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Freeports: An Introduction to the Next Battleground of International Tax Avoidance

Charles F. Whitten*

On November 15, 2017, headlines across the world reported that Salvator Mundi, a painting attributed to Leonardo da Vinci, sold for a record $450.3 million at an auction house in New York City.[1] The apparent tax implications that would arise based on where the painting would be brought after the sale garnered fewer of these headlines.[2] Because of how the state of New York structures its sales tax, the buyer of the painting, rumored to be Saudi Arabia's Crown Prince Mohammed Bin Salman, would not be required to pay the 8.875 percent city and local sales taxes if the painting were moved outside the United States.[3]

While the ultimate destination of Salvator Mundi remains unknown, one former CIA Officer explained that the painting's journey has opened people's eyes to how art or other valuable items can be moved through freeports to avoid or defer taxation.[4] While no universally accepted definition of freeport exists, they can generally be understood as areas that are designed to encourage economic activity that is specifically related to importing, processing, and re-exporting goods.[5] Goods that are stored at freeports, are considered "in transit" and thus not taxed until they are

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[1] Kelly Crow, *Leonardo da Vinci Painting 'Salvator Mundi' Smashes Records With $450.3 Million Sale*, N.Y. TIMES (Nov. 16, 2017, 12:01 AM), https://www.wsj.com/articles/leonardo-da-vinci-painting-salvator-mundi-sells-for-450-3-million-1510794281?mod=article_inline\.

[2] Karen Matthews, New York City Not Likely to Tax World's Priciest Painting, a da Vinci, After Record-Setting Sale, NBC NEW YORK (Dec. 8, 2017), https://www.nbcnewyork.com/news/local/leonardo-da-vinci-nyc-auction-record-salvator-mundi/366569/.

[3] *Id.*

[4] Dalya Alberge, *How did a £120 painting become a £320m Leonardo … then vanish?*, THE GUARDIAN (June 13, 2021), https://www.theguardian.com/artanddesign/2021/jun/13/how-did-a-120-painting-become-a-320m-leonardo-then-vanish.

[5] Eoin McLoughlin, Overview of Freeports or Free Zones, 1 (2020).

imported into their final destination.[6] The end result generates a system where art and other luxury goods can be traded and stored at some freeports for indefinite periods of time without owing tax and duty payments while the goods remain at these locations.[7] While the incentives provided by freeports can differ based on their geographic location, they remain designed to encourage economic activity through the creation of new jobs and lowering tax burdens on companies and private individuals.[8]

The origins of the current freeport model can be traced back to the 19th century when such facilities served as temporary storage for grain, tea, and industrial goods.[9] The luxury freeports of today, however, are distinct from their historical predecessors.[10] The Geneva Freeport, perhaps one of the world's most well-known freeports, once focused on the temporary storage of grain and other commodities but has evolved into its current form of storing art and other high-value items for extended periods of time.[11] Dubbed as "the greatest art collection no one can see," it is estimated that the Geneva Freeport houses between $80 to $100 billion in assets.[12]

Since the 1990s, the Geneva Freeport has found itself at the center of numerous controversies including the storage of looted antiquities and money laundering schemes enabled by laws providing anonymity to buyers and sellers.[13] Interestingly, the recent rise in popularity of art as an investment vehicle has coincided with the gradual discontinuation of bank

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[6] 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, 721 (2022).
[7] Oddný Helgadóttir, The New Luxury Freeports: Offshore Storage, Tax Avoidance, and 'Invisible' Art, ENV'T AND PLAN. A: ECONOMY AND SPACE, 3 (2020).
[8] Tanico, *supra*, note 6 at 725.
[9] 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.
[10] Helgadóttir, *supra*, note 7 at 4.
[11] Katie L. Steiner, *Dealing with Laundering in the Swiss Art Market: New Legislation and Its Threats to Honest Traders*, 49 CASE W. RES. J. INT'L L. 351, 355 (2017).
[12] Deloitte & ArtTactic, Art & Finance Report 2019, 237 (6th ed. 2019).
[13] *Id.* at 360-664.

secrecy within the Europe Union (EU) and Switzerland.[14] Swiss authorities have responded to these issues by implementing laws requiring freeport managers to keep lists of tenants and their goods being stored in the area as well as imposing a limitation on the amount of time a new item brought into a freeport may remain there.[15]

The risks of tax avoidance and money laundering associated with freeports have not gone unnoticed. In 2006, with the aim of bringing clarity to the role of customs laws in freeports, the World's Customs Organization developed new specific protocols to address the regulatory framework of freeports.[16] In 2019, the European Parliament called for freeports to be phased out entirely in the EU after investigations into several tax avoidance scandals including the Panama Papers and the LuxLeaks.[17] These concerns, however, are not shared by all. In 2021, the United Kingdom's government announced plans for the creation of freeports around the UK to attract investment.[18] Likewise, Japan has begun to introduce tax reforms aimed at eliminating import procedures and payment of duties and taxes within freeports with the ultimate goal of becoming the next art hub of Asia.[19]

The introduction of duty-free zones to attract foreign investment is not a new practice, and neither is it one that only functions abroad. During the

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[14] Ron Korver, *Money Laundering and Tax Evasion Risks in Free Ports*, 17 EURO. PARLIAMENTARY RSCH. SERV. 17 (Oct. 2018), https://www.europarl.europa.eu/cmsdata/155721/EPRS_STUD_627114_Money%20laundering-FINAL.pdf.

[15] Tanico, *supra*, note 6 at 736.

[16] *Id.* at 730.

[17] Naomi Rea, *In an Effort to Fight Money Laundering, the EU Parliament Wants to Scrap the Freeport System Beloved by Billionaire Art Collectors*, ARTNET NEWS (Apr. 3, 2019), https://news.artnet.com/art-world/eu-calls-scrap-freeports-1507435; The Panama Papers and LuxLeaks were two scandals where documents leaked to investigative journalists detailed how individuals and companies around the world avoided taxes and laundered hundreds of billions of dollars. *See* Davis VanOpdorp, *The biggest tax evasion data leaks in history*, DEUTSCHE WELLE (Nov. 7, 2017), https://www.dw.com/en/from-panama-to-paradise-the-biggest-tax-evasion-data-leaks-in-history/a-41277967.

[18] Paul Seddon, *Freeports: What are they and will they help the economy?*, BBC (Feb. 14, 2021), bbc.com/news/uk-politics-55819489.

[19] Deloitte & ArtTactic, Art & Finance Report 2021, 50-51 (7th ed. 2021).

Great Depression, Congress passed the Foreign Trade Zones Act of 1934 as a way to "expedite and encourage foreign commerce."[20] While not identical to freeports, these foreign-trade zones (FTZs) employ special customs procedures that offset customs advantages available to overseas producers who compete with producers located in the United States.[21] Today, 299 FTZs operate across the United States permitting businesses to make use of procedures that exempt duties on goods that are re-exported and defer other duties on goods that are imported. [22]

The establishment of new freeports comes not only at a time when many on the world stage are calling for the closure of such facilities but also as concerns over a global recession increase.[23] Just as the United States responded to the Great Depression with the creation of FTZs, other countries may pursue freeports as an opportunity to encourage foreign investment during a general decline in economic activity. The world's freeports that appear in the wake of a financial crisis may have a dramatic effect on efforts to combat international tax avoidance and money laundering.

Time is of the essence. Rather than waiting for further issues to materialize, the United States and other members of the international community would be wise to take proactive measures to respond to freeport expansion. By identifying regulatory gaps associated with existing freeports, a more equitable system of taxation can be created going forward.

Ultimately, proposals by foreign countries to establish new freeports with loose restrictions should be met with skepticism. While these efforts may be couched in language of attracting foreign investment and liberalizing trade, such endeavors would only add to ongoing issues related to international tax avoidance and money laundering.

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[20] *See* United States Foreign Trade Zones Act, 19 U.S.C. §§ 81a-81u (1934).

[21] Int'l Trade Admin., Dep't Com., *U.S. Foreign-Trade Zones*, https://www.trade.gov/about-ftzs.

[22] Int'l Trade Admin., Dep't Com., *Zone Information*, https://ofis.trade.gov/Zones.

[23] Press Release, The World Bank, Risk of Global Recession in 2023 Rises Amid Simultaneous Rate Hikes, (Sept. 15, 2022), https://www.worldbank.org/en/news/press-release/2022/09/15/risk-of-global-recession-in-2023-rises-amid-simultaneous-rate-hikes.

With the possibility of freeport expansion coinciding with a potential economic downturn, an evaluation of freeport regulations and the risks associated with specific tax incentives is necessary to bring order to this chaotic system.

Edited by Allison Frisella