023, the Met repatriated sixteen artifacts that were tied to Latchford's trafficking. Graham Bowley & Tom Mashberg, *Accused Art Trafficker's Estate Forfeits \$12 Million to End Case*, N.Y. TIMES (June 22, 2023), <https://www.nytimes.com/2023/06/22/arts/douglas-latchford-antiquities-trafficker-daughter.html> [<https://perma.cc/8DYH-GMFV>]; Spencer Woodman, *Met to Return 16 Khmer Relics Linked to Notorious Artifact Dealer*, ICIJ (Dec. 15, 2023) <https://www.icij.org/investigations/hidden-treasures/met-to-return-16-khmer-relics-linked-to-notorious-artifact-dealer/> [<https://perma.cc/K2SB-9VXL>].

¹⁷ *Id.*; "Provenance" is the historical origin of a work of art and "refers to the history of the ownership of a painting or other work of art." *Provenance*, NAT'L GALLERY, <https://www.nationalgallery.org.uk/paintings/glossary/provenance#:~:text=Provenance%20refers%20to%20the%20history,or%20other%20work%20of%20art> [<https://perma.cc/R5XU-7UR9>].

¹⁸ Cascone, *supra* note 16.

of his notoriety, but most individuals hiding their wealth in art and stolen cultural artifacts will go undiscovered as a result of the systems in place—such as the tax code and trust and estate laws—that allow for secrecy.¹⁹ Latchford's actions reflect how offshore accounts and trusts, specifically in Jersey and the British Virgin Islands, can be abused to protect assets, but the problem is just as rampant in the United States.²⁰

As the Pandora Papers confirmed, the United States has an “onshore” tax problem.²¹ The wealthiest Americans, with the aid of national and state legislatures, have carved out systems through which they can legally, and sometimes illegally, evade paying taxes on the majority of their wealth and assets. For instance, in 2021, the IRS commissioner publicly acknowledged this “tax gap,” and confirmed that the United States loses \$1 trillion a year as a result of unpaid or evaded taxes.²² For context, the country spent \$6.8 trillion total in 2021.²³ This marks a significant increase since 2013, when estimated losses due to tax evasion were \$441 billion per year.²⁴ The IRS attributes the evasion of taxes to a lack of IRS resources, the rise of cryptocurrency, income from foreign sources, and the “abuse” of the tax code by corporations.²⁵ Beyond physical art and cultural heritage objects, wealthy individuals have also begun storing their wealth in nonfungible tokens (NFTs), one-of-a-kind, unique digital assets purchased with cryptocurrency.²⁶ Top sales of NFTs have made headlines: Beeple's “Everydays—The First 5000 Days,” sold for \$69 million, and CryptoPunk's “#5822” sold for more than \$23 million.²⁷ But even beyond the splashy, high

¹⁹ Rachel Aima, *The Dubai Effect*, ART AM. (Jan. 1, 2019), <https://www.artnews.com/art-in-america/features/the-dubai-effect-63596/> [<https://perma.cc/QW7E-QJY3>].

²⁰ See Pegg, *supra* note 2; David Conn & Malia Politzer, *Offshore Loot: How Notorious Dealer Used Trusts To Hoard Khmer Treasures*, GUARDIAN (Oct. 4, 2021), <https://www.theguardian.com/news/2021/oct/05/offshore-trusts-used-pass-on-looted-khmer-treasures-leak-shows-douglas-latchford> [<https://perma.cc/V3TG-FE7B>].

²¹ See Pegg, *supra* note 2.

²² Alan Rappeport, *Tax Cheats Cost the U.S. \$1 Trillion Per Year, I.R.S. Chief Says*, N.Y. TIMES (Oct. 13, 2021), <https://www.nytimes.com/2021/04/13/business/irs-tax-gap.html> [<https://perma.cc/9NDZ-TN2S>].

²³ *The Federal Budget in Fiscal Year 2021*, CONG. BUDGET OFF. (Sept. 2022), <https://www.cbo.gov/system/files/2022-09/58268-Budget.pdf> [<https://perma.cc/FV4E-NSP3>].

²⁴ Rappeport, *supra* note 22.

²⁵ *Id.*

²⁶ Robyn Conti & Benjamin Curry, *What Is An NFT? Non-Fungible Tokens Explained*, FORBES (Mar. 7, 2023), <https://www.forbes.com/advisor/investing/cryptocurrency/nft-non-fungible-token/> [<https://perma.cc/U54T-QPHU>].

²⁷ Nicolaus Li, *CryptoPunk #5822 Sold for Record-Breaking 8,000 ETH, \$23.7 Million USD*, HYPEBEAST (Feb. 13, 2022), <https://hypebeast.com/2022/2/cryptopunk-5822-record-breaking-8000-eth-23-7-million-usd-sale-info> [<https://perma.cc/3WHF-3QVR>]; Scott Reyburn, *JPG File Sells for \$69 Million, as 'NFT Mania' Gathers Pace*, N.Y.

grossing NFTs, the market is robust; in 2021, NFT sales hit \$25 billion.²⁸ NFTs, along with their high price tags, have forged another potential avenue for tax avoidance and tax evasion.²⁹

One of the most popular ways of concealing wealth in the United States is through trusts.³⁰ As a result of the benefits offered by trusts, the American trust industry has rapidly grown in many states.³¹ Trusts are created when assets are transferred to a third party and the legal ownership remains with the grantor, a financial institution, or another individual.³² In general, trusts offer sizable financial benefits and lower the costs associated with owning property.³³ For instance, trusts allow assets to be sheltered from lawsuits, can shield wealth and assets from creditors, and can significantly lower one's tax burden.³⁴ Financial assets of any kind can be placed in a trust, such as artwork, the focal point of this note.

In the last decade, South Dakota has become known around the world as a haven for storing assets under minimal taxation while simultaneously avoiding payments to potential creditors.³⁵ By passing trust and estate laws that directly advance the state trust industry, South Dakota has established itself as a sanctuary for the “anonymous wealth of global billionaires.”³⁶ The amount held in trust in South Dakota alone “more than quadrupled over the past decade to \$360 billion,” a testament to the success of these pro-trust legislative efforts.³⁷ This is an immense amount of money for a single state, especially considering the state population is only around 895,000, roughly equivalent to the population of Charlotte, North Carolina.³⁸ Furthermore, as previously mentioned, the

TIMES (Mar. 11, 2021), <https://www.nytimes.com/2021/03/11/arts/design/nft-auction-christies-beeple.html> [<https://perma.cc/SW2R-TN8G>].

²⁸ Elizabeth Howcroft, *NFT Sales Hit \$25 Billion in 2021, But Growth Shows Signs of Slowing*, REUTERS (Jan. 11, 2022), <https://www.reuters.com/markets/europe/nft-sales-hit-25-billion-2021-growth-shows-signs-slowng-2022-01-10/> [<https://perma.cc/6N83-854G>].

²⁹ Carol R. Goforth, *How Nifty! But Are NFTS Securities, Commodities, or Something Else?* 90 UMKC L. REV. 775, 784 (2022); Conti & Curry, *supra* note 26.

³⁰ Knobel, *supra* note 11, at 2.

³¹ See Cenziper, *supra* note 5.

³² Matthew Erskine, *What is a Trust?*, FORBES (Aug. 5, 2022), <https://www.forbes.com/sites/matthewerskine/2022/08/05/what-is-a-trust/?sh=231ed17f4648> [<https://perma.cc/DF9F-P372>].

³³ *Id.*

³⁴ *Id.*

³⁵ See Collins, *supra* note 4.

³⁶ *Id.*; see Cenziper, *supra* note 5.

³⁷ Cenziper, *supra* note 5; see Collins, *supra* note 4.

³⁸ *Quick Facts: South Dakota*, U.S. CENSUS BUREAU (July 1, 2021), <https://www.census.gov/quickfacts/SD> [<https://perma.cc/SE86-9BBX>]; *Quick Facts: Charlotte City, North Carolina*, U.S. CENSUS BUREAU (July 1, 2021),

South Dakota Trust Co. alone has clients from over fifty-four countries, which indicates the global desirability of the South Dakota trust and tax law system.³⁹

The South Dakota Trust Co. proclaims that one type of trust in particular, the Domestic Asset Protection Trust (DAPT), is “excellent” for “wealth preservation and asset protection.”⁴⁰ The Pandora Papers also revealed that DAPTs, also known as Self-Titled Trusts, are one of the most popular forms of trusts used to conceal wealth around the country.⁴¹ A DAPT is a type of ownerless, self-settled (or “spendthrift”) irrevocable trust that “allows the grantor to be the beneficiary and retain full control over how the assets are used.”⁴² An “irrevocable trust” is a type of trust that cannot be dissolved or altered once created.⁴³ For DAPTs and self-settled trusts specifically, the creator of the trust is also one of the beneficiaries. When opening a DAPT, one could name themselves the beneficiary of a trust that includes assets, such as an art collection, and could then maintain full access over the items throughout their lifetime, including the ability to sell a piece of art from the trust.⁴⁴

Although irrevocable trusts lack malleability, there are significant benefits that make them predisposed to abuse. For instance, DAPTs offer an extreme form of asset protection by allowing one to conceal their assets from creditors.⁴⁵ DAPTs also offer greater ease by which assets can be stored in secret with minimal taxation; for instance, gift taxes can be entirely avoided or offset through irrevocable trusts.⁴⁶ Although the IRS states that “[t]axes must be paid on the income or assets held in trust, including the income generated by property held in

<https://www.census.gov/quickfacts/fact/table/charlottecitynorthcarolina/POP060210> [<https://perma.cc/ZB7P-T7XL>].

³⁹ See Cenziper, *supra* note 5.

⁴⁰ *Domestic Asset Protection Trust*, S.D. TRUST CO., <https://sdtrustco.com/why-south-dakota/asset-protection/> [<https://perma.cc/P8Q7-NLX6>].

⁴¹ Andrew Leahey, *Pandora's Box in South Dakota—Privacy Is Not the Enemy*, BLOOMBERG TAX (Oct. 7, 2021), <https://news.bloombergtax.com/tax-insights-and-commentary/pandoras-box-in-south-dakota-privacy-is-not-the-enemy> [<https://perma.cc/VU3U-P42V>].

⁴² See *id.*

⁴³ *Irrevocable Trust*, LEGAL INFO. INST. (last updated Mar. 2022) https://www.law.cornell.edu/wex/irrevocable_trust [<https://perma.cc/936U-QN98>].

⁴⁴ Blake Harris, *6 Best Asset Protection States*, BLAKE HARRIS L. (Oct. 11, 2022), <https://blakeharrislaw.com/blog/6-best-asset-protection-states> [<https://perma.cc/7CRX-5BXP>].

⁴⁵ Reid K. Weisbord, *A Catharsis for U.S. Trust Law: American Reflections on the Panama Papers*, 116 COLUM. L. REV. 93, 99 (2016).

⁴⁶ Leahey, *supra* note 41; Karen Hube, *The Art of Passing Down Heirlooms*, BARRONS (Mar. 28, 2020), <https://www.barrons.com/articles/the-art-of-passing-down-heirlooms-51585396802> [<https://perma.cc/NW8H-73RV>].

trust,”⁴⁷ the amount held in trust, and even the existence of a trust, is largely invisible to the IRS, especially when established through an irrevocable trust, such as a DAPT.⁴⁸ Lastly, when an artwork is transferred to an irrevocable trust, future appreciation of the work’s value can be excluded from the taxable estate.⁴⁹ For instance, if a piece of artwork worth \$5 million was transferred to an irrevocable trust, and the value of the work grew to \$10 million, the value of the taxable estate would remain \$5 million.⁵⁰

DAPTs can only be opened in jurisdictions where they are statutorily permitted, and they are subject to a unique set of laws and regulations depending on where they are formed.⁵¹ It has yet to be determined if one can create a DAPT in a state in which they do not reside. For nonresidents, the determining factor is “whether the nonresident’s domiciliary state has a ‘strong public policy’ against DAPT asset protection.”⁵² Currently, only nineteen states permit the establishment of DAPTs, although they have become increasingly popular in recent years, and other states are considering legislation that would allow for their creation.⁵³ The number of restraints on DAPTs depends on the jurisdiction. Many states require a statute of limitations between the time assets are transferred to a DAPT and the time those assets are shielded from creditors.⁵⁴ This theoretically prevents one from opening a DAPT with the intention of shielding their assets from a specific creditor. Additionally, most DAPT jurisdictions have “exception creditor” statutes, which permit creditors with preexisting claims to

⁴⁷ *Abusive Trust Tax Evasion Schemes - Talking Points*, I.R.S. (last updated Apr. 7, 2023), <https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-talking-points> [<https://perma.cc/QG5J-ENSX>].

⁴⁸ Mark P. Cussen, *Tax-Efficient Wealth Transfer*, INVESTOPEDIA (last updated Sept. 30, 2021), <https://www.investopedia.com/articles/retirement/07/reduce-estate-tax.asp#:~:text=For%20all%20practical%20purposes%2C%20the,the%20grantor%20from%20a%20sale> [<https://perma.cc/S3DR-GDXU>].

⁴⁹ Scott M. McCullough, *Uncovering the Potential of an Irrevocable Trust*, 28 UTAH B.J. 36, 39 (Nov./Dec. 2015).

⁵⁰ *Id.*

⁵¹ David G. Shaftel, *Variations in State Domestic Asset Protection Trust Statutes Compared*, 35 EST. PLAN. 14 (Apr. 2008).

⁵² *Id.*; see also *In re Huber*, 493 B.R. 798, 807 (Bankr. W.D. Wash. 2013).

⁵³ Mark Merric, Daniel G. Worthington, & John E. Sullivan III, *Best Situs for DAPTs in 2021: A Ranking of Jurisdictions That Offer the Best Asset Protection and the UVTA*, 160 TRS. & ESTS. 20, 20 (2021); see Danielle Greene, *Examining the Appeal of Self-settled Trusts*, SILICON VALLEY BANK (Mar. 22, 2022), <https://www.svb.com/private-bank/insights/trust-estate-perspectives/examining-the-appeal-of-self-settled-trusts> [<https://perma.cc/3JC5-A7GB>] (discussing that not all states permit the establishment of DAPTs).

⁵⁴ Steven J. Oshins, *The Domestic Asset Protection Trust: Ranking the Jurisdictions*, 26 PROB. & PROP. 40, 40 (2012).

access assets and also provide exceptions for those seeking alimony and child support.⁵⁵ However, these “exception creditor” statutes can also be avoided by locating a DAPT jurisdiction that does not have these statutes, such as Nevada.⁵⁶

The American trust system starkly differs from other countries’ systems.⁵⁷ Prior to the revelations of the Pandora Papers, the United States had already been described as the “leading jurisdiction for asset protection trusts” by Bloomberg.⁵⁸ In a defiant rejection of the United States’s penchant for trust secrecy, China’s trust regime includes the “most stringent requirements in the world.”⁵⁹ Chinese authors emphasize that the United States’s approach starkly differs from the rest of the international community and “have consistently warned of the dangers of the American approach” and the United States’s current rejection to reform.⁶⁰ As a result of the secrecy of the US trust system and the wide variety of trust laws across the states, the United States has become one of the most desirable countries in the world for those looking to store their assets without oversight.⁶¹

There has been minimal reporting on how these various forms of tax evasion and tax avoidance have been used in connection with art storage and through NFTs. This is largely due to the secrecy engrained in trust laws that allows for beneficiaries and grantors to remain anonymous and conceal the contents of their trusts.⁶² Additionally, the rise of the American trust industry has been bolstered by a lack of enforcement of the US tax code. Under US tax law, non-US citizens who own US assets—such as real estate and art, often held in trusts—must pay estate

⁵⁵ See *id.*; Ashlea Ebeling, *Comparing Domestic Asset Protection Trust States*, FORBES (July 6, 2016), <https://www.forbes.com/sites/ashleaebeling/2016/07/06/comparing-domestic-asset-protection-trust-states/?sh=58ecaa3959fd> [https://perma.cc/M2M7-7CFD].

⁵⁶ Courtney McCandless, *Nevada Asset Protection Trust*, NEV. LAW., Dec. 2018, at 25.

⁵⁷ The flaws in the American trust system are enunciated by Professor Frances H. Foster, who analyzes the American system of trust law through Chinese scholarship on the US system. See generally Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 MINN. L. REV. 602 (2010).

⁵⁸ Jimmy Sexton, *Why America Is the Leading Jurisdiction for Trusts*, BLOOMBERG TAX (Feb. 1, 2021), <https://news.bloombergtax.com/daily-tax-report/why-america-is-the-leading-jurisdiction-for-trusts> [https://perma.cc/4HN5-YL87].

⁵⁹ Foster, *supra* note 57, at 649.

⁶⁰ *Id.* at 648.

⁶¹ Nicole Sadek, *US Lands Top Spot as World’s Biggest Enabler of Financial Secrecy in New Index*, INT’L CONSORTIUM INVESTIGATIVE JOURNALISTS (May 17, 2022), <https://www.icij.org/investigations/pandora-papers/us-lands-top-spot-as-worlds-biggest-enabler-of-financial-secrecy-in-new-index/> [https://perma.cc/6AF6-YGNX].

⁶² Leahey, *supra* note 41; see Knobel, *supra* note 11, at 2.

taxes.⁶³ However, according to a former Swiss banker interviewed by CNBC, “this rule is widely ignored around the world,” and there is no way for the US government to quantify the true amount of taxes that should be owed under the tax code.⁶⁴

Since the publication of the Pandora Papers, in a move toward transparency, some significant steps have been made to crack down on shell companies. For instance, in September 2022, the US Treasury’s Financial Crimes Enforcement Network (FinCEN) issued a Federal Rule that created a new reporting structure under the Corporate Transparency Act.⁶⁵ The Federal Rule requires all corporations, companies, and other entities that either do business in the United States or are registered there to report to FinCEN the names of the individuals who control or own the company.⁶⁶ Although this is a significant and positive step, the Rule does not address private trusts and estates, which continue to enjoy minimal regulation across the country; the Rule only addresses companies and other entities.⁶⁷

Overall, the Pandora Papers revealed how the United States faces a *legal* tax avoidance crisis that the country has yet to address. This note will provide a glimpse into how the art world contributes to this crisis and what steps can be taken to address this burgeoning issue. It argues that the growth of art as an asset class has contributed to generational wealth and inequality as a result of the state-by-state system of wealth management and taxation that incentivizes tax avoidance and tax evasion through the art market.

Part I of this note addresses whether, and how, artwork and NFTs have become securities, and thus an increasingly popular asset class that requires increased regulation. Part II addresses the mechanisms through which tax avoidance occurs, such as storage in freeports and money laundering, as well as the main actors who contribute to the system of wealth accumulation through art collection. Part III proposes a multipronged approach to address the proliferation of tax avoidance and evasion as a means of accumulating

⁶³ Eamon Javers, *Why Billions of Dollars in Estate Taxes Go Uncollected*, NBC NEWS (Nov. 4, 2014), <https://www.nbcnews.com/business/taxes/why-billions-dollars-estate-taxes-go-uncollected-n457236> [<https://perma.cc/T7HQ-CCFU>].

⁶⁴ *Id.*

⁶⁵ Press Release, *FinCEN Issues Final Rule for Beneficial Ownership Reporting to Support Law Enforcement Efforts, Counter Illicit Finance, and Increase Transparency*, FIN. CRIMES ENF’T NETWORK (Sept. 29, 2022), <https://www.fincen.gov/news/news-releases/fincen-issues-final-rule-beneficial-ownership-reporting-support-law-enforcement> [<https://perma.cc/6RQD-B8PW>].

⁶⁶ *Id.*

⁶⁷ *See id.*

generational wealth through art collection, including: (1) a call for national legislation to create a trust registration system, (2) the elimination of DAPTs, (3) increased regulation of freeports, and (4) the United States's return to the United Nations Educational, Scientific and Cultural Organization (UNESCO). Together, these measures can curb the increasing wealth gap that threatens economic mobility and the health of the economy overall.

I. ART AS AN ASSET CLASS

Art as an asset class is not a new phenomenon. Auction houses like Christie's and Sotheby's have been around for more than two hundred years and throughout their history have demonstrated that works by the great masters are often purchased for their ability to hold and accumulate value.⁶⁸ However, what is increasingly common is the "securitization" of art as a means of diversifying one's investment portfolio.⁶⁹ First, this part discusses the securitization of art. It then discusses the impact of NFTs on the art world and under what circumstances NFTs will be classified as securities.

A. *Securitization of Art*

Compared to stocks, investing in art is generally riskier because the art market largely fluctuates based on the whims of "a small number of ultra-high-net-worth individuals whose sentiment and decision-making is highly uncorrelated with what equity markets are doing."⁷⁰ Other risks include the lack of transparency related to the provenance of a piece, a dearth of data related to "comps,"⁷¹ the prevalence of counterfeits, high storage costs, insurance, and tax compliance considerations.⁷²

⁶⁸ Mike Parsons, *Investing in the Art Market: A \$1.7 Trillion Asset Class*, CAIA ASS'N (July 22, 2022), <https://caia.org/blog/2021/07/22/investing-art-market-17-trillion-asset-class> [<https://perma.cc/RDZ6-6BU7>]; *About Us*, CHRISTIE'S, <https://www.christies.com/about-us/welcome-to-christies> [<https://perma.cc/STUY-SQJ7>].

⁶⁹ Jaclyn McLean, *Finance Nouveau: Prospects for the Securitization of Art*, 38 N.M. L. REV. 561, 575 (2008).

⁷⁰ Steve Schindler & Katie Wilson-Milne, *Fractional Ownership of Art: Can Regular People Own a Piece of the High End Art Market?*, ART L. PODCAST (June 9, 2022), <http://artlawpodcast.com/2022/06/09/fractional-ownership-of-art-can-regular-people-own-a-piece-of-the-high-end-art-market/> [<https://perma.cc/6YR4-HKT4>].

⁷¹ "Comps," short for comparables, are a "list of recent asset sales that reflect the characteristics of the asset an owner is looking to sell." Will Kenton, *Comparables Definition*, INVESTOPEDIA (Dec. 13, 2022), <https://www.investopedia.com/terms/c/comparables.asp> [<https://perma.cc/G7CD-GEPV>].

⁷² *What are the Risks of Investing in Art?*, MASTERWORKS (Oct. 19, 2022),

Despite the risks, for those who can afford to participate, the art market delivers generally higher returns compared to stocks and bonds.⁷³ Furthermore, under US securities laws, banks generally have no obligation to reveal to the US government the identities of non-US citizens who hold US-based assets unless certain stringent exceptions apply.⁷⁴

In its most basic form, a security is an investment, typically through the form of a stock or bond.⁷⁵ Section 2(a)(1) of the Securities Act provides a detailed, specific definition of the term “security,” but the Supreme Court has since established that the definition of “security” is “quite broad.”⁷⁶ In the seminal case *SEC v. W.J. Howey Co.*, the Supreme Court defined an “investment contract” as a type of security that requires registration under the Securities Act.⁷⁷ To determine whether an asset constitutes an investment contract, courts apply the *Howey* test: there must be (1) “an investment of money,” (2) a common enterprise, and (3) “a reasonable expectation of future profits derived from the work of others.” In *Marine Bank v. Weaver*, the Court further held that a security includes “many types of instruments that in our commercial world fall within the ordinary concept of a security.”⁷⁸ As a result of the Court’s rulings, various instruments and schemes fall under the category of an investment contract that do not fall under the other Securities Act categories, such as a “stock” or “bond.” If

<https://insights.masterworks.com/alternative-investments/art-investing/what-are-the-risks-of-investing-in-art/> [<https://perma.cc/9XDM-DLNF>].

⁷³ McLean, *supra* note 69, at 574–75.

⁷⁴ Javers, *supra* note 63; Under the Bank Secrecy Act, the Secretary of the Treasury can require “financial institutions . . . to keep records and file reports on financial transactions that may be useful in investigating and prosecuting money laundering and other financial crimes.” *Anti-Money Laundering (AML) Source Tool for Broker-Dealers*, SEC (updated May 16, 2022), <https://www.sec.gov/about/offices/ocie/amlsourcetool#4> [<https://perma.cc/7EFR-727F>]; The Bank Secrecy Act was later amended by Section 312 of the USA PATRIOT Act, which required financial institutions to “maintain . . . due diligence program[s] . . . that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving a ‘private banking account’ . . . in the U.S.” *Id.* Additional requirements also apply to accounts owned by “senior foreign political figure[s].” *Id.*

⁷⁵ *Securities Law*, GEORGETOWN L., <https://www.law.georgetown.edu/your-life-career/career-exploration-professional-development/for-jd-students/explore-legal-careers/practice-areas/securities-law/> [<https://perma.cc/4Y56-AXQS>].

⁷⁶ *Marine Bank v. Weaver*, 455 U.S. 551, 555–56 (1982).

⁷⁷ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

⁷⁸ *Marine Bank*, 455 U.S. at 555–56 (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)). The majority of financial transactions involve securities, and thus, the securities field combines transactional legal work; maneuvering the regulatory landscape of the US Securities and Exchange Commission; and litigation, in cases of fraud. *Securities Law*, *supra* note 75.

NFTs should be classified as securities, as some argue, they would fall under the investment contract category.⁷⁹

“Securitization” occurs when assets that are expected to produce income over time are consolidated.⁸⁰ Financial institutions then reconfigure these consolidated assets as securities, or “Asset Backed Securities,” which provide accountholders with interest.⁸¹ Securitization can occur with many different types of assets, such as loans, receivables, future revenues, and of course, artwork.⁸² Through the securitization process, investment risk decreases by dividing the debt obligation. Securitization involving art occurs when a company owns a piece of art that it believes will increase in value over time and registers it with the Securities and Exchange Commission (SEC).⁸³ This “securitizes” that piece of artwork. Once approved by the SEC, the company can sell a “piece” of the art through assets.⁸⁴ An asset sold as a security not registered with the SEC is a violation of Section 5 of the Securities Act.⁸⁵

It is likely that the trend in securitization of art, and the development of art as an asset class, will continue in coming years.⁸⁶ A 2019 report on art and finance concluded that “the performance of art as an asset class over the last two decades[] . . . displays a considerable positive return over time for art,” outpacing the S&P 500 consistently.⁸⁷ The report attributes growth in the art market to investors’ motivation for returns and portfolio diversification in addition to the “desire to hedge against inflation and store wealth in a safe haven asset.”⁸⁸ As art becomes increasingly viewed as an investment, oversight of how it is stored and taxed will become more critical.

⁷⁹ Ahad Syed, *NFTs: Sharks and Shards*, 110 ILL. B.J. 18, 18 (2022).

⁸⁰ Andreas Jobst, *Back to Basics: What is Securitization?*, INT’L MONETARY FUND FIN. & DEV. MAG., Sept. 2008, at 48.

⁸¹ *Id.*

⁸² McLean, *supra* note 69, at 562–63.

⁸³ *Id.* at 563.

⁸⁴ *Id.* at 576.

⁸⁵ 15 U.S.C. § 77e; *Securities Act of 1933*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_act_of_1933 [<https://perma.cc/V4U9-CU6E>]; Penalties for violations of the Securities Act differ, depending in part on the party pursuing the enforcement. Barry W. Rashkover, *Fundamentals of SEC Enforcement Defense Practice: Outline of Investigative and Remedies Issues*, 20110311A NYCBAR 698, 2011 WL 7100031, at *2 (Mar. 11, 2011). The SEC can seek civil remedies in federal court; remedies include statutory injunctions, disgorgement of illegal profits, fines, and sanctions. *Id.* at *10. The SEC cannot pursue criminal charges, but criminal prosecutors can seek criminal contempt for violations of SEC injunctions, in addition to criminal sanctions. *Id.* at *31.

⁸⁶ Parsons, *supra* note 68.

⁸⁷ DELOITTE, ART & FINANCE REPORT 2019 129 (6th ed. 2019).

⁸⁸ *Id.* at 128.

B. *Securitization of Nonfungible Tokens and the Risks of Underregulation*

The meteoric rise of NFTs has contributed to the recent increase in securitization of art and will likely continue to do so. The rapid surge in the popularity of NFTs has led some to compare the interest in NFTs to the short lived seventeenth century Dutch “Tulip mania” craze, and some have gone so far as to proclaim that “NFTs are Dead.”⁸⁹ However, these assertions gravely underestimate the importance of NFTs and put them at risk of underregulation and subsequent tax avoidance and tax evasion.⁹⁰ In 2021, IRS Commissioner Charles Rettig proclaimed that the United States loses \$1 trillion in taxes every year, and he specifically called out the rise of the \$2 trillion “lightly regulated” cryptocurrency sector as a primary reason for the increase in tax evasion over the past decade.⁹¹

Typically, NFTs are “digital representations of artwork” and therefore, “*should* mimic the taxation of any tangible artwork.”⁹² For an NFT seller, any money made from a sale is taxable income, even if that money is in the form of a cryptocurrency.⁹³ However, for a buyer, the IRS classifies the NFT purchase as *either* a gain or a loss, depending on how the value of the cryptocurrency fluctuates after the purchase.⁹⁴ Determining the value of an NFT depends on a variety of factors, such as the lowest possible value attributed to the NFT, rarity, and general demand.⁹⁵

⁸⁹ Birupaksh Kaundilya, *NFTs Are Dead: OpenSea NFT Volume Drops 99% and Stays for Entire Month*, TECHSTORY (Oct. 3, 2022), <https://techstory.in/nfts-are-dead-opensea-nft-volume-drops-99-and-stays-for-entire-month/> [https://perma.cc/AMJ4-XD3C].

⁹⁰ Yusuf Berkan Altun, *NFTs: The Fad That Is Here To Stay*, FORBES (Nov. 8, 2021, 7:00 AM), <https://www.forbes.com/sites/forbestechcouncil/2021/11/08/nfts-the-fad-that-is-here-to-stay/?sh=199982bb23a0> [https://perma.cc/YV4R-MSU6]; Kaundilya, *supra* note 89. The phenomenon of “Tulipmania” refers to the Dutch society’s obsession with exotic, expensive tulips in the 1630s. The short-lived craze created a bubble that subsequently burst, supposedly “[wrecking] havoc on the Dutch economy,” although historians have recently questioned whether the tulip bubble is really to blame for the economic downturn. Dave Roos, *The Real Story Behind the 17th-Century ‘Tulip Mania’ Financial Crash*, HISTORY (Mar. 16, 2020), <https://www.history.com/news/tulip-mania-financial-crash-holland> [https://perma.cc/766M-4EDV].

⁹¹ Rappeport, *supra* note 22. The SEC is not ignoring the meteoric rise of cryptocurrency and the potential securities fraud violations in its wake; in June 2023, the SEC filed a complaint against Coinbase, one of the largest trading platforms for crypto assets. Complaint at 1, SEC v. Coinbase, Inc., No. 1:23-cv-04738 (S.D.N.Y. June 6, 2023), ECF No. 1.

⁹² Kelli María Kordecki, *Happy Tax Season, Crypto Bros*, ATLANTIC (Apr. 12, 2022), <https://www.theatlantic.com/technology/archive/2022/04/file-taxes-nft-irs-guidelines/629542/> [https://perma.cc/JF3M-RJN9].

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

Similar to fine art, digital art sold through cryptocurrency as NFTs is often sold with the understanding that the value will appreciate and therefore could be securitized.⁹⁶ In applying the *Howey* test to cryptocurrency, the SEC has suggested that the first two elements are met: (1) there is usually an investment of money and (2) a common enterprise.⁹⁷ However, applying the analysis to NFTs is demonstrably more difficult. With NFTs, although there is likely “payment of money or something of value,” the second and third prongs of *Howey* pose a challenge because NFTs are rarely purchased by a “pool[] of investors whose fortunes depend on the profitability of the enterprise.”⁹⁸

In response to a motion to dismiss, the Southern District of New York, in *Friel v. Dapper Labs, Inc.*, was the first to apply the *Howey* test to NFTs.⁹⁹ The case involved the purchase of NFTs called “NBA Top Shot Moments,” which correlated to short, digital clips of NBA game highlights.¹⁰⁰ Plaintiffs, purchasers of the NFTs, alleged that the NFTs should have been registered with the SEC because the digital clips constituted investment contracts, and thus securities. The court held it facially plausible that the NFTs in this specific case constituted securities under *Howey*. In applying *Howey*, the court found that plaintiffs sufficiently alleged that (1) there was a significant investment of money; (2) that investors had pooled money together, thus constituting a common enterprise; and (3) that the purchasers could have expected profits based on the managerial efforts by the sellers.¹⁰¹ As the first case to apply *Howey* to NFTs, *Friel* is especially significant. However, the court specified that its holding was narrow: “[n]ot all NFTs offered or sold by any company will constitute a security, and each scheme must be assessed on a case-by-case basis.”¹⁰²

⁹⁶ Goforth, *supra* note 29, at 789.

⁹⁷ *Id.* at 783–84. “A common enterprise exists wherever there is ‘horizontal commonality’ between purchasers and a given defendant[]” or vertical commonality. SEC v. Terraform Labs Pte. Ltd., No. 23-CV-1346 (JSR), 2023 WL 4858299, at *13 (S.D.N.Y. July 31, 2023). Commonality is formed when “each investor’s fortunes are ‘ti[ed] . . . to the fortunes of the other investors by the pooling of assets,’ and there is a ‘pro-rata distribution of profits’ earned from these combined assets.” *Id.* (quoting *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994)) (alteration in original).

⁹⁸ Goforth, *supra* note 29, at 787; Brian Elzweig & Lawrence J. Trautman, *When Does a Non-Fungible Token (NFT) Become a Security?*, 39 GA. ST. U. L. REV. 295, 328 (2023).

⁹⁹ *Friel v. Dapper Labs, Inc.*, No. 21-CIV-5837, 2023 WL 2162747, at *9 (S.D.N.Y. Feb. 22, 2023).

¹⁰⁰ *Id.* at *4.

¹⁰¹ *Id.* at *8.

¹⁰² *Id.* at *22.

The court's decision in *Friel* was likely an exception.¹⁰³ As a result of the difficulty of applying *Howey* to NFTs, the SEC will likely not pursue thorough investigations of the majority of NFT sales to determine whether they abide by securities law.¹⁰⁴ Given the frequency of scenarios in which NFTs *do not* qualify as securities, the SEC will likely not pursue potential fraud cases even where NFTs *do* meet the definition of a security.¹⁰⁵ As a result, taxes on capital gains earned from the sale of the NFTs that qualify as securities will likely go unpaid.¹⁰⁶ Where NFTs appreciate in value and have not been securitized, the IRS confirms that income, gains, or losses must still be reported on federal income tax returns.¹⁰⁷ Failure to report income from NFTs on federal income tax returns is just one avenue of tax avoidance contributing to the \$1 trillion in losses the US government faces from unpaid taxes.¹⁰⁸

II. THE MECHANISMS OF TAX AVOIDANCE AND TAX EVASION

State tax laws and the tax havens they create allow for the accumulation of wealth and perpetuation of inequality through art and NFTs. This part discusses some of the most common means by which tax evasion and tax avoidance occur. First, this part delves into freeports, which are deterritorialized storage facilities often used to keep art tax free.¹⁰⁹ Second, this part discusses how money is laundered through art, often through the use of freeports and trusts.¹¹⁰ Third, this part discusses the industries and actors responsible for perpetuating

¹⁰³ Elzweig, *supra* note 98, at 328 (discussing the attributes missing from traditional NFTs that would classify them as a security, specifically a lack of horizontal and vertical commonality).

¹⁰⁴ Goforth, *supra* note 29, at 790.

¹⁰⁵ *Id.*

¹⁰⁶ Justin Resuello and Benjamin Curry, *Taxes On Stocks: What Capital Gains Tax Do You Owe?*, FORBES ADVISOR (Mar. 5, 2021), <https://www.forbes.com/advisor/investing/taxes-on-stocks/> [<https://perma.cc/M2XY-3RGC>]. Capital gains taxes are paid on income derived from the sale of a long-term asset, whereas income taxes are paid on earnings in the form of money, property, or services. Evan Tarver, *Income Tax vs. Capital Gains Tax: Differences*, INVESTOPEDIA (Jan. 12, 2023), <https://www.investopedia.com/ask/answers/052015/what-difference-between-income-tax-and-capital-gains-tax.asp#citation-1> [<https://perma.cc/KPQ8-FFBJ>].

¹⁰⁷ *Frequently Asked Questions on Virtual Currency Transactions*, I.R.S. (updated June 27, 2023), <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions> [<https://perma.cc/NFG5-G2YH>].

¹⁰⁸ Rappeport, *supra* note 22.

¹⁰⁹ John Zarobell, *Freeports and the Hidden Value of Art*, 9 ARTS 1, 1 (Nov. 18, 2020).

¹¹⁰ *Id.* at 2.

these systems, including auction houses, law firms, and banks.¹¹¹ Finally, this part addresses the problem with hoarding wealth in art and why the practice should be curbed.

A. *Freeports as Tax Havens*

Much of the art purchased for the purpose of investing, rather than public consumption or cultural clout, is kept in tax-free storage facilities around the world called “freeports,” also referred to as Free Zones, Export Processing Zones, Free Trade Areas/Zones, or simply “offshore.”¹¹² Freeports exist in deterritorialized spaces and are thus not subject to import or export taxes.¹¹³ Freeports are generally permitted to keep most information about their holdings confidential.¹¹⁴ This means that the amount of art held at a freeport, the value of the art, or anything related to the specific pieces of art is entirely unknown.¹¹⁵ These storage facilities have become notorious tax havens based on their ability to operate outside of the public eye as “secrecy jurisdictions,” in which they function largely away from legal authority.¹¹⁶

Freeports have existed in various forms for centuries around the world to promote trade.¹¹⁷ Historically, freeports were used for the temporary housing and storage of goods, but today, they have become popular facilities for long-term art storage.¹¹⁸ For those who buy art as an investment, freeports offer “the perfect storage solution” for wealth accumulation.¹¹⁹ These tax-free storage facilities house artworks that can

¹¹¹ DEP’T TREASURY, STUDY OF THE FACILITATION OF MONEY LAUNDERING AND TERROR FINANCE THROUGH THE TRADE IN WORKS OF ART 11–18 (Feb. 2022); Sydney P. Freedberg, Agustin Armendariz, and Jesús Escudero, *How America’s Biggest Law Firm Drives Global Wealth Into Tax Havens*, INT’L CONSORTIUM INVESTIGATIVE JOURNALISTS (Oct. 4, 2021), <https://www.icij.org/investigations/pandora-papers/baker-mckenzie-global-law-firm-offshore-tax-dodging/> [<https://perma.cc/M7M9-N54N>]; SHUYI CHENG & YAXUAN QI, AM. ECON. ASS’N, DO BANKS ASSIST CORPORATE TAX AVOIDANCE? EVIDENCE FROM SIMULTANEOUS DEBT-EQUITY HOLDING (2019), <https://www.aeaweb.org/conference/2020/preliminary/paper/AbfDsYBs>.

¹¹² Desiree Moore & Blaise Niosi, *Art Market Tax Probes Make Domestic Freeports Appealing*, LAW360 (Jan. 18, 2017), <https://www.law360.com/tax-authority/articles/882258/art-market-tax-probes-make-domestic-freeports-appealing> [<https://perma.cc/RPX2-6JMX>]; Zarobell, *supra* note 109, at 1.

¹¹³ Zarobell, *supra* note 109, at 1.

¹¹⁴ *Id.* at 2.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Richard Partington, *What is a Free Port? All You Need to Know about the Free-Trade Zones*, GUARDIAN (July 6, 2019), <https://www.theguardian.com/politics/2019/jul/06/what-is-a-free-port-all-you-need-to-know-about-free-trade-zones-brexit> [<https://perma.cc/7UZS-4J6F>].

¹¹⁸ Aima, *supra* note 19.

¹¹⁹ *Id.*

accumulate in value and can also be bought and sold with little to no taxes paid on the transaction.¹²⁰

The increased popularity of freeports has led some to describe them as “the greatest museums no one can see.”¹²¹ At the Geneva, Switzerland freeport alone, it is estimated that there are at least one thousand works by Picasso, in addition to works by Andy Warhol, Jeff Koons, and Joan Miró that potentially total \$28 million.¹²² According to a 2018 International Monetary Fund study, “at least \$7 trillion in holdings and an additional \$12 trillion in Foreign Direct Investment assets[]” are kept in freeports without taxation by any jurisdiction.¹²³ For context, Apple Inc. is worth \$2.6 trillion, Alphabet Inc. (Google) is worth \$1.5 trillion, and Amazon is worth \$1.4 trillion.¹²⁴ As law enforcement agencies promise to crack down on tax compliance in the art world, freeports may become increasingly appealing to art collectors hoping to avoid taxes.¹²⁵ The practice of storing art in these facilities has been widely criticized as a form of “trad[ing] in cultural capital for the benefit of tax-free investment,” but objectively represents a shift from the role of art as a form of cultural capital toward art as investment.¹²⁶

B. *Money Laundering*

The ability to store physical assets in freeports without taxation outside the purview of regulation creates a situation susceptible to money laundering. Money laundering is the process through which illegally acquired money is spent to disguise its illicit history, and it is typically conducted through two phases: placement and layering.¹²⁷ In the placement stage, the sum of money is reintroduced into the financial system

¹²⁰ *Id.*

¹²¹ Graham Bowley & Doreen Carvajal, *One of the World's Greatest Art Collections Hides Behind this Fence*, N.Y. TIMES (May 28, 2016), <https://www.nytimes.com/2016/05/29/arts/design/one-of-the-worlds-greatest-art-collections-hides-behind-this-fence.html> [<https://perma.cc/3HJZ-Q32X>].

¹²² *Id.*

¹²³ Zarobell, *supra* note 109, at 2.

¹²⁴ Matthew Johnston, *Biggest Companies in the World by Market Cap*, INVESTOPEDIA (Sept. 24, 2022), <https://www.investopedia.com/biggest-companies-in-the-world-by-market-cap-5212784> [<https://perma.cc/37R2-TSR2>].

¹²⁵ See Kelley R. Taylor, *Are 87,000 New IRS Agents Coming for Your Tax Dollars?*, KIPLINGER (Jan. 20, 2023), <https://www.kiplinger.com/taxes/605107/new-irs-agents-and-the-inflation-reduction-act> [<https://perma.cc/59JH-FH5P>].

¹²⁶ Zarobell, *supra* note 109, at 1.

¹²⁷ *Money Laundering FAQ*, FIN. ACTION TASK FORCE, <https://www.fatf-gafi.org/faq/moneylaundering/> [<https://perma.cc/ABW5-6BFA>].

through smaller bank account deposits.¹²⁸ The layering phase requires a series of purchases or conversions that further separate the money from the initial source.¹²⁹ In the art context, this is the stage in which high-value art is purchased and kept in freeports where the art holds, and often gains, value outside the scope of regulators.¹³⁰ According to a Department of Treasury study on how art is used in money laundering and terror finance, the “the high-dollar values of single transactions, the ease of transportability of works of art, the long-standing culture of privacy in the market . . . and the increasing use of art as an investment . . . asset,” contribute to the vulnerability of art as a means for money laundering.¹³¹

The American trust industry also incentivizes money laundering through art. Although it is illegal for trust companies to *knowingly* accept money or assets acquired through criminal activity, if the trust companies do not ask, then there is no culpability.¹³² Additionally, most jurisdictions permit nearly “impenetrable secrecy” and allow for the content and value of trusts to be hidden from the IRS, the FBI, or the public.¹³³ These trusts can then be used to protect shell companies, evade taxes, and attempt to protect transactions through money laundering.¹³⁴ Trusts and freeports are therefore key elements behind money laundering, and they are expertly manipulated by professionals in a variety of fields.¹³⁵

C. *The Main Actors*

The structures through which money laundering, tax evasion, and tax avoidance occur varies across multiple industries that are eager to help others make money in exchange for making money themselves. These systems require actors who are intimately familiar with tax codes, regulations, and technical norms, and are thus capable of helping their clients avoid taxes at all costs without breaking any laws.¹³⁶ Auction

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ DEP'T TREASURY, *supra* note 111, at 18.

¹³¹ *Id.* at 1.

¹³² *See* Cenziper et al., *supra* note 5.

¹³³ *Id.*

¹³⁴ Nicole F. Stowell et al., *The Use of Wills and Asset Protection Trusts in Fraud and Other Financial Crimes*, 65 DRAKE L. REV. 509, 526 (2017).

¹³⁵ DEP'T TREASURY, *supra* note 111, at 11–19.

¹³⁶ *See id.* at 11, 14–15, 18–19 (explaining the ways in which relevant systems can be exploited, and the processes and actors involved in exploiting them); *see also* Freedberg et al., *supra* note 111 (discussing the law firm Baker McKenzie's work with

houses, law firms, and banks all play a role in facilitating tax evasion and avoidance.¹³⁷ For instance, in August of 2022, the Office of the New York State Attorney General revealed that it discovered evidence of a tax fraud scheme at Sotheby's associated with twelve clients.¹³⁸ This discovery was related to an existing lawsuit filed four years prior, in which the Attorney General accused Sotheby's of tax fraud related to \$27 million worth of art.¹³⁹

In addition to the auction houses, law firms and banks are also known to assist their clients in avoiding taxes, often through the creation of trusts. In fact, prominent organizations, such as the Organization for Economic Cooperation and Development and the Financial Action Task Force, have condemned "weak regulation of lawyers and other professionals," as a contributing factor to financial crime internationally.¹⁴⁰ In many instances, law firms and banks explicitly state their intention to assist clients with sheltering their assets from taxes and creditors on their websites. One law firm describes South Dakota as "favorable . . . for those planning to protect assets for multiple generations," based on the state's lack of income tax or capital gains tax, which allows "assets within a trust [to] be sheltered from . . . state taxation."¹⁴¹ Another firm describes a DAPT as "established and operated for the purpose of sheltering assets from judgement creditors in court proceedings."¹⁴² Banks are just as blatant. In a blog post by J.P. Morgan, titled "Looking to reduce or eliminate state taxes on your trusts? It's possible," a wealth adviser offered insight into how clients can avoid paying taxes under their trusts.¹⁴³

With regard to self-settled trusts and DAPTs, trust and estate attorneys are adept at manipulating domiciliary laws and residency requirements. Attorneys will assist their clients in

tech corporations and foreign-actor clients to help avoid taxes); Cheng & Qi, *supra* note 111, at 2.

¹³⁷ DEP'T TREASURY, *supra* note 111, at 11, 14–15, 18–19; Freedberg et al., *supra* note 111; Cheng, *supra* note 111.

¹³⁸ ANGELICA VILLA, *New York Attorney General Expands Sotheby's Tax Fraud Investigation*, ARTNEWS (Aug. 26, 2022), <https://www.artnews.com/art-news/news/sothebys-tax-fraud-investigation-expands-1234637480/> [<https://perma.cc/4J7S-499U>].

¹³⁹ *Id.*

¹⁴⁰ Freedberg et al., *supra* note 111.

¹⁴¹ Harris, *supra* note 44.

¹⁴² *What is a Domestic Asset Protection Trust and Is it Right for Me?*, HOUGUM L. FIRM (July 28, 2020), <https://hougumlaw.com/what-is-a-domestic-asset-protection-trust-and-is-it-right-for-me/> [<https://perma.cc/Z3JR-A34D>].

¹⁴³ Jordan Sprechman, *Looking to Reduce or Eliminate State Taxes on Your Trusts? It's Possible.*, J.P. MORGAN PRIVATE BANK: TAXES (Mar. 15, 2022), <https://privatebank.jpmorgan.com/gl/en/insights/planning/looking-to-reduce-or-eliminate-state-taxes-on-your-trusts-its-possible> [<https://perma.cc/RA9A-RXVH>].

“build[ing] a record to stand the best chance of defending a challenge to [their] DAPT.”¹⁴⁴ Depending on state laws, building this record could include recommending a client visit the state where the DAPT is established, signing documents in that state, and making asset transfers to the state.¹⁴⁵ For artwork in particular, experts generally recommend that clients store their artwork in the state where the DAPT is set up.¹⁴⁶ By tactfully assisting clients in avoiding taxes, attorneys are helping their clients to accumulate wealth, which comes with a societal cost that must be acknowledged.

D. The Problem with Hoarding Wealth

The use of art and NFTs to shield oneself from taxation demonstrates how the law promotes unequal wealth distribution. The danger of these methods of tax avoidance is a danger inherent in all forms of wealth hoarding: depletion of the economic safety net for welfare states, declining community health, and the eventual loss of effective self-governance and democracy.¹⁴⁷ Wealth hoarding and resulting inequalities impact the health of the whole community, even the affluent, because “inequality reduces social cohesion, a dynamic that leads to more stress, fear, and insecurity for everyone.”¹⁴⁸ Inequality has also been linked to obesity, declining life expectancy, and high infant mortality.¹⁴⁹ Additionally, states that allow for and promote tax-friendly trusts and other forms of tax avoidance hollow out the economic safety net for the welfare state.¹⁵⁰ Shielding capital from taxation also potentially depletes the state’s ability to prepare for catastrophic threats, like climate change and pandemics.¹⁵¹

Furthermore, along with the rise of the United States as the preeminent territory for low-tax wealth storage and money laundering, the country’s status as a democratic state has faltered.¹⁵² In 2021, a “well-respected index” went so far as to briefly downgrade the United States to an anocracy, “a system

¹⁴⁴ Ebeling, *supra* note 55.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ QUINN SLOBODIAN, CRACK-UP CAPITALISM: MARKET RADICALS AND THE DREAM OF A WORLD WITHOUT DEMOCRACY 234 (2023).

¹⁴⁸ *Inequality and Health*, INEQUALITY.ORG, <https://inequality.org/facts/inequality-and-health/#us-inequality-health> [<https://perma.cc/9QG2-943K>].

¹⁴⁹ *Id.*

¹⁵⁰ See SLOBODIAN, *supra* note 147, at 222–223.

¹⁵¹ *Id.*

¹⁵² *Id.* at 234.

mixing features of democratic and autocratic rule.”¹⁵³ Generally, the more “loopholes” that permit tax avoidance, tax evasion, and general wealth hoarding, “the less effective self-governance will be.”¹⁵⁴ For example, “the failure of the United States, almost uniquely amongst the high-income countries, to establish a federal sales tax [has] made financing the kind of government spending needed to sustain a substantial welfare state almost impossible.”¹⁵⁵ The trend toward DAPTs and blossoming of tax avoidance in the United States has coincided with a decline of self-governance and an “abdication from [a] shared set of responsibilities.”¹⁵⁶ Whether or not this is a coincidence has yet to be determined, but the correlation is worth considering.

III. A MULTIPRONGED APPROACH TO COMBATTING THE USE OF TAX AVOIDANCE AND TAX EVASION THROUGH ART AND NONFUNGIBLE TOKENS

The below section offers multiple solutions, that when implemented together, could curb the rampant abuse of the tax system in the United States through art and NFTs. These solutions include a national trust registration system, the elimination of DAPTs and Self-Titled Trusts, a strict regulation of freeports, and rejoining UNESCO.

A. *Centralized Trust Registration*

A trust registration would allow for beneficiaries to be more easily identified and may also dissuade illegal behavior. Identifying the beneficiary of a trust is necessary when it is suspected that the trust has been used for laundering money, hiding assets related to corruption, tax evasion, or avoiding creditors.¹⁵⁷ Recently, such centralized systems have been successful. In 2021, the European Union (EU) passed regulation requiring trustees to file ownership information in a Central Register of Beneficial Ownership of Trusts (CRBOT).¹⁵⁸ The registration was created to improve

¹⁵³ *Id.*; *Extremists Are the Tools of Change for Aspiring Autocrats*, CTR. SYSTEMIC PEACE, <https://www.systemicpeace.org/> [<https://perma.cc/45J6-KPHM>].

¹⁵⁴ KATHRINA PISTOR, *THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH AND INEQUALITY* 225 (2019).

¹⁵⁵ Jonathan Hopkin, *The Politics of Tax Justice in Democracies: Redistribution Beyond the Median Voter Theorem*, 2 LSE PUB. POL’Y REV. 1, 3 (Nov. 24, 2022).

¹⁵⁶ SLOBODIAN, *supra* note 147, at 5.

¹⁵⁷ Knobel, *supra* note 11, at 9.

¹⁵⁸ BRÍD MCCOY, LEXOLOGY, *CENTRAL REGISTER OF BENEFICIAL OWNERSHIP OF TRUSTS (‘CRBOT)* (Nov. 14, 2021), <https://www.lexology.com/library/detail.aspx?g=64001919-ce69-4044-b9cd-7dbfa9e80e08> [<https://perma.cc/PM9M-Y8H5>].

transparency, prevent money laundering, and ultimately clarify who is benefitting from trusts and who owns them.¹⁵⁹ Although the EU has required trustees to maintain beneficial ownership registers since 2019, the CRBOT goes further by providing government authorities and law enforcement with information from the registry when “necessary to identify the beneficiaries of a trust,” such as during an investigation into tax fraud.¹⁶⁰ The United Kingdom (UK) has also passed specific regulation in hopes of better regulating and monitoring trusts.¹⁶¹ There, all existing UK express trusts—which are trusts typically created through writing, in addition to specific non-UK trusts—were required to register by September 2022.¹⁶² The UK also implemented a number of requirements to ensure compliance, such as requiring proof of registration and instituting penalties for late registration.¹⁶³ The long-term success, however, of the EU and UK models is still unknown.

Unlike the EU and UK, the United States has not attempted to implement any national form of trust registration system, although there have been feeble attempts to require registration at the state level.¹⁶⁴ For example, Colorado previously required that trusts be documented in a state-run registration system.¹⁶⁵ However, in 2019, the state lifted this mandate.¹⁶⁶ North Dakota previously required trust registration, but eliminated this requirement in 2007.¹⁶⁷ In Hawaii, one is required to register the names and addresses of a trust’s grantor, original trustee, and current trustee; however, registration of the beneficiaries, assets, and provisions is not required.¹⁶⁸ Importantly, commentary underneath the state statute explicitly states that “[a]lthough required by the statute, very few trusts are actually registered.”¹⁶⁹ The inconsistency among state trust registration systems and the general lack of uniformity across the United States demonstrates the fault lines in the country’s patchwork, state-focused approach to trust law.

¹⁵⁹ *Id.*

¹⁶⁰ Micky Yang, *The Register of Beneficial Ownership of Overseas Entities Owning UK Property*, 7 J. INT’L BUS. FIN. L. 437, 437 (2018).

¹⁶¹ *All UK Express Trusts Must Now Register Under Anti-Money Laundering Laws*, PINSENT MASONS (Sept. 12, 2022) <https://www.pinsentmasons.com/out-law/news/uk-trusts-must-register-anti-money-laundering> [<https://perma.cc/J8RB-YZJX>].

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ JENNIFER M. SPITZ, COLORADO ESTATE PLANNING HANDBOOK § 24.4.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ N.D. CENT. CODE § 30.1-32 (repealed by S.L. 2007, ch. 549, § 27).

¹⁶⁸ HAW. PROB. R. 127 (1995).

¹⁶⁹ *Id.*

To address the exploitation of the trust system for the purposes of wealth accumulation through art and NFTs, a National Trust Registry (the Registry) should be implemented. Although this is a radical shift from the current model, it is moderate compared to international standards previously discussed. A mandatory, national registration, such as the systems in China or the EU, which obligate that every trust be registered by a certain date, would likely not succeed in the United States. Trust and estate laws have largely been delegated to the states and have not been addressed by Congress—this is unlikely to change.¹⁷⁰ Rather than a mandatory registration system, the Registry should be conditionally tied to an 8 percent flat-rate annual federal tax (the Tax) on the assets of the trust. Similar to the UK model, government authorities and law enforcement investigating issues such as tax fraud should have access to the Registry for information “where it is necessary to identify the beneficiaries of a trust.”¹⁷¹ To be optimally effective, the Registry should require that all trust beneficiaries and potential beneficiaries are mentioned in the trust documents.¹⁷² Disclosure of all updates made to a trust should also be required.¹⁷³

The Tax could be avoided entirely if one decides instead to register the trust in the Registry. In other words, there would be two options for trust owners: either register and avoid an 8 percent federal tax on the trust’s assets, or do not register and incur the Tax. The Tax would apply to anyone creating a trust, regardless of whether they reside in the United States or not and would also apply retroactively to any trusts in existence. Although the contents of the trust would not need to be revealed, the Tax would require a disclosure of the amount of assets to ensure the correct amount is properly taxed. Compliance with the Tax would be instituted through randomized audits by the IRS, legal under the Bank Secrecy Act and The USA PATRIOT Act.¹⁷⁴ If an audit revealed that the

¹⁷⁰ U.S. CONST. art. 1, § 8, cl. 1 (Commerce Clause gives Congress sole power to regulate commerce among the states); Alexander B. Shiffman, *The Domestic Asset Protection Trust and Its Federalism Implications*, 13 CARDOZO PUB. L. POL’Y & ETHICS J. 853, 869 (2015).

¹⁷¹ Yang, *supra* note 160, at 438.

¹⁷² Knobel, *supra* note 11.

¹⁷³ *Id.*

¹⁷⁴ *Anti-Money Laundering (AML)*, *supra* note 74. The Bank Secrecy Act “authorizes the Secretary of the Treasury to issue regulations requiring financial institutions (including broker-dealers) to keep records and file reports on financial transactions that may be useful in investigating and prosecuting money laundering and other financial crimes.” *Id.* Under Section 356 of the USA PATRIOT Act, broker-dealers are required “to monitor for, and report, suspicious activity.” *Id.*

taxable amount was improperly disclosed or intentionally underestimated, fines based on the value of the trust would be imposed and the trust would be placed on an IRS watchlist subject to heightened future scrutiny.

The Tax would be constitutional under the taxing powers provided by Article I, Section 8 of the Constitution and the Sixteenth Amendment. Under Article I, Congress has the power “[t]o lay and collect Taxes[] . . . for the . . . general Welfare of the United States,” provided that the taxes imposed are uniform across the country.¹⁷⁵ The Tax would contribute to the general welfare of the country through funding vital government services, such as infrastructure, healthcare, and education.¹⁷⁶ Additionally, the tax would apply uniformly across states, and in turn, would be constitutional under Article I.¹⁷⁷

The constitutionality of the Tax is further bolstered by the Sixteenth Amendment, which gives Congress the “power to lay and collect taxes on incomes, from whatever source derived.”¹⁷⁸ Although not all trusts generate taxable income, many do, and the trusts that do are subject to federal income tax regulations. If a trust “has \$600 in income or the trust has a non-resident . . . as a beneficiary,” a US Income Tax Return for Estates and Trusts must be filed.¹⁷⁹ Therefore, the proposed Tax is also constitutional for income-generating trusts on Sixteenth Amendment grounds. The Tax on those who choose not to register their trusts is also constitutional under Supreme Court precedent established by *National Federation of Independent Business v. Sebelius* in combination with *South Dakota v. Dole*.

In *Sebelius*, the Court held that an individual mandate to purchase health insurance was a constitutional use of Congress’s power to tax under the Necessary and Proper clause.¹⁸⁰ The Court reasoned that the tax was not a penalty because (1) the total amount paid under the tax would be significantly less than the cost of insurance, (2) there was no

¹⁷⁵ U.S. CONST. art. I, § 8, cl 1.

¹⁷⁶ *Paradise Papers*, *supra* note 12. Funds raised from the Tax on trusts could be applied similarly to how money from the estate tax is used to “fund essential programs, from health care to education to national defense.” Chye-Ching Huang & Chloe Cho, *Ten Facts You Should Know About the Federal Estate Tax*, CTR. BUDGET & POLY PRIORITIES (Oct. 30, 2017), <https://www.cbpp.org/research/federal-tax/ten-facts-you-should-know-about-the-federal-estate-tax#:~:text=The%20money%20the%20estate%20tax,to%20education%20to%20national%20defense> [https://perma.cc/VJ7Y-4LC9].

¹⁷⁷ U.S. CONST. art. I, § 8, cl 1.

¹⁷⁸ *Id.* amend. XVI.

¹⁷⁹ *Abusive Trust Tax Evasion Schemes - Questions and Answers*, I.R.S. (Dec. 6, 2021), <https://www.irs.gov/businesses/small-businesses-self-employed/abusive-trust-tax-evasion-schemes-questions-and-answers> [https://perma.cc/XK2X-W9WE].

¹⁸⁰ *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 566, 618 (2012).

requirement of scienter (knowledge of wrongdoing), and (3) the individual mandate would be collected by the IRS.¹⁸¹ Furthermore, the Court stated that “taxes [which] seek to influence conduct are nothing new.”¹⁸² Here, similarly, the Tax would not be considered a heavy burden because it could be avoided entirely by simply registering one’s trust. The 8 percent tax here is less than the 10 percent in *Bailey v. Drexel Furniture Co.*, which the Court held was a “heavy burden.”¹⁸³ Further, failure to register one’s trust would not be considered illegal and the tax would be collected by the IRS.

The legislation at issue in *Dole* was the National Minimum Drinking Age Act, which withheld 5 percent of federal highway funds from states that permitted alcohol sales for those under twenty-one.¹⁸⁴ In seeking to avoid instituting a minimum drinking age of twenty-one without losing federal highway funding, South Dakota argued that the National Minimum Drinking Age Act violated constitutional limits on congressional spending.¹⁸⁵ However, the Court rejected the state’s argument and held that Congress indeed did have the power to attach conditions to the receipt of federal funds.¹⁸⁶ Together with *Sebelius*, these cases demonstrate that a condition can be attached to avoiding payment of a tax, as long as the tax imposed does not constitute a penalty.

One potential argument against the Tax and Registry is that a trust registration endangers an individual’s implied right to privacy under the Due Process clause of the Fourteenth Amendment.¹⁸⁷ A similar argument has been made throughout Europe in response to the implementation of their trust registration.¹⁸⁸ However, critics of this argument emphasize the human costs of trust privacy, such as the perpetuation of wealth concentration, the increased likelihood of money laundering, the concealment of money from corruption, and tax evasion.¹⁸⁹ Furthermore, if an individual is so deeply concerned about their

¹⁸¹ *Id.* at 566.

¹⁸² *Id.* at 567.

¹⁸³ *Bailey v. Drexel Furniture Co. (Child Labor Tax Case)*, 259 U.S. 20, 36–37 (1922).

¹⁸⁴ *South Dakota v. Dole*, 483 U.S. 203, 205 (1987).

¹⁸⁵ *Id.* at 210.

¹⁸⁶ *Id.* at 211–12.

¹⁸⁷ Fern L. Kletter, Annotation, *State or Municipal Liability for Invasion of Constitutional Right to Informational Privacy Under 42 U.S.C.A. § 1983*, 65 A.L.R. Fed. 3d Art. 1 (2021).

¹⁸⁸ Carlos De Serpa Pimentel et al., *European Union: UBO Register Of Trusts The EU’s 5th Anti-Money Laundering Directive*, MONDAQ (Mar. 15, 2018), <https://www.mondaq.com/wealth-management/683096/ubo-register-of-trusts-the-eu39s-5th-anti-money-laundering-directive> [<https://perma.cc/UM2Y-XXTT>].

¹⁸⁹ See Knobel, *supra* note 11.

privacy that they wish for their trust to remain anonymous, they could choose to pay the Tax instead. Although some may try to skirt regulations by hiding their identity through listing the beneficiary of a trust as a corporation or partnership through which they are a shareholder, the crackdown on shell companies since the publication of the Pandora Papers has decreased some of this risk.¹⁹⁰

It could also be argued that the implementation of the Registry and Tax would simply result in a migration of trusts to another part of the world. However, since the United States has established itself as the “Leading Jurisdiction for Trusts,” the argument that individuals will simply move their trusts to other jurisdictions falls flat.¹⁹¹ The United States is the leader in trust secrecy and the trend around the world has been toward reform. The American trust and estate field is considerably out of step with its international counterparts, and is in fact moving further away from the norm.¹⁹² In fact, an analysis done by the Tax Justice Network named the United States as the “world’s largest enabler of financial secrecy,” surpassing other countries infamous for providing tax havens, such as Switzerland and the Cayman Islands.¹⁹³ Overall, given the United States’s reputation regarding trusts, it is unlikely that individuals will be able to successfully move their trusts to better locations.

B. Elimination of Domestic Asset Protection Trusts

As previously discussed, DAPTs and Self-Titled Trusts are commonly used for the purpose of sheltering wealth. In addition to the creation of a Registry, DAPTs should be entirely eliminated on a national scale for both legal and moral reasons.

1. Legal Basis for Eliminating Domestic Asset Protection Trusts

The elimination of DAPTs should be taken through congressional legislation under the authority of the Commerce Clause, which gives Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States.”¹⁹⁴ Under the Commerce Clause, Congress can regulate DAPTs because an individual’s ability to store their assets in trusts where the

¹⁹⁰ See *FinCEN Issues Final*, *supra* note 65.

¹⁹¹ See Sexton, *supra* note 58.

¹⁹² See Foster, *supra* note 57, at 648–51.

¹⁹³ See Sadek, *supra* note 61.

¹⁹⁴ U.S. CONST. art. I, § 8, cl. 3.

grantor is also the sole beneficiary has a negative and significant effect on commerce. Although in recent years the Supreme Court has trended away from an expansion of the Commerce Power, it remains a pillar of legislative power.

In *Sebelius*, the Court rejected the use of the Commerce Power as a justification for the Affordable Care Act's individual mandate.¹⁹⁵ The Court held that the individual mandate could not be justified under the Commerce Clause because it impermissibly compelled individuals "to *become* active in commerce by purchasing a product, on the ground that their failure to do so affects interstate commerce."¹⁹⁶ However, cases such as *Gonzales v. Raich* have demonstrated that the Court still respects the principle that economic activity, when taken in the aggregate, could have a substantial economic effect on interstate commerce and thus justify regulation by Congress under the Commerce Power.¹⁹⁷ Here, unlike in *Sebelius*, the elimination of DAPTs would not compel anyone to do anything. Furthermore, storing wealth in DAPTs and Self-Titled Trusts could have a substantial economic effect on interstate commerce when taken in the aggregate and thus justifies regulation by Congress under the Commerce Power.¹⁹⁸

In the aggregate, Self-Titled Trusts and DAPTs have a substantial and negative effect on interstate commerce in two ways. First, these types of trusts take money out of the economic system and contribute to the wealth disparity gap. Without the requirement of a third party, Self-Titled Trusts and DAPTs incentivize storing one's assets, such as art, in trusts where they can increase in value, rather than contribute to and grow the economy.¹⁹⁹ Trusts can cause real societal harm by sheltering wealth and assets from taxation.²⁰⁰ It has been argued that "[t]rusts are one of the primary vehicles used to create and perpetuate wealth concentration, enabling wealthy elites [to]

¹⁹⁵ Nat'l Fed'n Indep. Bus. v. Sebelius, 567 U.S. 519, 552 (2012) (opinion of Roberts, C.J.); *id.* at 657 (Scalia, Kennedy, Thomas, & Alito, JJ., dissenting).

¹⁹⁶ *Id.* at 552 (opinion of Roberts, C.J.).

¹⁹⁷ See *Gonzales v. Raich*, 545 U.S. 1 (2005). In *Gonzales*, medical marijuana users and growers argued that under the California Compassionate Use Act, the federal Controlled Substances Act was unconstitutionally applied to them. *Id.* at 1. The Court held that it "need not determine whether respondents' activities, taken in the aggregate, substantially affect interstate commerce . . . but only whether a 'rational basis' exist[ed]" for Congress's action. *Id.* at 22. The Court concluded that "Congress had a rational basis for believing that failure to regulate the intrastate manufacture and possession of marijuana would leave a gaping hole in the [Controlled Substances Act]." *Id.*

¹⁹⁸ U.S. CONST. art. I, § 8, cl. 3.

¹⁹⁹ See *Why the World is Saving Too Much Money for Its Own Good*, ECONOMIST (Feb. 5, 2022), <https://www.economist.com/briefing/2022/02/05/why-the-world-is-saving-too-much-money-for-its-own-good> [<https://perma.cc/T9FD-UNUC>].

²⁰⁰ See Knobel, *supra* note 11.

escape tax, regulation and creditors.”²⁰¹ Trusts enable the protection of wealth through shielding assets from creditors, tax authorities, and law enforcement and by allowing interest to accumulate over time, sometimes for generations through “[D]ynasty [T]rusts,” which are created with the express purpose of ensuring a family’s generational wealth continues to grow.²⁰² Based on the evidence proffered by the Tax Justice Network, trusts are central to the growing wealth inequality gap and therefore must be central to discussions involving inequality.²⁰³

The inequality gap, in turn, is unequivocally bad for interstate commerce based on its harmful impact on the middle class. The Organization for Economic Co-operation and Development concluded that “[t]he single biggest impact on [economic] growth is the widening gap between the lower middle class and poor households compared to the rest of society.”²⁰⁴ Additionally, the International Monetary Fund has also concluded that “inequality has . . . a direct economic cost in terms of reduced durability of growth.”²⁰⁵ This evidence by the world’s leading financial institutions demonstrates how inequality has a direct impact on interstate commerce. Congress has the right to regulate factors that significantly contribute to that inequality.

Second, Self-Titled Trusts and DAPTs create unhealthy competition between states in a bitter “race to the bottom” for the least amount of regulation, as the primary function of trusts has shifted toward preserving assets.²⁰⁶ The estate planning bar and the banking industry have both successfully lobbied for state legislative reforms that promote Self-Titled Trusts and DAPTs.²⁰⁷ The success of these lobbying efforts is evident in the expansion of trusts as asset protectors across the United States.²⁰⁸ As states compete to enact more trust friendly legislation that benefits the booming trust industry, government funds that benefit the whole population become limited as taxes

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *Inequality Hurts Economic Growth, Finds OECD Research*, ORG ECON. COOP. & DEV., <https://web-archiver.oecd.org/2014-12-09/331636-inequality-hurts-economic-growth.htm> [<https://perma.cc/5PWL-FDWM>].

²⁰⁵ Prakash Loungani & Jonathan D. Ostry, *The IMF’s Work on Inequality: Bridging Research and Reality*, IMF BLOG (Feb. 22, 2017), <https://www.imf.org/en/Blogs/Articles/2017/02/22/the-imfs-work-on-inequality-bridging-research-and-reality> [<https://perma.cc/2CGH-QYL8>].

²⁰⁶ See Pegg, *supra* note 2.

²⁰⁷ Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 WASH. & LEE L. REV. 257, 261 (2015).

²⁰⁸ *Id.*

are decreased.²⁰⁹ This “race to the bottom” lack of regulation and taxation lobbied for by the estate planning bar advantages those looking to store their assets by providing minimal taxation and maximum secrecy through Self-Titled Trusts and DAPTs.²¹⁰

As shown, there is a strong constitutional argument that can be made for regulating these trusts through the Commerce Clause. However, there is little precedent for regulating DAPTs and Self-Titled Trusts, and as a whole, there have been few Supreme Court decisions related to state regulation of trusts and estates.²¹¹ Although DAPTs exist in seventeen states, significant litigation testing enforceability of Self-Titled Trusts has yet to occur.²¹² To identify a Supreme Court decision that meaningfully impacted trust law, one must look back to *Nichols v. Eaton* in 1875, in which dictum by Justice Miller “had great influence in persuading the state courts to accept spendthrift trusts.”²¹³ This dictum contributed to the proliferation of trusts that protect assets from creditors, including DAPTs, a type of spendthrift trust.²¹⁴

2. Moral Support for Eliminating Domestic Asset Protection Trusts

Aside from the legal arguments for and against these trusts, there is also a moral argument against the accessibility of Self-Titled Trusts and DAPTs. Particularly, many have argued that DAPTs are morally reprehensible because they allow one to avoid paying their debts, even when they have the means to do so.²¹⁵ This sentiment against spendthrift trusts and their ability to shield assets from creditors has been expressed as far back as 1895:

[I]t is hard to see the Americanism of spendthrift trusts. That grown men should be kept all their lives in pupilage, that men not paying

²⁰⁹ *Id.* at 309.

²¹⁰ *Id.*

²¹¹ J. Gordon Hylton, *The U.S. Supreme Court's Most Important Decision Affecting the Law of Trusts & Estates Was Decided a Very Long Time Ago*, MARQUETTE UNIV. L. SCH. FAC. BLOG (Oct. 31, 2010), <https://law.marquette.edu/facultyblog/2010/10/the-u-s-supreme-courts-most-important-decision-affecting-the-law-of-trusts-estates-was-decided-a-very-long-time-ago/> [<https://perma.cc/K3ZR-4KTG>].

²¹² Greene, *supra* note 53; Brendan Duffy, *In States We “Trust”: Self-Settled Trusts, Public Policy, and Interstate Federalism*, 111 NW. U. L. REV. 205, 218 (2016).

²¹³ HELENE S. SHAPO, GEORGE G. BOGERT, & GEORGE T. BOGERT, *BOGERT'S THE LAW OF TRUSTS AND TRUSTEES* § 222 n.4; Hylton, *supra* note 211; Cheyenne VanKirk, *Domestic Asset Protection Trusts: Ushering in the Klabacka Era*, 42 SEATTLE U. L. REV. 1559, 1563–64 (2019).

²¹⁴ VanKirk, *supra* note 213, at 1559, 1560, 1563.

²¹⁵ JOHN CHIPMAN GRAY, *RESTRAINTS ON THE ALIENATION OF PROPERTY* 137, 247 (1883).

their debts should live in luxury on inherited wealth, are doctrines as undemocratic as can well be conceived . . . The general introduction of spendthrift trusts would be to form a privileged class, who could indulge in every speculation, could practice every fraud, and yet, provided they kept on the safe side of the criminal law, could roll in wealth. They would be an aristocracy, though certainly the most contemptible aristocracy with which a country was ever cursed.²¹⁶

Furthermore, it is worth recognizing that art is a vital, precious reflection of our culture and the public benefits from the ability to see itself depicted through artwork by the greatest masters, past and present. The particular pieces of art that are most likely to be stored in trusts are also the most likely to be culturally significant pieces that will appreciate in value over time.²¹⁷ For that very reason, the US government should not create systems that allow some of the world's greatest works of art to go unseen, and at the very least should not incentivize this from happening through opaque trusts that shield assets from creditors, often untaxed.

Even if the elimination of DAPTs is unlikely to occur in the near future, states, at a minimum, should place significant limits on the ability of nonresidents to form DAPTs. The Uniform Voidable Transactions Act (UVTA) offers a temporary solution that could allow for DAPTs to become more difficult to access.²¹⁸ In states where DAPTs are not legal, the UVTA “place[s] significant additional limits on the use of DAPTs by residents of non-DAPT states.”²¹⁹ By limiting DAPTs of nonresidents, the usage of DAPTs overall will likely decrease. The issue of whether nonresidents of DAPT states may form a DAPT in another state is still contested, and thus opens the door to this temporary solution that could allow for DAPTs to become more difficult to access. Experts in trust and estate law suggest that the “most likely test” to determine whether one can open a DAPT in a state of which they are not a resident “is whether the nonresident’s domiciliary state has a ‘strong public policy’ against DAPT asset protection.”²²⁰ Therefore, it is likely that courts would find a strong public policy against DAPT asset protection in states where the UVTA is enacted, and a DAPT trust formed by someone from a UVTA state would be invalid.

²¹⁶ *Id.* at 246–247.

²¹⁷ Bowley, *supra* note 121.

²¹⁸ As of October 2023, twenty-three states have adopted the UVTA. CARRIE V. HARDMAN & DAVID NEIER, CREDITORS’ RIGHTS IN BANKRUPTCY § 11:2 (2d ed. last updated Oct. 2023).

²¹⁹ Merric, *supra* note 53.

²²⁰ Shaftel, *supra* note 51, at 14.

In sum, the elimination of Self-Titled Trusts and DAPTs through congressional legislation could significantly help to reduce tax evasion and tax avoidance through the trust system. In addition to being morally dubious, DAPTs negatively impact interstate commerce when aggregated, because they take money out of the economy and contribute to growing inequality in the United States. In the meantime, the UVTA offers a viable, albeit temporary, state-level solution to this burgeoning issue.

C. *Regulation of Freeports*

Another way in which Congress should address tax avoidance through physical art is the regulation of freeports, notorious tax havens that operate largely outside the purview of the government.²²¹ There are currently 293 freeports in the United States.²²² Congress should regulate these freeports by incentivizing states to (1) adopt a six-month time limit on goods meant for export in any freeport, (2) require buyers to declare whether they plan to export the goods or store them permanently in the freeport, and (3) mandate the registration of a buyer's name and address. These proposed regulations are based on the Swiss model of freeport regulation, which became effective January 1, 2016.²²³ After Switzerland implemented these regulations, it was said that “[t]he days of collectors hiding their prized artworks from tax authorities could be numbered.”²²⁴ These measures were meant to delineate between goods meant for export and goods intended for storage, the distinction of which determined the necessary taxes owed.²²⁵

The Swiss government claimed that the tightened regulations would assist authorities in their efforts against money laundering by providing more transparency.²²⁶ It has been shown that storing high value goods for long periods of time is “indicative of illegal storage for the purpose of tax optimization or to circumvent trade regulations on cultural goods or weaponry.”²²⁷ The effectiveness of these measures has

²²¹ Zarobell, *supra* note 109, at 2.

²²² Petar Chakarov, *USA Free Zones in 2023*, HEALY CONSULTANTS, <https://www.healyconsultants.com/usa-company-registration/free-zones/> [https://perma.cc/3D6F-BC9C].

²²³ Henri Neuendorf, *Switzerland's Tough New Stance on Freeports Will Shake the Art World*, ARTNET (Nov. 19, 2015), <https://news.artnet.com/market/switzerland-freeport-regulations-367361> [https://perma.cc/D298-DYQL].

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ *Id.*

²²⁷ *Id.*

been tested by the war in Ukraine, which has resulted in sanctioned Russian officials turning to freeports to hide their assets.²²⁸ Since the invasion of Ukraine in 2022, the Swiss Federal Office for Customs and Border Security has seized goods in 112 cases, although it is unclear whether the new regulations have directly contributed to these seizures.²²⁹

Despite the potential benefits of these regulations, concerns about them have also been raised. Promoters of freeports argue that increased regulation of freeports could negatively impact the art market by discouraging sales, and that the tax breaks and secrecy “encourage reinvestment into the economy,” create jobs, and decrease the costs of doing business.²³⁰ Freeport proponents also argue that regulation of freeports in one country simply shifts the market for tax-free storage of goods to another country and that country-by-country regulation is ineffective.²³¹ Although this may be true in regard to smuggling art and looted goods, instituting a time limit, such as six months, in addition to requiring the disclosure of a buyer’s identity for goods meant to be exported, can be an effective route to preventing tax avoidance by preventing buyers from hiding from tax authorities in anonymity.

D. *Rejoining the United States Educational, Scientific and Cultural Organization*

Lastly, to further combat a rise in art trafficking and money laundering, the United States should rejoin UNESCO, and repay the \$600 million owed in back dues. UNESCO, often referred to as the UN’s cultural organization, is perhaps best known for its protection of Cultural Heritage Sites, which are places around the world that benefit from protection by the UN and other government organizations.²³² Once designated, an official Cultural Heritage Site located in a “developing countr[y]”

²²⁸ Olivia Chang, *Russian War in Ukraine Renews Pressure on Swiss Free Ports*, SWI SWISSINFO.CH (June 17, 2022) <https://www.swissinfo.ch/eng/business/russian-war-in-ukraine-renews-pressure-on-swiss-free-ports/47671636> [<https://perma.cc/P4CN-TC6B>].

²²⁹ *See id.*

²³⁰ Daniela Tanico, *The Secret Lives of Freeports: An Analysis of the Regulation of Freeports and the Illicit Antiquities Inside*, 45 *FORDHAM INT’L L. J.* 717, 725 (2022).

²³¹ *See* Neuendorf, *supra* note 223.

²³² Gardiner Harris and Steven Erlanger, *U.S. Will Withdraw From Unesco, Citing Its ‘Anti-Israel Bias,’* N.Y. TIMES (Oct. 12, 2017), https://www.nytimes.com/2017/10/12/us/politics/trump-unesco-withdrawal.html?_r=0 [<https://perma.cc/HWW4-C3JE>]; UNESCO, NAT’L GEOGRAPHIC: RES. LIBR., <https://education.nationalgeographic.org/resource/unesco> [<https://perma.cc/Q2C8-SE4C>].

can receive grants from UNESCO's preservation fund.²³³ After playing a significant role in its founding, the United States racked up a tab of unpaid dues totaling nearly \$600 million, and then withdrew from the organization in 2019 based on "anti-Israel bias."²³⁴ Although the United States stopped paying its dues to UNESCO back in 2011 based on the organization's admittance of Palestine as a member, the withdrawal sent a "profoundly negative message, akin to the U.S. announcing its withdrawal from the Paris Climate Accord earlier this year."²³⁵

The United States's withdrawal from this critical organization, and its lack of financial contribution throughout the last decade, potentially puts cultural artifacts at increased risk of theft and trafficking—means through which they will likely end up in freeports. By rejoining UNESCO, the United States has the potential to prevent instances of looting and the illegal sale of cultural artifacts by bad actors, such as British art dealer Douglas Latchford.²³⁶ According to a UNESCO report, freeports lure criminals hoping to use the government tax breaks to their advantage.²³⁷ The United States's participation in this organization sends a message to the world about the value of cultural heritage. Furthermore, the financial support from the United States will contribute significantly to the organization's ability to adequately protect some of the world's most significant objects through its preservation fund.

CONCLUSION

The United States has become a magnet for those who wish to store their wealth in art and pay minimal taxes as their art continues to accumulate value. Through mechanisms like trusts and freeports, art can sit for decades and contribute to an individual's or families' long-term hold on millions of dollars, often the sum of which is minimally taxed. This

²³³ Paul Vallely, *The Big Question: What is a World Heritage Site, And Does The Accolade Make A Difference?*, INDEPENDENT (Nov. 7, 2008), <https://www.independent.co.uk/news/world/politics/the-big-question-what-is-a-world-heritage-site-and-does-the-accolade-make-a-difference-997955.html> [<https://perma.cc/5SUA-U9KE>].

²³⁴ See Angela Charlton & Matthew Lee, *U.S. Plans to Rejoin UNESCO and Pay \$600 Million in Back Dues*, PBS (June 12, 2023) <https://www.pbs.org/newshour/world/u-s-plans-to-rejoin-unesco-and-pay-600-million-in-back-dues> [<https://perma.cc/TZT6-SBWL>].

²³⁵ Isaac Kaplan, *The U.S. Is Withdrawing from UNESCO—What Happens Now?*, ARTSY (Oct. 13, 2017), <https://www.artsy.net/article/artsy-editorial-withdrawing-unesco-now> [<https://perma.cc/4JN4-LBDK>].

²³⁶ Cascone, *supra* note 16.

²³⁷ U.N. EDUC., SCI. & CULTURAL ORG., FREEPORTS AND THE RISKS OF ILLICIT TRAFFICKING OF CULTURAL PROP. 2 (Sept. 29–30, 2016), <https://unesdoc.unesco.org/ark:/48223/pf0000372793> [<https://perma.cc/VCS2-CVPY>].

“onshore” tax problem was blown open by the Pandora Papers, but little has been suggested in terms of addressing the art collections that contribute to this problem. Although legislation has been passed to address money laundering and the proliferation of shell companies,²³⁸ the underlying problem is much larger. Beyond illegal activity, tax avoidance and storage of art in Self-Titled Trusts or DAPTs causes real, measurable harm to the US economy. Inequality has been shown to be one of the greatest threats to the economic stability of the middle class and democracy as a whole. If the US government only addresses the illegal underbelly of the art trade, art collection as investment will continue to contribute to the growth of inequality as art sits comfortably, often untaxed, in trusts and freeports across the country.

As art and NFTs become increasingly seen as asset classes, the lack of taxation and oversight will balloon. To curb tax avoidance and the use of art as a mechanism for increasing one’s wealth, this note proposes several solutions. First, there should be a centralized trust registration system established through Congress’s taxing powers. Registration would be mandatory unless one chooses instead to pay an 8 percent tax on their assets and reveal the total holdings of the trust. Second, Self-Titled Trusts should be made illegal under the Commerce Clause, based on their contribution to wealth inequality, a known cause of economic harm for the middle class. Third, freeports should be more tightly regulated, including the imposition of a six-month time limit on goods stored within them. Lastly, the United States should rejoin UNESCO. The funds the country would contribute to UNESCO would greatly benefit the world’s ability to preserve cultural objects and heritage and avoid the looting of art altogether. These measures, taken together, can begin to walk back the use of art as a vehicle for wealth accumulation and monetary value, and allow art to exist, primarily, as objects of beloved, cultural value.

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²³⁸ See *FinCEN Issues Final Rule*, *supra* note 65.

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