



TAXATION AND CULTURAL HERITAGE

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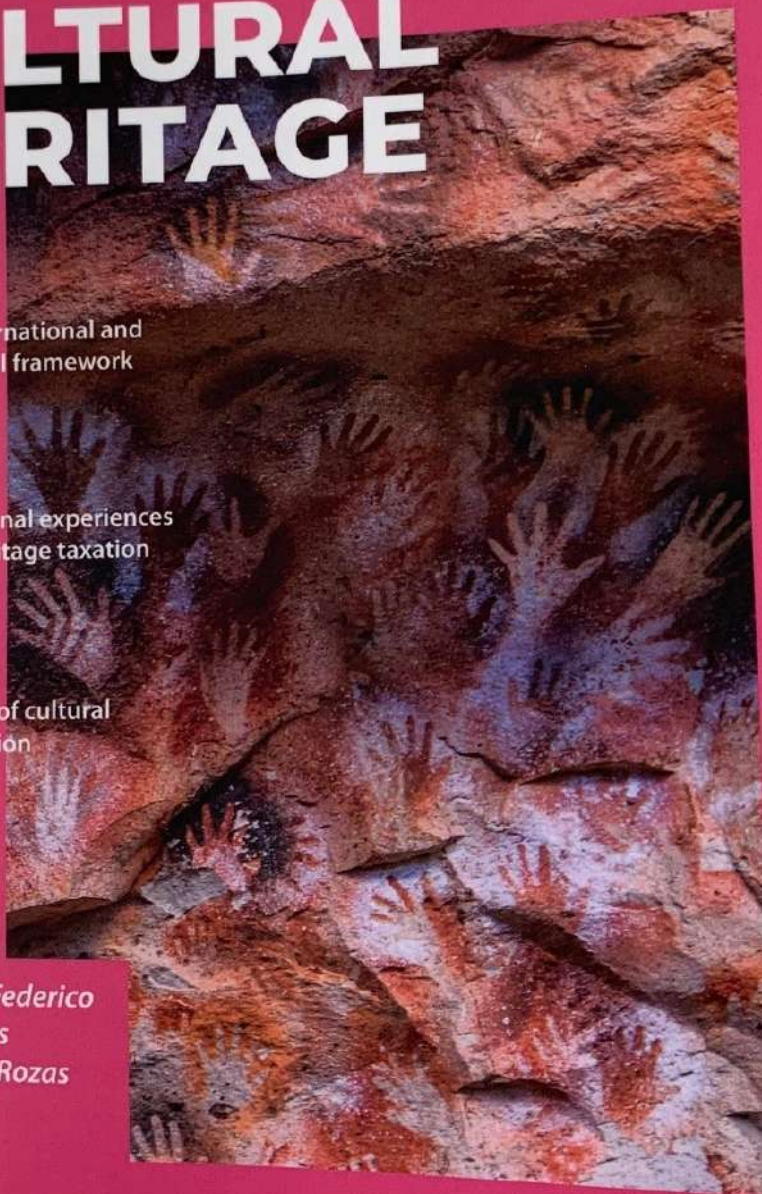
Editors

Lorenzo del Federico

Sigrid Hemels

José-Andrés Rozas

Silvia Giorgi



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Chapter 25

Tax Incentives for Artists and Contemporary Art

Dick Molenaar*

25.1. Introduction

Cultural heritage can be supported with tax incentives for artists. They play an important role in cultural heritage because they create what can be shown or they assist with preserving and restoring pieces created by others, often decades before. Developed societies find it important for there to be enough artists to contribute to preservation, experimentation, new directions, developments, opinions, discussions and insights. These societies believe that their own quality is related to the amount of freedom with which artists can work and create their art and present it to the public. This means that they prefer to have more artists than the economic balance of the market would allow and, therefore, create funding for artists, either through subsidies or through tax incentives.

Another reason for these tax incentives may be that governments find the market position of artists vulnerable, which leads to lower income than desired. In ancient times, artists were financially supported by benefactors, but this been taken over mainly by the government. Tax incentives are different from subsidies because they create opportunities for more economic activity by the artists in order to obtain the financial advantage.

The protection and stimulation of the culture and heritage of a country may also be a reason for tax incentives. In the globalizing world, the cultural influence of other countries can become overpowering, and a country can take measures to protect its own culture with tax incentives. This is combined with the acknowledgement of the contributions of artists and culture to the economy, which might be increased with tax incentives, not only in the country itself, but also as an export product abroad.

This chapter will discuss tax incentives in Ireland (section 25.2.), Belgium (section 25.3.), Mexico (section 25.4.) and the United States (section 25.5.) and will explain where artists, companies and institutions in cultural herit-

* Partner, All Arts Tax Advisers, Rotterdam; researcher, Erasmus University Rotterdam School of Law.

age and contemporary art are taxed when they have income from sources in other states. VAT is not mentioned as a tax incentive in this chapter, notwithstanding the fact that it can be of importance for artists, because it was already discussed in chapter 19.

25.2. Ireland: Exemption from income tax for artists

Income earned by writers, composers, visual artists and sculptors from their work is exempt from tax in Ireland under certain circumstances. The exemption scheme was introduced in 1969 to support artists and make it possible for them to experiment and create new work without the pressure of tax payments.

The scheme resulted in many artists, composers, musicians and writers located in Ireland to take advantage of the benefits. A small number of high earners were said to profit hugely from the scheme with their income being totally exempt from tax. This led to debate in Ireland in 2004 over the need to review this tax incentive scheme. The government believed that the concept of unrestricted relief was no longer acceptable to the general taxpaying public. However, a survey also noted that many visual artists lived below the poverty line: 67% earned less than EUR 10,000 per year from their creative works, and a further 24% earned between EUR 10,000 and EUR 25,000, which meant that they were dependent on other work and support to make ends meet. Influenced by a recommendation of the European Commission in 2006, the tax exemption was capped at EUR 250,000 per year. However, because of the 2008 economic crisis, this was lowered to a maximum of EUR 40,000 per year in 2011 and then raised to EUR 50,000 in 2015.¹

The Revenue Commissioners are allowed to determine whether certain artistic works are original and creative works generally recognized as having cultural or artistic merit. Earnings from these works are exempt from income tax for the year in which the claim is made.²

The Revenue Commissioners can make determinations in respect of artistic works in the following categories:

- books and other forms of writing;

1. The artist's exempt income is subject to the Universal Social Charge (health insurance) and PRSI (other social insurance schemes) at the appropriate annual rates.
2. IE: Taxes Consolidation Act, sec. 195 (1997).

- plays;
- musical compositions;
- paintings and other similar pictures; and
- sculptures.

Guidelines have been drawn up to determine whether a work is an original and creative work and whether it has cultural or artistic merit.

The term "original and creative" encompasses any unique work that is brought into existence for the first time as an independent entity by the use of its creator's imagination. It is not necessary that the work has both cultural and artistic merit: the presence of either quality is sufficient. A work has cultural merit when its quality of form and/or content significantly enhances one or more aspects of national or international culture, and it has artistic merit when its quality, form and/or content enhances the standard of work in the relevant category to a significant degree.

The following payments are exempt from tax from when they are made to an artist who has received an artist's exemption:

- payments from the sale of works that are considered eligible under the artist exemption scheme;
- Arts Council bursaries, when paid directly to the artist;
- consideration for residencies, when paid directly to the individual by the Arts Council for the purpose of producing a qualifying work;
- *cnuas* payments (5-year grant) made under the Aosdána Scheme;³ and
- advance royalties.

Initially, artists had to be resident in Ireland to qualify for the exemption. They were allowed to leave the country for a period of time and still retain the tax-exempt status so that they could travel outside of Ireland to promote their work and widen their experience. However, in 2006, under the threat of forbidden State aid, this was changed, and now, artists must be resident in an EU Member State or in an EEA country in order to apply for the exemption.

However, it very often happens that non-resident artists will not profit from the Irish exemption because they have to mention the Irish income in the income tax returns of their residence state as part of their worldwide income and will be taxed there accordingly. They will not receive a tax exemption in their residence state because the Irish income will fall under

3. See <http://aosdana.artscouncil.ie/> (accessed 26 Oct. 2021).

article 7 (business profits) or article 12 (royalties) of the OECD Model Tax Convention (OECD Model),⁴ and these articles do not give the taxing right to the source state (Ireland).

This is only different when the non-resident artist has a fixed place of business in Ireland, giving Ireland the taxing right under article 7(1) and article 12(3) of the OECD Model. Then, it depends on the method of elimination of double taxation under article 23 of the OECD Model as to how this will work out in the residence state: either a tax exemption with or without a subject-to-tax provision or a tax credit.

Permanent establishments (PEs) of artists in Ireland are rare, which means, in practice, that basically only Irish-resident artists will profit from this Irish tax exemption.

25.3. Belgium: Special tax scheme for copyright income

Individual copyright holders fall under a special tax regime in Belgium since 2009. The Belgian government wants to support the creation of copyright and strengthen the financial position of copyright holders and is aware that the creative process may take many years, while the income can be received later in a short period of time. This means that the progression in the tax rates can hit harder than when the income would be divided over the total period. Therefore, Belgium has come up with a special tax regime for copyright income, which applies to literature, art, sculptures, paintings, drawings, music, choreography, databases, computer software, etc.

The special tax scheme works as follows (figures for 2020):

- a fixed tax rate of 15%, up to EUR 62,090 profit after forfait expenses/normal tax rates above this profit;
- a forfait deduction for expenses of 50% for income of up to EUR 16,560;
- a forfait deduction for expenses of 25% for income between EUR 16,560 and EUR 33,110; and
- no forfait deduction for expenses for income above EUR 33,110 earnings.

The payer of the copyright income needs to apply a withholding tax and pay this to the Belgian tax authorities. The artist (or other copyright holder)

4. OECD Model Tax Convention on Income and on Capital (21 Nov. 2017), Treaties & Models IBFD.

has to mention the gross copyright income in their yearly income tax return and apply the forfait expenses and the tax rate, after which the withholding tax can be deducted. Most often, the tax amounts are equal, but mentioning them in the tax return makes it possible for the government to levy the municipal surcharge of the Belgian federal income tax on the copyright income.⁵ This leads to a slightly higher effective tax rate.

25.4. Mexico: Artists can pay taxes with their artwork

Pago en especie (payment in kind) is the tax arrangement in Mexico for painters, sculptors and other graphic artists to donate part of their annual production of artwork as an alternative to paying federal taxes. This programme started in 1957 after an agreement between artists David Alfaro Siqueiros and Secretary of State Hugo Margain. It was a proposal to keep a friend and fellow artist out of jail because of tax evasion, saying: “Let him pay his debt in art.” The Secretary was convinced and made this possible for many Mexican artists. In 1975, the *pago en especie* programme became an official part of the Tax Code.

Artists who sell five or fewer pieces per year may give one piece to the government. Artists who sell six to eight pieces may give two, and so on, until the six-piece donation cap is reached. Relieved of the paperwork, audits and counting pesos, an artist can devote themselves completely to their creativity and take pride in knowing that the work they submit on tax day will become part of the national repository.

In return, Mexico has collected a huge collection of contemporary art from Mexican artists, including around 7,000 paintings, sculptures and graphics, which are shown on walls and in open spaces of public buildings across Mexico. However, not every Mexican artist qualifies. A rotating committee of seven artists and curators evaluates proposed art donations to see whether they fairly represent (in terms of size and technique) the essential aspects of the work of the artist. The committee makes no effort to censor the art, regardless of how graphic or provocative it is.

If the art is of particularly high calibre, it becomes part of the “national heritage collection”, which is displayed in a permanent exhibition in Mexico City. Certain pieces are also sent abroad to foreign museums. Mexican

5. BE: Income Tax Act art. 17, § 1(5) and art. 37(2) (1992).

artists are proud of the programme, knowing that their art becomes part of a historic collection that reflects Mexico's creative heritage.

Pago en especie does not help the tax situation in Mexico, and the government has never calculated the total tax revenue lost to the programme, but promoting the arts is important enough in Mexican culture to outweigh that lost revenue. The programme continues to enjoy the support of the Mexican art community and the taxpaying public at large. There are many reasons for this, including the ease of payment and the collective pride in the ever-growing national collection. The Mexican government has repeatedly justified *pago en especie* as a means of collecting cultural pieces that reflect Mexico's national heritage. In this way, *pago en especie* highlights Mexico's contemporary artwork with pieces that link the past, present and future of the country.⁶

25.5. Stimulus for the US contemporary art market

The emergence of the market for pop and other contemporary art was facilitated in part by interesting tax deductions. This started in the 1950s in the United States with the use of financial structures that were leveraged by generous income tax deductions and supported the development of a lucrative modern art market. The United States was important after World War II, as Europe was in ruins and influential European artists had found asylum in the United States during the War. Although US soldiers had fought all over the world against the enemies, the US territory itself had not been part of the war. This made it possible for the US cultural market to become active much earlier than other markets.

During and after the war, the United States had high personal income rates. The top rate was 94% up until 1964, when it was brought down to 70%. In 1981, under President Reagan this top rate was 50%. This meant, for many years, that creating tax deductions was very profitable.

In the 1950s and 1960s, gallerists were promoting work from young artists, such as Jasper Johns, Jackson Pollock and Andy Warhol, and selling their pieces of art as soon as they were made by these artists. The art buyers kept

6. E. Hershaw, *In Mexico, Artists Can Pay Taxes With Artwork*, The Atlantic (11 Apr. 2014); and J.L.M. Bogdanovich, *Devising an Artful Tax: An Appraisal of Payment-In-Kind Income Taxes in Mexico*, 164 *University of Pennsylvania Law Review*, p. 983 (2016).

these paintings (and sculptures) for some years and then donated them to museums. These were charitable institutions, so the donations became tax deductible. As no market price was present, it made it possible to come with high valuations to maximize the tax effect. The personal capital gain was not taxable for the art buyer, and the higher value of the paintings (and sculptures) did not affect the museums. A high value combined with the high tax rate could lead to more tax advantages than the initial purchase price of the art piece. Gallerists were helping with appraisals of art pieces, also for clients who were buying new paintings and sculptures from their galleries.⁷ This very much stimulated the art market for minimalist and pop art in the 1950s and 1960s.

At the end of the 1950s, more and more valuations were made by the Art Dealers Association (ADA), the organization for commercial galleries. The ADA tried to give these valuations a more objective profile, but even after it started to charge fees for their valuations, it was still very hard to maintain an independent image, as it was also important for its members to maintain good relationships with their customers in the elite contemporary art world.

In response to the appraisal abuse, the US Internal Revenue Service (IRS) created its own Art Advisory Panel in 1968. This Panel still exists today and currently consists of 25 art experts who meet twice a year to assist the IRS in reviewing art appraisals and make recommendations to the IRS Office of Appeals. The IRS now also allows taxpayers to apply for a Statement of Value, supported by a qualified appraisal, if the claim for a charitable contribution is over USD 50,000, for which it charges a fee of USD 2,500. Such application can be made before the income tax return is filed so that certainty can be achieved in advance. Despite this, overvaluations are still possible, leading to high tax deductions.⁸

With lower personal income tax rates – not only in the United States, but also in other countries – the profitability of this tax deduction also decreases. It also happens in some countries that these deductions can no longer be applied against the top tax rate, but only at a lower marginal income tax rate.⁹

7. W.M. Speiller, *The Favoured Tax treatment of Purchasers of Art*, 80 *Columbia Law Review*, p. 214 (1980).

8. M.W. Maizels & W.E. Foster, *The Gallerist's Gambit: Financial Innovations, Tax Law and the Making of the Contemporary Art Market*, 42 *Columbia Journal of Law & the Arts* 2 (2019).

9. For example, the Netherlands changed, per 2019, to two tax brackets of 37% (for up to EUR 68,000 in income) and 49.5% (for over EUR 68,000 income), but it financed this with the restriction that tax deductions can only be made against the lower rate of 37%.

25.6. Allocation of taxing rights under bilateral tax treaties

25.6.1. Taxation in two states: Bilateral tax treaties

Most states have a withholding tax in their national tax legislation for non-residents earning income in that state. This is a method against tax avoidance and non-compliance for the situation in which a non-resident would not report their income in their residence state or any other state, and it raises tax revenue for the source state. At the same time, residence states will tax the worldwide income of its residents, regardless of where it is earned. This means that international income can easily be taxed twice, both in the source state and in the residence state. Inevitably, this would obstruct international work, and, therefore, already 100 years ago, states started to conclude bilateral tax treaties with each other in which taxing rights are allocated and double taxation is eliminated. Since 1963, this is coordinated by the OECD in Paris with the OECD Model, which was followed up by a comparable UN Model Tax Convention.¹⁰ Almost every state in the world follows these Models in their approaches to tax treaty negotiations. There is a wide network of tax treaties all over the world, and developed countries have between 50 and 110 bilateral tax treaties each with other countries.

25.6.2. Article 7 on business profits

International artists, companies and institutions in the field of both cultural heritage and contemporary art normally fall under article 7 of the OECD Model, which is reserved for business profits, because they are working independently. Article 7 allocates the taxing right to the residence state of the artist, company or institution, unless the work in the other state is done through a PE. Without a PE, the source state does not have a taxing right over the income of non-resident artists, companies and institutions, although it might be the case that an administrative procedure is needed in order to obtain an exemption in the source state.

10. *United Nations Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD.

25.6.3. Tax advantage and less administration

It is an advantage for international work that, with the correct application of article 7 on business profits, withholding tax in the source state can be prevented. In that case, only taxation in the residence state applies, which means that the deductibility of expenses is clear, special tax deductions and allowances can be used in the best way and administrative expenses can remain low. No withholding tax at source means that the foreign income can be reported in the same manner as domestic income. This makes taxation much easier than when tax returns also need to be prepared and filed in other states in order to eliminate excessive international taxation.

25.6.4. Exemption in the source state necessary

It is important to apply for an exemption in the source state, because if not, the source tax is levied and no tax relief will be given in the residence state. The tax authorities in the residence state will then refer back to the source state to claim a tax refund there, as that state did not have the taxing right under article 7 of the applicable tax treaty.

25.6.5. PE in the source state

When the artist, company or institution has a PE in the source state, this state has the taxing right over the profit arising from this PE. This makes the allocation of income and expenses more complicated because, not only direct but also indirect income and expenses can be part of the profit of the PE. Separate administration is needed in order to adequately fulfil the reporting requirements regarding the profit in the PE state. Conversely, the residence state will also tax the foreign PE profit as part of the worldwide income, but it will allow either a tax exemption or credit to eliminate double taxation. This leads to more administrative work and expenses to divide the taxation rights between the PE and residence states.

25.6.6. Article 12 on copyright

A separate allocation rule exists for royalties from any sort of copyright, as these are mentioned in article 12 of the OECD Model. Most often, the result is the same as with article 7 because article 12 also recommends taxation only in the residence state and an exemption in the source state.

A difference may be that some states will prefer to charge low source tax on outgoing royalties for which they have negotiated an exception in their bilateral tax treaties. This exception is also mentioned in the official Commentary on Article 12 of the OECD Model, and states utilizing this exception also have to allow a tax credit on their residents' worldwide income to eliminate double taxation.

25.6.7. Article 15 on employees

It may be that artists and other staff members of companies and institutions are working as employees. Article 15 of the OECD Model provides for special allocation rules for "dependent personal services", under the basic principle that an employee should be taxable in the state of their actual work. However, there is an important exception for employers accompanying their employees or sending them to another state when they keep paying their salaries from their office, do not spend more than 183 days per year in the other state and do not use a PE in the other state. If so, it is only the residence state – and not the work state – that has the taxing right over the salaries.

25.6.8. Article 17 on entertainers and sportspersons

Another special allocation rule is specified in article 17 of the OECD Model for performing entertainers and sportspersons, but this falls outside the scope of this chapter and book. These entertainers and sportspersons are taxable in the state of their work, which does not make a difference when they do not have a PE (when self-employed) or when they go for their employer for a short period abroad (when employees). Article 17 of the OECD Model creates many tax problems, but it does not apply to artists, companies and institutions in cultural heritage and contemporary art.

25.7. Conclusion

This chapter gives examples of tax incentives for artists and contemporary art in four states. The conclusion should be that these are very national and not cross-border focused. As explained in section 25.1., the protection and stimulation of culture and heritage is often a major reason for a tax incentives for artists.

Calculations of the costs of these tax incentives are difficult. Mixed thoughts may come up about their effectiveness and efficiency, but the results are quite visible because they attract much attention and are widely used in the sector. Abuse and fraud may not happen more often than with other tax measures. These tax incentives seems to empower the sector, which needs support in order to achieve better financial results.

Artists, companies and institutions can profit from the allocation rules in bilateral tax treaties, because without a PE in another state of work, tax will only apply in the residence state. This means less administrative expenses and no risk of double taxation compared to taxation in the other work state.