



Tax: Contributing to a sustainable arts sector in Australia — Lessons from overseas

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The arts sector can be plagued by characteristics that make its sustainability difficult. In Australia's recent 2020 Summit, a number of tax reform ideas mooted to assist the arts appeared to be influenced by overseas practice. This article considers a number of foreign practices to ascertain whether they are formative for future reforms in Australia. The mechanisms considered will include exempt income, tax credits, value added tax concessions, transfers of art, deferred gifts and testamentary donations. It will be argued that individual characteristics of jurisdictions will mean that not all reforms are viable in the Australian context. However, it will be suggested that there is scope for improving Australia's tax treatment, particularly for transfers of art and testamentary gifts.

Introduction

Within the 2020 Summit, at least 19 recommendations by the committee on 'Towards a creative Australia' related to proposed tax changes. Indeed, the word 'tax' was mentioned 41 times in their chapter.¹ It would appear that those in the arts sector consider that Australia's tax system has an important role to play in contributing to a sustainable arts sector. A number of the committee's recommendations appeared to be influenced by overseas practices. This raises questions regarding which tax measures are used overseas to assist the arts sector, and whether Australia could benefit from the introduction of similar measures.

This article considers some of the tax concessions provided to the arts in a number of selected jurisdictions to ascertain whether there are measures that could be appropriate for Australia. Given the prominence of its level of giving, the United States is one of the studied jurisdictions, along with the United Kingdom, Canada and Ireland. Reference is also made to concessions provided for in Germany, the Netherlands, Mexico and Singapore.

An overview of the Australian arts sector will be provided, as well as the economic arguments for concessions. The current tax treatment of the Australian arts sector will then be canvassed. I will then analyse a number of

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¹ Barton, Department of the Prime Minister and Cabinet, 'Chapter Eight: Towards a Creative Australia: The Future of the Arts, Film and Design', *Final Report*, 2020 Summit, Australia, 2008. Some of these recommendations were controversial, such as the reintroduction of death duties with the exemption for public art and performing arts in public places: Recommendation 8.27.

practices used by foreign jurisdictions to assist the arts, either directly or indirectly. Their potential application in Australia will also be considered. The foreign practices considered include exempt income for artists, value added tax (VAT) concessions, transfers of art in lieu of payments of tax, deferred gifts and testamentary gifts. I conclude with recommendations for potential reforms to improve the sustainability of the arts sector in Australia.

The Australian arts sector

The arts sector can cover many types of endeavour, either in government or privately provided, including writers, visual artists, craft practitioners, theatre performers, dancers, choreographers, musicians, singers and composers, as well as museums, heritage centres, festivals and digital media. In this analysis, the arts sector is divided into three broad categories: artists,² art organisations³ and contributors.⁴

While defining the arts sector can be problematic,⁵ it has been estimated that it directly represents approximately 1.6% of Australia's gross domestic product (GDP),⁶ although its impact could be greater due to its influence on complimentary services such as tourism. In 2007, an estimated 3.5 million Australians were involved in either paid or unpaid work in the arts and leisure sector, representing 22% of Australians.⁷ However, of those involved, two-thirds were unpaid: Figure 1. Accordingly, the support of volunteers appears to be critical for the arts sector.⁸

2 The term 'artist' is used to describe individuals who are creating art, whether the artists are authors of literary, dramatic, musical or artistic works; inventors; performing artists; or production associations. Artists may either trade under their own names (sole trader or independent contractor) or use a business form (such as company, discretionary trust or general partnership). Alternatively, artists can undertake their artistic endeavours as employees.

3 The term 'art organisations' describes organisations that act as collectors of artistic work (such as museums, libraries and galleries), and/or that facilitate and organise artistic endeavours (such as dance or theatre companies). These art organisations may be incorporated associations, unincorporated bodies, corporations limited by shares, corporations limited by guarantee, an aboriginal corporation, government or statutory authority.

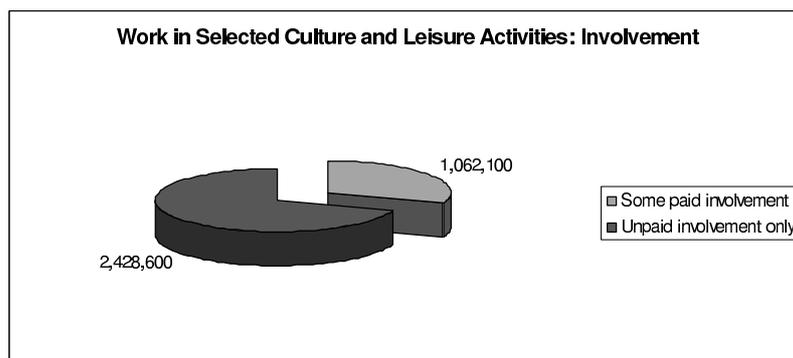
4 The term 'contributors' describes individuals or organisations supporting artistic endeavours through direct funding, contributions, grants and/or donations. Contributors cover a spectrum of different people and entities.

5 For example, an alternative term that may be used is 'culture industry'; see A Payne, *Role of Government Panel: The Cultural Industry*, Department of Economics, McMaster University, Ontario, 2003.

6 H Hoegh Guldberg, *The Arts Economy 1968–1998: Three Decades of Growth in Australia*, Australia Council, Sydney, 2000, p 150 (referring to the 1994 year).

7 ABS Work in Selected Culture and Leisure Activities 6281.0 April 2007, p 3. The data refers to Australians aged 15 years and older.

8 It is estimated that about 207,000 volunteers provided over 30 million hours of work for arts and heritage organisations in 2006: Australia Council for the Arts, *Quick Art Facts*, 2008 <<http://www.australiacouncil.gov.au>> (accessed 6 March 2009).

Figure 1: Involvement in Arts and Leisure: 2007 (Aust)⁹

It is estimated that 474,000 Australians were employed in a cultural occupation or cultural industry as their main job in 2006.¹⁰ In terms of lodgment of tax returns, there were 121,532 taxpayers conducting businesses in both the arts and recreational services, with the vast percentage of businesses conducted as sole traders: Figure 2. These sole traders generated a total of \$1,457 million of arts income,¹¹ an average of \$12,000 income per taxpayer.¹²

⁹ Source: ABS Work in Selected Culture and Leisure Activities 6281.0 April 2007, Table 1.

¹⁰ Australia Council for the Arts, above n 8, referring to the 2006 Census.

¹¹ Table 4: Taxation Statistics 2005–06: A summary of tax returns for the 2005–06 income year and other reported tax information for the 2006–07 financial year. The breakdown for business forms for artists was: sole trader – 107,703; general partnership – 4481; trust – 2520; and corporations – 6828.

¹² It is acknowledged that the use of ‘averages’ may not be representative due to the vast distribution of income levels in the sector. The ‘medium’ level of wages is later referred to in Figure 5 per the research of D Throsby and V Hollister, ‘Don’t Give up Your Day Job: An Economic Study of Professional Artists in Australia’, Division of Economic and Financial Studies, Macquarie University, Sydney, 2003, p 45.

Figure 2: Arts Businesses Lodging Tax Returns¹³



The extent to which Australians are involved in the different parts of the arts sector is illustrated in Figure 3 and Figure 4, with some sectors having greater paid involvement than others. For example, there is greater paid involvement for design, website design and teaching. In comparison, there is greater unpaid involvement (volunteering) for heritage, festival organising and art shows. Indeed, it has been observed that Australia has a culture of supporting not-for-profit organisations or projects through volunteer work rather than the gifting of money or goods.¹⁴

¹³ Source: Table 4: Taxation Statistics 2005–06: A summary of tax returns for the 2005–06 income year and other reported tax information for the 2006–07 financial year.

¹⁴ N Crimm, 'Shortcomings in America's Federal Tax Regulatory Regime of Private Foundations: Insights for Australia' (2002) 31 *ATR* 90 at 100–1, referring to the research of M Lyons and S Hocking, 'Australia' in L Salamon et al (Eds), *Global Civil Society: Dimensions of the Nonprofit Sector*, The Johns Hopkins Comparative Nonprofit Sector Project, Baltimore, 1999, pp 203–12.

Figure 3: Number of People Involved (Part 1) (Aust)¹⁵

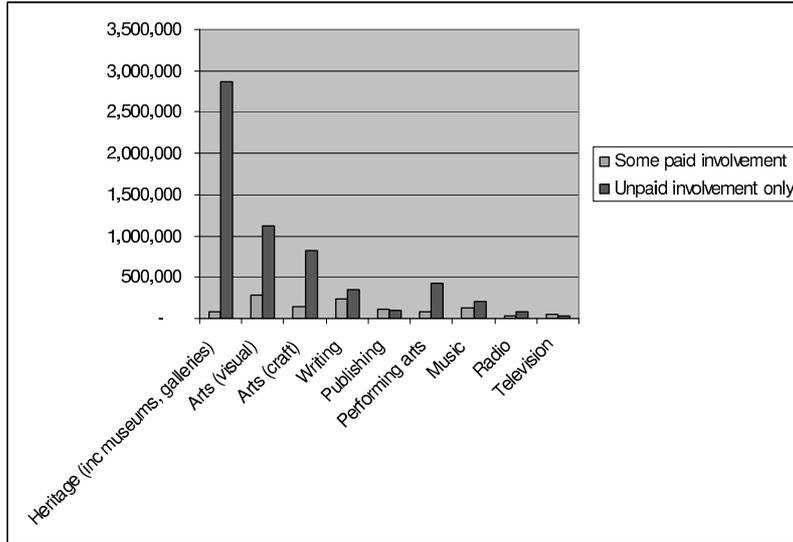
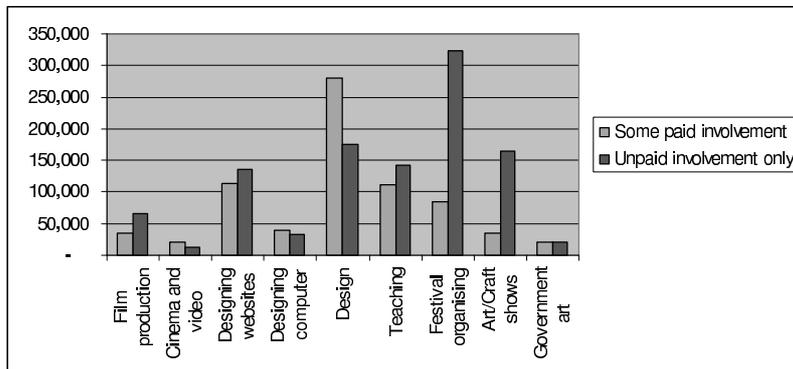


Figure 4: Number of People Involved (Part 2) (Aust)¹⁶

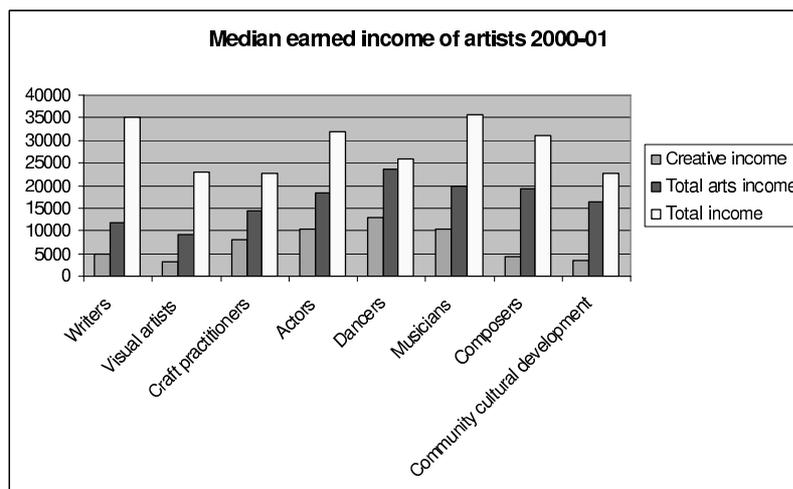


Even when payment is received for artistic work, a vast amount of it can be below \$5000 per annum.¹⁷ The low level of income earned is supported by the findings of Throsby and Hollister, who found that the median figure for Australian artists' incomes in 2001 ranged from \$9200 to \$23,600: Figure 5.

¹⁵ Source: ABS Work in Selected Culture and Leisure Activities 6281.0 April 2007, Table 4.

¹⁶ Source: *ibid.*

¹⁷ See ABS Work in Selected Culture and Leisure Activities 6281.0 April 2007. Note that some components have an estimate relative standard error greater than 50% and are considered too unreliable for general use.

Figure 5: Median Earned Income 2000–01¹⁸

Justification for concessions

The plight of artists appears universal. Da Silva has pointed out the features common to many artists around the world, including sporadic employment, poor and unpredictable income levels and combining artistic work with another paid employment.¹⁹

In recognition of this, the arts sector can receive support from the government; in Australia this may be at the federal, state or local level. The form of this support may be in grants, tax concessions (exemptions, additional deductions or tax offsets), regulation or advertisement.²⁰ Indeed, the government is seen as pivotal in providing 'cultural infrastructure' from built environments, technology and funding of pillar cultural organisations.²¹

Baumol has analysed the economic reasons that are used to justify such government support of the arts, and these centre on the reasons of positive externalities, public goods, significant worthiness, greater access and infant industry.²² 'Positive externalities' of the arts refers to the economic theory that 'if an activity generates a benefit to more than just the consumer of the activity, the activity will be underprovided because the consumer is only

18 Source: Throsby and Hollister, above n 12, p 45. The median can be a better representative figure, given the outliers that can occur. Also, 78% of artists are registered for an ABN, although only 38% are registered for GST: p 54.

19 H Da Silva, *Report on the Situation and Role of Artists in the European Union*, European Commission, Brussels, 1999.

20 Payne, above n 5, p 3.

21 K Ferres and D Adair, *Who Profits From the Arts? Taking the Measure of Culture*, Currency House Inc, Strawberry Hills, 2007, p 8.

22 W Baumol, 'Applied Welfare Economics' in Ruth Towse (Ed), *A Handbook of Cultural Economics*, Edward Elgar, Cheltenham, UK, Northampton, MA, 2003.

willing to pay to the extent that the consumer benefits from the activity'.²³ Also through government support, there may be an increased provision of art, which can lead to broader benefits for society. An example of such positive externalities is represented by the sample survey conducted by Thorsby and Withers of residents in Sydney. In that study, 95% of participants agreed or strongly agreed that the 'success of Australian painters, singers, actors etc gives people a sense of pride in Australian achievement'.²⁴

The second economic justification for support is that certain art may be considered a 'public good', when it is characterised by: the ability of more than one person being able to consume the same good; the marginal cost of providing this public good to another being zero (or close there to); and the prohibitively expensive cost of excluding persons from consuming it.²⁵

The notion of 'significant worthiness' relates to the idea that people will not acquire a taste for some arts until they are exposed to it, and thus demand is restricted prior to exposure.²⁶ The justification of providing 'greater access' is based on the argument that if art is only privately provided it may not be accessible to all members of society, and that government can facilitate greater access for people who may not otherwise be able to afford it.²⁷ To some extent, research from the United States on data from the early 1970s supports this, as it was found that 'on balance, income to the arts is paid for disproportionately by the very wealthy and is enjoyed more by the moderately wealthy and well educated'.²⁸ However, while there does appear to be some progressivity with support of the arts,²⁹ it appears that the output of arts and culture of the not-for-profits sector is consumed by individuals on income and wealth attributes above national averages.³⁰

The further justification for government support is that some arts may be considered to be in their 'infancy', requiring support in their early stages of

23 Positive externalities may relate to (a) peer effects such as inspiring others; (b) societal benefits, as there may be a connection with people with interest in the arts and their impact on society; (c) economic development, either directly or through complementary goods and services; or (d) culture for the future: Payne, above n 5, p 6.

24 C Gray, *Financing the Nonprofit Performing Arts: Economic Theory, Empirical Evidence, and US Practice* (Paper presented at the International Seminar of Policies for the Financing in Performing Arts, 2008) p 10, referring to C Thorsby and G Withers, *The Economics of the Performing Arts*, St Martin's, New York, 1979. This led the authors to conclude that there was support that there were positive externalities due to the arts, with public benefits accruing. This research appears to be consistent with other research, for example in Canada: W Morrison and E West, 'Subsidies for the Performing Arts: Evidence on Voter Preference' (1986) 15 *Journal of Behavioral Economics* 57.

25 Payne, above n 5, p 6.

26 Ibid, p 7.

27 Ibid.

28 A Feld, M O'Hare and J Schuster, *Patrons Despite Themselves: Taxpayers and Arts Policy: A Twentieth Century Fund Report*, New York University Press, New York, 1983, p 102-03, referred to in J Schuster, 'Tax Incentives in Cultural Policy' in V Ginsburgh and D Thorsby (Eds), *Handbook of the Economics of Art and Culture*, Vol 1, Elsevier, Amsterdam, 2006, p 1281.

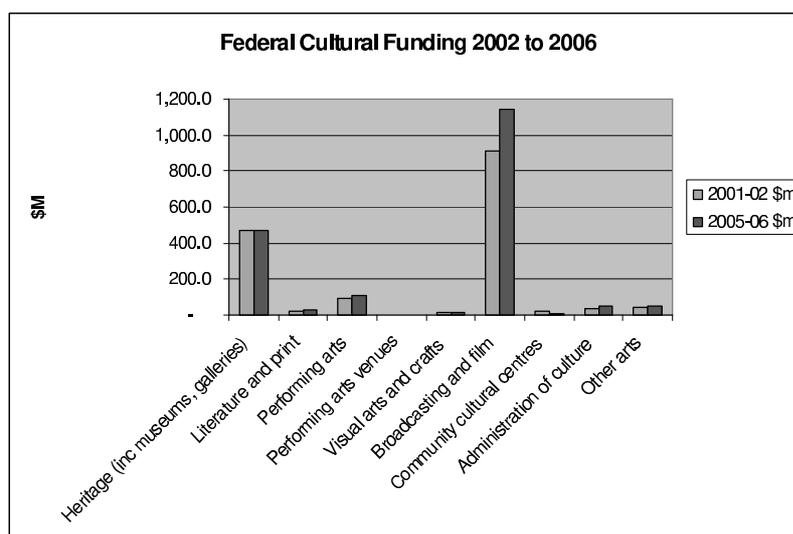
29 'Progressivity' refers to the notion of vertical equity with wealthier taxpayers contributing more to the tax revenue than low income taxpayers.

30 D Netzer, 'Arts and Culture' in D Netzer, *Who Benefits from the Non-Profit Sector?*, The University of Chicago Press, Chicago, 1992, p 186-87, referred to in Schuster, 'Tax Incentives in Cultural Policy', above n 28, p 1281.

development. For example, this argument has been used to support concessions for films. In terms of the previous tax concessions provided to Australia's film industry, it was estimated that employment had increased by up to 690 full-time jobs between 2001 and 2006.³¹ An additional advantage was that the attraction of foreign crews to Australia facilitated the transfer of skills to Australian workers.³² For an extensive overview of the various considerations for tax policy and culture, see Schuster.³³

In terms of government grants to the arts, there are concerns about the level of direct government funding in Australia. Figure 6 and Figure 7 demonstrate the largely static nature of federal, state and local government funding in Australia from 2002 to 2006.

Figure 6: Federal Cultural Funding (Aust)³⁴

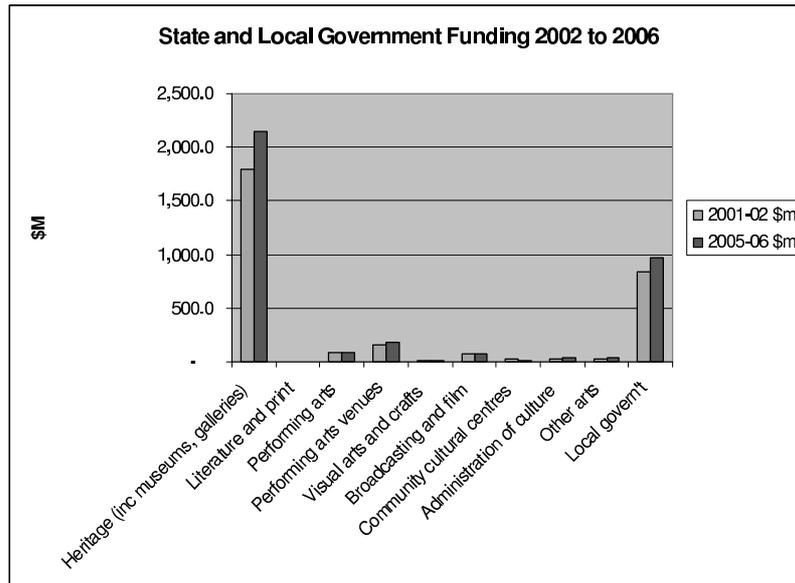


31 Department of Communications Information Technology and the Arts, *Refundable Film Tax Offset Scheme: Report of the 2006 Review of Division 376 of the Income Tax Assessment Act 1997*, 2006, p 9.

32 Ibid.

33 Schuster, above n 28.

34 Source: National Centre for Culture and Recreation Statistics — Australian Bureau of Statistics, *Cultural Funding in Australia Three Tiers of Government 2005–06*, Commonwealth of Australia, 2007, Table 11.

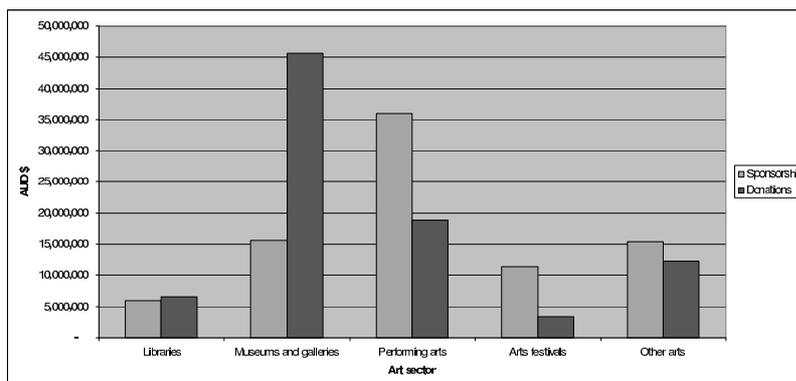
Figure 7: State and Local Government Cultural Funding (Aust)³⁵

Of course, governments are not the only source of funding for the arts; there can be substantial support from the private sector in the form of sponsorship and donations. *The Giving Australia Report* noted that while there was an 88% increase in individual giving between 1997 and 2004, of the 2004 donations arts and cultural organisations received only 2.3% (\$131 million) of individual giving.³⁶ Figure 8 illustrates the level of private sponsorship and donations in Australia for the 2007 financial year. The structure of the tax system can have mechanisms to encourage such giving. For example, the introduction from July 2001 of Prescribe Private Funds (PPFs) (now to be known as Private Ancillary Funds) with concessional tax treatment encourages private giving.³⁷

³⁵ Source: *ibid.*

³⁶ C Hunt and P Shaw, 'A Sustainable Arts Sector: What Will It Take?' in *Platform Papers Quarterly Essays on the Performing Arts, No 15*, Currency House Inc, Strawberry Hills, 2008, p 27.

³⁷ In 2009, it is estimated to cost Australian tax revenue of \$280 million: Treasury, *Tax Expenditures Statement 2008*, Commonwealth of Australia, Canberra, 2009, p 89: Table A70. Pursuant to Income Tax Assessment Act 1997 (Cth) (ITAA) Div 30. For the new guidelines, see N Sherry (Assistant Treasurer), *Private Ancillary Fund Guidelines 2009: Taxation Administration Act 1953*, commencing 1 October 2009.

Figure 8: Private Sponsorship and Donations 2006–07 (Aust)³⁸

Indeed, distributions from PPFs are a growing source of funds for the arts sector in Australia. Where previously it was estimated that the arts received 10% of distributions, in the 2007 year 33% of a total \$117,072,843 of distributions was to the arts: Figure 9.³⁹

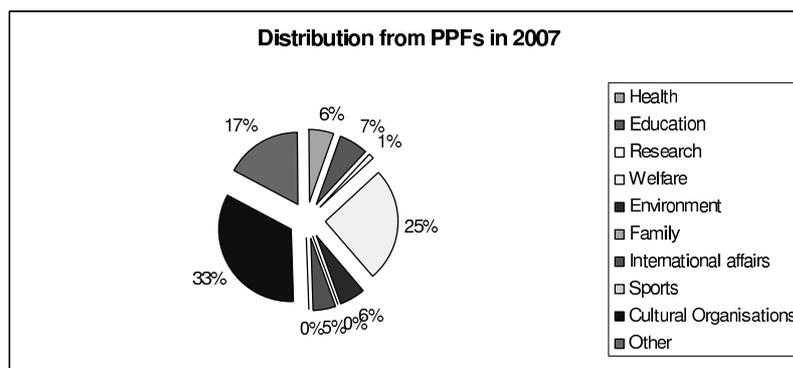
However, the overall effectiveness of tax concessions for the arts, whether direct or indirect, can be questioned. For example, one way that the arts sector receives indirect support is via donations being deductible when made to art organisations that are ‘deductible gift recipients’ (DGRs). However, it is uncertain to what extent taxpayers are motivated by the tax deductibility of donations they make, as other motivations may be stronger.⁴⁰ Although tax deductibility does play some role, as Madden and Newton found, over 75% of advisors see that an important or an extremely important reason to provide philanthropic advice is because in ‘planning wisely, philanthropic giving can reduce taxes’. Madden and Scaife also found that 71% of respondents strongly agreed or agreed with the statement that they expected their donations to be tax deductible.⁴¹

38 Source: Australian Business Arts Foundation, *AbaF Survey of Private Sector Support for the Arts 2008 — Key Findings*, 2008, p 9.

39 Australian Tax Office, *Prescribed Private Funds Statistics*, 2008 <<http://www.ato.gov.au/print.asp?doc=/content/00163533.htm>> (accessed 31 October 2008). Of the total \$117,072,843, the distributions were as follows: Cultural 33%, Welfare 25.43%, Education 6.59%, Health 5.52%, Environment 5.64%, International affairs 5.02%, Research 1.16%, Sports 0.04%, Family 0.01%, and Other 17.25%. Another important source of funds is corporate sponsorship. For example, in 2006 major performing arts companies reported that they received \$25.3 million (54%) in corporate sponsorship, \$17.9 million (38%) in donations and \$3.8 million (8%) from fundraising activities: Australian Major Performing Arts Group, *Tracking Changes in Corporate Sponsorship and Private Donations 2008*, 2008.

40 Source: Australian Tax Office, *Prescribed Private Funds Statistics*, 2008 <<http://www.ato.gov.au/print.asp?doc=/content/00163533.htm>> (accessed 31 October 2008).

41 K Madden and C Newton, *Is the Tide Turning? Professional Advisers’ Willingness to Advise about Philanthropy*, Working Paper No CPNS 30, Centre of Philanthropy and Nonprofit Studies, Queensland University of Technology, Brisbane, 2006, p 6. However, tax

Figure 9: Distributions from Prescribed Private Funds in 2007 (Aust)⁴²

Another confounding factor is that it is questionable to what extent tax concessions will be effective if knowledge or understanding of them is low. Madden and Newton found that the capacity for advisors to provide philanthropic advice appeared to be lacking as a large percentage of advisors thought that they were only somewhat informed at best (compared with well informed or extremely informed).⁴³

Furthermore, when the tax system is used compared to direct government grants to assist industries, it can be hard to determine whether the measures are effective. To this end, it has been argued by Surrey that indirect government support, such as tax incentives, should be analysed and assessed in a similar manner to that of direct government expenditure.⁴⁴ Also it has been observed that the use of tax incentives values 'individual' rather than collective decision making:

Individual donors not only decide how their private net-of-tax contribution is to be allocated; but they are also accorded the right to make the same decision with respect of the forgone taxes.⁴⁵

concessions appear to encourage a higher level of giving by the affluent: The Prime Minister's Community Business Partnership, *Giving Australia: Research on Philanthropy in Australia*, Department of Family and Community Services, Australian Government, October 2005.

42 K Madden and W Scaife, *Keeping Giving GOING*, The Australian Centre for Philanthropy and Nonprofit Studies, Queensland University of Technology, Brisbane, 2008, pp 31–2.

43 Madden and Newton, above n 41, pp 36–7: (a) advisers who do not advise on charitable strategies 83%; and (b) advisers who do advise on charitable strategies 40%. Previous studies have found that advisors can be lacking the 'hard technical tax knowledge' relevant to philanthropy: T Cohen, 'Advisers Focus on Donor Values' (2002) *Philanthropy Jnl*, available at <<http://www.philanthropyjournal.org/archive/53156>> (accessed 3 June 2010); and R Prince, 'Philanthropic Market is Huge Opportunity' (1998) 102 *National Underwriter* 43 at 53–4.

44 S Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures*, Harvard University Press, Cambridge, MA, 1973.

45 Schuster, above n 28, p 1269.

This can be compared to grants; Adair expresses concern within Australia that there can be a lack of political accountability with government grants of the arts when there is peer assessment about allocations.⁴⁶

In congruence with Surrey's arguments, the Australian Federal Government releases an annual Tax Expenditures Statement, which reports the estimated direct monetary value of the different tax benefits provided.⁴⁷ Some of the tax expenditure relevant to the arts is detailed in Table 1. For the 2008 financial year, the total reported tax expenditure for recreation and culture is estimated to be \$231 million, whereas the direct government spending was much greater at \$3,207 million.⁴⁸

Table 1: Tax Expenditure 2008

| Description | Revenue forgone | Year |
|--|-----------------|------|
| Income averaging for authors, inventors, performing artists, production associates and sport persons ⁴⁹ | \$9 million | 2009 |
| Exemption of refundable film tax offset payments ⁵⁰ | \$38 million | 2009 |
| Income tax exemption for not-for-profit societies in recreation and culture ⁵¹ | \$25 million | 2009 |
| Income tax exemption for recreation-type not-for-profit societies ⁵² | \$20 million | 2009 |
| Income tax exemption for Australian Film Finance Corporation ⁵³ | \$- | 2009 |

There have been a number of deliberations of the effectiveness of the Australian tax treatment of the arts, whether directly on artists, or indirectly through art organisations or donations. The book by Throsby and Withers is very comprehensive.⁵⁴ However, other deliberations are not as holistic, and instead focus on one aspect or industry.⁵⁵ For example, there have been numerous submissions in terms of the application of the non-commercial loss provisions for artists.⁵⁶ Alternatively, industry tax publications may be informative only, explaining the Australian tax system's application to the arts

46 A Adair, 'Performing Public Funding of The Performing Arts' (1999) *Policy* 20 at 23.

47 Treasury, above n 37, p 1. The measuring of 'tax benefits' requires establishing a 'benchmark' of what is the normal tax treatment that neither favours or disadvantages similar activities or classes of taxpayers. The report uses a 'revenue forgone' approach in measuring the tax expenditures.

48 Ibid, p 15: Table 2.5.

49 Ibid, p 81: Table A53. Pursuant to ITAA Div 405.

50 Ibid, p 102: Table B28. Pursuant to ITAA Div 376.

51 Ibid, p 103: Table B29. Pursuant to ITAA s 50-40.

52 Ibid, Table B30. Pursuant to ITAA ss 50-40 and 50-45.

53 Ibid, p 104: Table B31. Pursuant to ITAA s 504-5.

54 C Throsby and G Withers, *The Economics of the Performing Arts*, St Martin's Press, New York, 1979.

55 In terms of the performing arts, see Adair, above n 46.

56 For example, Arts Law Centre, 'The Impact of the Non-Commercial Loss Provisions of the ITAA on Professional Artists', Submission to the Board of Taxation, Sydney, 2004; National Association of the Visual Arts, 'For the Post-Implementation Review of the

rather than assessing the effectiveness of it.⁵⁷ Ferres and Adair provide a thorough consideration of the potential externality benefits provided by the arts in Australia.⁵⁸

One area that has received great attention is the Australian film industry, with there being a history of providing tax concessions, even though 90% of Australian films break even or worse.⁵⁹ It is unclear to what extent the film tax concessions have been successful. For example, it has been observed that there can be hesitation in investing in film due to concerns that the Australian tax office will audit activities closely, and thereby creating the necessity to obtain product rulings, which can add to cost and time delays.⁶⁰ In addition, measuring the benefits of film can be difficult. For example, how can the cultural benefits that may be derived (including providing an historical record of contemporary issues and events) be effectively and reliably measured?⁶¹ While there has been a recent government review of the new film offset provisions, the review noted it was too early to draw firm conclusions about its effectiveness.⁶²

A number of articles have considered the effectiveness of the philanthropy provisions in Australia, which may be informative to the arts due to the treatment of some art organisations as DGRs.⁶³ In terms of the not-for-profit sector, there have been a number of pieces written, including ones comparing

Non-Commercial Losses (Division 35) of the ITAA 97', Submission to the Board of Taxation, Sydney, 2004; and B Tucker, 'Post-Implementation Review of the Quality and Effectiveness of the Non-Commercial Losses Legislation', Submission to the Board of Taxation, Brisbane, 2004.

57 Australian Council for the Arts, *Art & Facts: The Arts & Tax: A Practical Tax Workbook for the Arts Sector*, Australian Council for the Arts, Sydney, 2000.

58 Ferres and Adair, above n 21.

59 D Gonski, *Review of Commonwealth Assistance to the Film Industry*, Department of Communications and the Arts, 1997. In terms of the prior Divs 10B and 10BA, Clark argued that a similar tax credit system to Canada should be introduced which would be available to a successful project: B Clark, 'Using Tax Incentives to Encourage Investment in the Australian Film Industry' (1999) 9 *Revenue LJ* 58 at 74. Some of the economic justifications to support this industry include that it is can be considered to be in its 'infancy', that it is labour intensive, and can provide an immediate economic benefit to the local region. But given the length of time of support of this industry, it is questionable how long 'infancy' can be a valid contention.

60 Australian Film Commission, 'Information Technology and Arts Review of Divisions 10B and 10BA', Submission to the Department of Communications, 2005, p 10.

61 Clark, above n 59, at 62.

62 Department of Communications Information Technology and the Arts, *Refundable Film Tax Offset Scheme: Review of Division 376 of the Income Tax Assessment Act 1997*, 2009, p 13. However, it did note problems with timing of refunds resulted in the incurring of interest costs.

63 For example, Philanthropy Australia Inc, *Australian Philanthropy: Research Papers 2000*, D Leat (Ed), *Monograph #3*, Philanthropy Australia Inc, Melbourne, 2000; Madden and Scaife, above n 42; M McGregor-Lowndes and C Newton, *An Examination of Tax Deductible Donations Made by Individual Australian Taxpayers in 2004–2005*, The Australian Centre for Philanthropy and Nonprofit Studies, Queensland University of Technology, Brisbane, 2007; Madden and Newton, above n 43; and M McGregor-Lowndes, *Planned Giving Strategies*, Presentation at Modernising Charity Law, Australian Centre for Philanthropy and Nonprofit Studies, 2009, <<http://www.bus.qut.edu.au/research/cpns/podcasts>> (accessed 29 July 2009). M Lyons and A Passey, 'Need Public Policy Ignore the Third Sector? Government Policy in Australia and the United Kingdom' (2006) 65(3) *Aust Jnl of Public Administration* 90.

Australia's PPF regime to the United States.⁶⁴ Research has also considered the motivation behind giving, from personal as well as corporate perspectives.⁶⁵ For example, it has been stated that corporate sponsorship can be more attracted to 'special events' to which the company name can be attached, with high visibility important.⁶⁶

While it can be difficult to ascertain whether these direct and indirect support mechanisms provided by the government are effective, they can be considered as assisting the arts sector to be more 'financially sustainable' so that artists can continue to produce works of art. For example, assistance may lower the direct tax burden applying to artists, thus providing the artist with more money to finance their operations. Or alternatively, it may provide concessions to others to purchase their work, or provide grants to finance operations. However, it has been observed that financial sustainability for the arts needs to look beyond dollars, as Hunt and Shaw have stated:

Sustainability in the arts is about much more than money. Questions concerning the quality of artistic work and services, the efficiency of an organisation's operating systems, and the breadth and depth of its audience are as important as the more familiar ones about how to achieve a diverse and healthy funding base.⁶⁷

For example, a concern expressed with support of the arts is that it may in fact encourage and/or support poor management practices; that is, although there may be sufficient funding, it may be poorly managed.⁶⁸

While the term 'sustainability' is broad, what is considered in this article is how the Australian tax system can be structured to assist (rather than hinder) the arts sector, allowing for greater financial security to encourage the continued production of artistic works.⁶⁹ Part of this can be by increasing the diversity of its financial base, balancing earned and contributed income.

Prior to reviewing the overseas jurisdictions studied, an overview of the current tax treatment of the Australian arts sector will be canvassed.

Overview of Australia's tax treatment of the arts

The tax considerations for each of the broad categories of the parties involved in the arts sector (artists, art organisations and contributors) are detailed below.

Artists

Artists can undertake their artistic endeavours as employees. Alternatively, artists may either trade in their own names (sole trader or independent contractor) or use a business form (such as company, discretionary trust or general partnership).

⁶⁴ Crimm, above n 14.

⁶⁵ A Sargeant and K Crissman, 'Corporate Giving in Australia: An Analysis of Motives and Barriers' (2006) 41(4) *Aust Jnl of Social Issues* 477.

⁶⁶ Gray, above n 24, p 19.

⁶⁷ Above n 36, p 2. This can be important given that the art sector 'would not be able to sustain itself on public funding and earned income alone': pp 7 and 12.

⁶⁸ Adair, above n 46, at 22.

⁶⁹ For example, the structure of the tax system could be detrimental for the arts: for example, the non-deductibility of entertainment expenses may inhibit businesses taking clients to art performances: ITAA Div 32.

If an artist is employed by an organisation (employee-artist), then the artist's salary and wages will be assessable income. Generally, the employer is obliged to withhold tax from such wages and remit this to the tax office. This withholding is part of the Pay As You Go (PAYG) system and means that employee-artists, like other Australian employees, are contributing towards their annual tax obligations as they earn their wages. PAYG assists taxpayers in funding their annual tax liabilities.

An employee-artist may be able to claim certain payments as a tax deduction if there is a connection between the payment and the derivation of their employee wages.⁷⁰ Examples of deductible expenses for an employee-artist could include work-related travel and telephone expenses. Normally, travel between home and work is not 'work related travel', although if an artist has to carry heavy equipment a tax deduction may be available.⁷¹

For employee-artists, employers are required to contribute an additional 9% of their salary as a guarantee superannuation contribution.⁷² This superannuation contribution is not assessable directly to the employee-artist; instead, it is assessable to the superannuation fund at 15%.⁷³

If employee-artists receive fringe benefits from their employer, the employer (not the employee) can be liable for fringe benefits tax (FBT).⁷⁴ The FBT rate is equivalent to the highest marginal tax rate plus Medicare, and is currently 46.5%. However, employee-artists may have a 'reportable fringe benefit amount' stated on their annual payment summary if the value of their benefits for the year exceeds \$2000. Employee-artists do not pay income tax on this reported fringe benefit amount, although it does affect their potential entitlement to government benefits, amount of HECs repayment and child support payments.

For artists who undertake their artistic endeavours in their own capacity, a fundamental question for tax purposes is whether their artistic endeavours amount to 'carrying on a business'.⁷⁵ This is a critical question, as it will affect what has to be declared as income, and what can be claimed as a tax deduction.

If an artist is not regarded as conducting a business then none of the receipts from the sale of the artist's work is assessable as income. It also means that the artist cannot claim deductions for any payments incurred due to the artistic endeavours, such as the cost of clay for a potter. In an artist's initial years of operation it may be difficult to determine whether the artistic activities amount to conducting a business or not. This can be complicated by the fact that artists 'are often motivated by creative purpose' and 'art is not always produced with a pre-existing market in mind'.⁷⁶ The tax office has released *Tax Ruling TR 2005/1*, which details the opinion of the Commissioner of Tax about what constitutes 'carrying on a business of a professional artist'. Such factors

⁷⁰ Ibid, s 8-1.

⁷¹ *FCT v Vogt* 75 ATC 4073.

⁷² Superannuation Guarantee Charge Act 1992 (Cth).

⁷³ This is on the assumption that it is a complying superannuation fund.

⁷⁴ Fringe Benefits Tax Assessment Act 1986 (Cth).

⁷⁵ It is possible for employee-artists to conduct artistic endeavours outside of their employment that may or may not amount to 'carrying on a business'.

⁷⁶ Tax Ruling TR 2005/1, para 7.

include significant commercial purpose, intention to make a profit, regularity of activity and whether the activity is carried on in a business-like manner.

This status of 'carrying on a business' may alter over time, and it may be that after a number of years, the artistic endeavours will then constitute a business. It is important that artists do not get their status as a 'business' incorrect, as it may lead to the application of penalties and interest for the under-payment of income tax.

If an artist is actually conducting a business (referred to as a 'business-artist') in the artist's own name (sole trader/independent contractor) then assessable income will include the sales of artistic work, grants, awards, royalties, commissions, endorsements, advertisements and money for interviews.⁷⁷ Allowable deductions (either immediately or over time) for certain expenditure incurred in the artistic endeavours will be available.⁷⁸ These could be immediate deductions, such as: agent fees; consumables (ie, paints); equipment costing \$300 or less;⁷⁹ costumes for performances; coaching classes for existing skills; work-related travel; research expenses for upcoming roles; seminar fees; and professional publications. If the artist is regarded as 'self employed', superannuation contributions can also be claimed.⁸⁰ Deductions claimable over time would include depreciation on work-related equipment costing greater than \$300 (such as computers, software, answering machines and mobile phones).⁸¹

Deductions would require proportioning if there was a percentage of private use with the expenditure. Substantiation rules can require documentation to be maintained to verify the deductions.⁸² Generally, certain payments will not be deductible if they are private in nature or if they are excluded by the income tax acts. For example, the following payments are normally not deductible: child care fees, driver's licence renewal fee, and parking/speeding fines.

In comparison to the situation of an employee-artist, when a business-artist receives income from artistic endeavours, generally there is no requirement for the payer to withhold any amount for tax. This means that business-artists receive a gross amount, and have to ensure that they have sufficient funds to pay their tax obligations. Some taxpayers can find this funding problematic if they are not disciplined or have financial pressures. To address this, it is possible for contractors to enter into voluntary withholding agreements, where

77 If the artist conducted the art business through a company, then it would be the company that would have the income tax consequences.

78 See Taxation Ruling TR 95/20 for a comprehensive listing of potential deductible and non-deductible amounts for artists.

79 Note, would be entitled to an immediate tax deduction for equipment costing \$1000 or less if regarded as a 'small business entity' when aggregated turnover is less than \$2 million: ITAA Div 328.

80 Ibid, s 290-160.

81 If the taxpayer is a small business entity, their capital allowances are deductible as follows: (a) immediate deduction for low-cost assets (cost less than \$1000); (b) assets with effective lives of less than 25 years are pooled, and the total value of the pool is depreciated at the declining value rate of 30%; (c) assets with effective lives greater than 25 years, can go in a long life pool (at a diminishing value rate of 5%): *ibid*, s 328-110.

82 For individuals trading in their own names or through a general partnership: *ibid*, Div 900.

the payer will withhold a certain amount and remit this withholding to the tax office on behalf of the contractor.⁸³

After the lodgment of a tax return by the business-artist, the tax office can issue a business-artist with a PAYG instalment rate. This means that the business-artist will have to remit quarterly instalments of estimated income tax liability for the year. It is possible for profitable authors, artists and other special professionals to apply to have two instalments rather than four.⁸⁴

In addition to the income tax consequences, a business-artist would have to register for an Australian Business Number (ABN). The ABN is a unique number allocated to businesses to assist government agencies (at federal, state and local levels) in monitoring business activities within Australia. If a business-artist does not have an ABN, then the entities paying the business-artist have to withhold 46.5%.⁸⁵

Furthermore, a business-artist may have to register for Goods and Services Tax (GST) purposes. If business-artists' annual turnover is greater than \$75,000 then this GST registration is mandatory.⁸⁶ If annual turnover is less than \$75,000, then it is optional for the business-artist to be GST registered. One reason that business-artists may opt for GST registration is so they can claim back (or get a refund of) the GST included in most of their business acquisitions.⁸⁷ However, GST registration means that business-artists will be liable for GST on their sales and performance payments.

Normally, organisations that pay sole traders (independent contractors) are not liable to contribute the additional 9% superannuation guarantee. Instead, the sole trader has the option of claiming tax deductions for their own contributions to superannuation.⁸⁸ However, there is an exception to this general rule for some business-artists, as the definition of 'employee' under the Guarantee Superannuation legislation is extended to include a:

person who is paid to perform or to participate in the performance of presentation of, any music, play, dance, entertainment, sport, display or promotional activity or any similar activity involving the exercise of intellectual, artist, musical, physical or other personal skills.⁸⁹

This means for such business-artists that their clients can be liable to pay the additional superannuation guarantee amount.⁹⁰

A problem confronted by business-artists is that income from their artistic

83 Taxation Administration Act 1953 (Cth) Sch 1 s 12-55.

84 Ibid, Sch 1 Div 45.

85 Ibid, Sch 1 s 12-190.

86 If an artist is just an 'employee' it is not possible for the artist in that capacity to be GST registered, as GST registration is only available to 'enterprises': A New Tax System (Goods and Services Tax) Act 1999 (Cth), Div 23.

87 Ibid, s 11-5. Referred to as 'GST input tax credit'.

88 A deduction can be claimed on these superannuation contributions, provided the taxpayer has less than 10% of their income from employment activities: ITAA s 290-160.

89 Superannuation Guarantee (Administration) Act 1992 (Cth), s 12(8).

90 This extended definition of 'employee' does not include all artists. Pursuant to SGR 2005/1 the tax office excludes this group of artists, on the reasoning that the extended definition involves a *notion of active participation* by the artist. However, the tax office considers the following artists are not covered by the extended definition: painters, photographers, journalists, authors, draught people, commercial artists, and sign writers. Therefore, payments to these artists will not be subject to the superannuation guarantee system.

endeavours can be 'lumpy'; an artist may have little income in one year, and a substantial income in another. This fluctuation between tax years can be adverse for business-artists trading in their own names due to the progressive marginal tax rates applying to individuals, which impose higher tax rates as taxable income increases.

To smooth out this 'lumpiness', certain business-artists are able to apply an average tax rate over the last 4 years when their income from their artistic endeavours is large.⁹¹ The averaging is available to Australian resident 'special professionals'⁹² whose 'taxable professional income' is greater than \$2500 for the current or the prior year. Essentially, this mechanism determines the average rate of tax that would have applied to one-fifth of the above-average amount⁹³ if it had been the top slice of the taxpayer's taxable income.⁹⁴ This average tax is then applied to the above-average professional income for the year.

Another way a business-artist could reduce the effect of fluctuations is by claiming a tax deduction for contributions to superannuation.⁹⁵

For some business-artists the deductions from their artistic endeavours exceed the income generated, thus creating a tax loss. Normally, tax losses can be used as a deduction against other income generated by the artist in other capacities, such as interest or wages from part-time or casual employment.⁹⁶ This loss deduction can be beneficial for the artist, as it means that she or he has a lower overall tax burden for the year.

However, artists need to be careful that these business-art losses are not quarantined from reducing their other income. This loss quarantining can occur if the artist's endeavours, while a business, are not of a scale to be regarded as 'commercial'.⁹⁷ To be regarded as commercial, the artist would have to satisfy one of the following tests to freely utilise losses:

- assessable income from art-business is at least \$20,000 for the year; or
- or
- the art-business had profit three out of the last 5 years; or
- the art-business uses real property of at least \$500,000 value; or
- the art-business uses other assets worth at least \$100,000.⁹⁸

91 ITAA s 405-25.

92 This is defined to mean 'authors of literary, dramatic, musical or artistic works, inventors, performing artists, production associations and sport persons'.

93 The 'above average amount' is determined by comparing the current year professional earnings to the 4 years prior.

94 Note there are special rules for first-time artist in calculating their average income.

95 This is provided that the business-artist is regarded as 'self employed'. For most taxpayers the concessional contributions cap makes it tax effective to claim only \$50,000 annually as deduction for superannuation contributions. From 1 July 2009, due to the lowering of the concessional contributions cap, this has been reduced to \$25,000.

96 Statistics indicate that many artists have part-time employment to supplement their art businesses.

97 ITAA Div 35.

98 If one of the commerciality tests is not satisfied, then the art-business losses are quarantined and carried forward until a future year when one of the tests described can be satisfied.

There is a carve-out from these loss quarantining rules for ‘professional arts businesses’,⁹⁹ provided that their other (non-artistic work) income (ie, wages) is less than \$40,000 for the year. This figure has not altered since these loss quarantining rules were introduced in July 2000,¹⁰⁰ and the rules have been subject to much criticism from those in the arts sector.¹⁰¹

A way in which a business-artist may mitigate their tax liability is through operating via a business form, such as a company, discretionary trust or general partnership. Such a business form may enable income to be split among taxpayers (ie, between the artist, spouse and their children) or be sheltered at a lower rate. For example, if the artistic business is operated through a company, then income earned by the company is taxed at 30% compared to a potential 46.5% for individuals on the top marginal tax rate.¹⁰² The artist could be an employee of this company, and be paid a modest wage from the company with guarantee superannuation contributions.¹⁰³ In these circumstances, it would be the company itself which would be directly commissioned by clients to provide the artistic services or products.

It is possible that a business-artist will be regarded as a ‘small business’ for tax purposes. If so, this will potentially allow the business-artist to access a number of tax concessions, including the small business capital gains tax (CGT) concessions.¹⁰⁴ A business-artist will be regarded as small if the aggregated turnover is less than \$2 million.¹⁰⁵ Alternatively, for the CGT concessions, if a business-artist’s net CGT assets are less than \$6 million, then the artist will also be regarded as small.¹⁰⁶

With the exception of the income averaging provisions, it can be seen that generally there are little direct tax concessions provided for artists pursuant to the Australian tax system, and that, on the whole, artists are subjected to the same rules as other taxpayers.

99 ITAA s 35-10(5) defines as ‘author of literary, dramatic, musical or artistic works, performing artist or production associate’.

100 The Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009 provides for the ITAA to be amended by tightening the application of the non-commercial losses rules in relation to individuals with an adjusted taxable income of \$250,000 or more.

101 Refer to the prior discussion of the various submissions made.

102 However, it should be noted that, with the 2009 tax rates for individuals, an individual can have taxable income of \$120,000 and be paying on average 30% tax — which is equivalent to the company tax rate.

103 Furthermore, the artist could receive dividends as a shareholder of the company.

104 ITAA Div 152, which include: 15 year retirement exemption; further 50% reduction; \$500,000 retirement concession and roll-over concession. Other concessions are: simpler depreciation rules (ITAA subdiv 328D); simplified trading stock rules (ITAA subdiv 328E); FBT car parking exemption (FBTAA 1986 (Cth) s 58GA); deducting certain prepaid expenses immediately (ITAA 1936 (Cth) ss 82KZM and 82 KZMD); accounting for GST on a cash basis (A New Tax System (Goods and Services Tax) Act 1999 (Cth) s 29-40); annual apportionment of input tax credits for acquisitions and importations that are partly creditable (A New Tax System (Goods and Services Tax) Act 1999 (Cth) s 131-5); Paying GST quarterly instalments (A New Tax System (Goods and Services Tax) Act 1999 (Cth) s 162-5); PAYG instalments based on GDP-adjusted notional tax (Taxation Administration Act 1953 (Cth) s 45-130 of Sch 1); and having a 2 year time limit for the amendment of assessments by the Commissioner.

105 ITAA 1997 (Cth) s 328-110.

106 *Ibid*, s 152-15.

Art organisations

The term 'art organisations' describes organisations that act as collectors of artistic works (such as museums, libraries and galleries), and/or that facilitate and organise artistic endeavours (such as dance or theatre companies). These art organisations could be in the form of incorporated associations, unincorporated bodies, corporations limited by shares, corporations limited by guarantee, aboriginal corporations, or be government or statutory authorities.

For companies and incorporated associations, the default income tax treatment is that they are taxed as a company, at a rate of 30%. Any tax losses generated would be trapped within the company and subject to carry-forward rules.¹⁰⁷ However, this general tax treatment will be altered if the art organisation is not-for-profit and exempted from income tax. Needless to say, such tax exemption is a major advantage for an art organisation. However, if the exemption does not apply, then the normal tax rules apply. The various ways that an art organisation can be taxed if it is regarded as a not-for-profit is detailed in Table 2.

To be regarded as a not-for-profit organisation, the art organisation's constitution or governing document must prevent the organisation from distributing profit or assets to its members and must provide for the distribution of any assets remaining on a winding-up to another not-for-profit organisation.

Table 2: Tax Concessions Available for Not-For-Profit Organisations¹⁰⁸

| | Charities | Public benevolent institutions and health promotion charities | DGRs | Not-for-profit and public hospitals and public ambulance services |
|--------------------------|------------------------------|---|------|---|
| Income tax exemption | Yes | Yes | – | Yes |
| GST concessions | Yes | Yes | Yes | Yes |
| FBT exemption (\$17,000) | – | – | – | Yes |
| FBT exemption (\$30,000) | – | Yes | – | – |
| FBT rebate | Charitable institutions only | – | – | – |
| Deductible gifts | – | Yes | Yes | Yes |

If it is determined that an art organisation is a not-for-profit organisation, it then may be possible for that organisation to be exempt from income tax. Relevant to this article, exemption from income tax is possible if the art

¹⁰⁷ Ibid, Div 165.

¹⁰⁸ Source: *Australia's Future Tax System: Consultation Paper*, Henry Review, Commonwealth of Australia, Barton, 2008, p 162. Note: entities may have more than one status — for example, a charity could also be a DGR.

organisation is established for musical purposes, or for the encouragement of art, literature or music.¹⁰⁹ Tax exempt status means that the organisation is not liable for income tax on its receipts, although it cannot claim its outgoings as a tax deduction.

In addition, for an art organisation that is income tax exempt, other tax concessions may be available, including the concessional calculation of FBT for benefits provided to employees.¹¹⁰ However, even if exempt from income tax, it would be mandatory for the art organisation to be GST-registered if its annual turnover exceeds \$150,000.¹¹¹

A related but separate issue is status as a DGR. In terms of the art industry, DGR status may be granted to:

- a public library, museum, art gallery or a fund organised for a charitable purpose;¹¹² or
- an organisation registered as a cultural organisation.¹¹³ An art organisation can be registered as a cultural organisation if its principal purpose is the promotion of 'literature, music, design, community arts, crafts, video, movable cultural heritage, performing arts, visual arts, radio, aboriginal arts, television or film'.¹¹⁴

The status as a DGR means that taxpayers may be encouraged to 'donate' to the art organisation as they may be entitled to claim a tax deduction. The tax treatment of donations is canvassed in the discussion for 'contributors' below.

Contributors

The third sector of the arts considered in this article is that of 'contributors' to the arts. The term 'contributors' describes individuals or organisations supporting artistic endeavours through direct funding, contributions, grants and/or donations. contributors cover a spectrum of different people and entities, including:

- individuals (alive);
- individuals (dead);

109 ITAA s 50-45. Additional requirements are that it be physically present in Australia, and incur its expenditure and pursue its objectives principally in Australia, or be listed as a DGR and distribute solely to charities or other DGRs.

110 This is because such exempt art organisations would be entitled to the FBT rebate to reduce their FBT liability. Availability of this rebate is subject to certain caps per employee.

111 This GST registration will be mandatory if the non-profit organisation's annual turnover is greater than \$150,000. If an organisation is GST registered, then it will have a GST liability on the receipt of any grants paid to it.

112 Taxation Ruling TR 2000/10. It is expected such a public institution would have the following features: (a) it is an institution whose collection is made available to the public; (b) it is owned or controlled by a government or quasi-government authority, or by persons or an institution having a degree of responsibility to the public; and (c) it is constituted and recognised as a library, museum or art gallery and it conducts itself in ways that are consistent with such a character.

113 This register is administered by the Department of Environment, Water, Heritage and Arts. More than 1000 cultural organisations are currently on the Register of Cultural Organisations (ROCO), which was established in 1991.

114 ITAA s 30-300. Other requirements for non-profit status are that a public fund is maintained to receive gifts for principal purpose, provides information every 6 months on donations, and is subject to periodic reviews.

- enterprises/companies; and
- PPFs (now to be known as Private Ancillary Funds).

Individuals (alive)

While alive, a person can contribute to the arts in a number of ways, including donations of cash, donations of goods or property, donations of time (volunteer) and the purchase of services or goods. The tax treatment of these various contributions to the arts is canvassed below.

Donations of cash

Normally, a donation of cash is not deductible for a taxpayer under the general deduction rules, as a donation does not have the necessary connection with the derivation of assessable income for the taxpayer. However, to encourage such donations the government has provided specific deductions for donations, provided strict criteria are met.¹¹⁵

If an art organisation is registered as a DGR, then it is possible for taxpayers to claim a tax deduction for cash donations for \$2 and greater. However, for this tax deduction to be available it is important that the cash contribution is in fact a 'donation'. A contribution will not be a donation if there are conditions attached to it, or the donor receives a material benefit in return for it.¹¹⁶

However, a limitation on the tax deductions for a donation is that donations cannot create a tax loss. That is, the donation deduction cannot exceed the assessable income of the taxpayer for the year. If the donation deduction is in excess of the taxpayer's assessable income, then the excess donation deduction is lost. However, it is now possible for certain donation deductions to be spread over 5 years, thus providing greater potential to fully use the deduction.¹¹⁷

To facilitate cash donations by individuals, it is possible to integrate donations into an employer's payroll system, known as the 'Workplace Giving Program'. This integration occurs where part of the employee's wages is regularly paid to a nominated DGR.¹¹⁸

If a person donates to a non-DGR, then it is unlikely that a tax deduction will be available, unless the donor can establish that there is a connection between the contribution and the derivation of assessable income for the donor. For private individuals, this is an unlikely circumstance. However, for taxpayers conducting businesses, then it is possible to argue that the contribution helps advertise the business, so a deduction under the general provisions may be available.¹¹⁹

115 ITAA Div 30.

116 Taxation Ruling TR 2005/13 contains examples of what the tax office considers material and immaterial benefits from arts organisations.

117 ITAA s 30-247. This 5 year spread applies to donations of cash and property to DGRs, PPFs, the Australiana Fund, public art galleries, museums, libraries, archives and the Artbank.

118 Note: the employee would still declare their gross income in their own tax returns and claim the donations as tax deductions. Recent figures of such Workplace Giving estimate donations of \$11 million to over 200 organisations.

119 Technically, such a contribution by a business would not be a 'donation' as there is a material benefit (the advertisement of the business) being received for the contribution.

Intermediary DGR

While art organisations may be registered as DGRs, many individual artists or artistic companies will not be. This means donations directly to these non-DGR artists or artistic companies will not be deductible for the contributor. However, it is possible for such artists to use an intermediary DGR to facilitate tax deductible donations. Such an intermediary DGR is the Australian Business Arts Foundation (AbaF),¹²⁰ with which artists and artistic companies can register.¹²¹

Once an artist is registered with the AbaF, then the artist can direct people to donate money to the AbaF, nominating the artist or a certain production as the preferred beneficiary of the donated funds. Such a donation to the AbaF will be tax deductible for the contributor as the AbaF itself is a DGR. However, while the AbaF does consider the donor's preferences, it cannot guarantee that the funds will be directed to the preferred person or project. The reason for this non-guarantee is to ensure that the technical meaning of 'donation' is met.¹²²

Inflated prices

Another avenue for tax deductions is when individuals pay 'inflated' prices for goods received from a DGR, such as the purchasing of a ticket to attend a fundraising event. Normally, such a contribution would not be regarded as a 'donation' as the person is receiving a material benefit in return for the contribution (ie, a dinner), and therefore it would be non-deductible. However, amendments now allow individuals to claim the net inflated amount as a tax deduction¹²³ when the value of the contribution is greater than \$150 and the minor benefit received in return is no more than the lower of either \$150 or 20% of the value of the contribution.

A related issue is a contribution by way of an inflated price paid at a charity auction conducted by a DGR. The net inflated amount can also be deductible for an individual when certain conditions are satisfied.¹²⁴ However, these provisions can add complexity as it is necessary to ensure that the precise restrictions are satisfied.

Donations of goods or property while alive

An alternative to donating cash is the donation of 'goods' by a person to a DGR. The amount and eligibility for a donation will depend upon the type of goods involved, particularly if they are cultural goods, non-cultural goods, or land (or interest in land). Each of these circumstances is described below.

120 The AbaF is a Commonwealth-owned corporation whose mission is to increase the private sector support for the arts, through sponsorship and business-arts partnerships.

121 The eligibility requirements for artists or artistic companies to register with the AbaF are: (a) The registrant is either (i) a bona fide not-for-profit art organisation; or (ii) an arts practitioner; AND (b) the funds are to be used to further Australia's cultural life.

122 Recall that for a contribution to be a donation there cannot be any conditions attached to it.

123 ITAA s 30-15. The 'net inflated amount' is the amount that the contribution exceeds the actual value of the benefit received.

124 The conditions for a deduction are that the value of the contribution is greater than \$150, and market value of the goods bid for is no more than the lower of \$150, or 20% of the value of the contribution. Note that it is not possible to spread the donation deduction over 5 years.

Cultural goods

There are special tax rules that govern the tax treatment for the donation of cultural goods. The term 'cultural goods' excludes land but includes paintings, books, sculptures, manuscripts, personal papers, jewellery, ceramics, technological, mechanical, scientific and social history, indigenous art, and antiques with a value of at least \$2.¹²⁵

For a tax deduction to be available to the donor of the cultural good, the recipient of the cultural goods must be an eligible entity under the Cultural Bequest Program, which could include the Australiana Fund, public art galleries, museums, libraries, archives and the Artbank.¹²⁶ Furthermore, the cultural good must be accepted for inclusion in a collection (either maintained or being established). If these conditions are satisfied, the amount of the tax deduction for the contributor depends upon how long the cultural good has been held.¹²⁷

As previously noted, tax losses cannot be created through the claiming of 'donation' deductions. However, for cultural goods it is possible for the donor to spread their deduction entitlement over 5 years, thus allowing the potential to offset income over an extended period.¹²⁸ A variation to the normal tax donation rules is that it is possible for the donor to retain some control of the cultural goods.¹²⁹ However, if some control is retained over the cultural goods, then the value of the tax deduction will be decreased to represent this.¹³⁰ In the circumstances that the donor is an artist or an art dealer, then the amount of the tax deduction can vary.¹³¹

In addition to the tax deduction, the donor will not have a capital gain on the transfer of the cultural goods to the recipient, as transfers pursuant to the Cultural Bequest Program are disregarded for CGT purposes.¹³²

If the donation does not satisfy these conditions, then no tax deduction is available and there is the potential for a capital gain or loss by the donor, as it is deemed that the market value of the property was received for the transfer, even though no money was received for the donated good.¹³³

125 ITAA s 30-230.

126 Artbank is a non-profit government agency founded in 1980 to acquire contemporary Australian art for rental to public and private sector clients.

127 If greater than 12 months: the tax deduction is the average GST market value plus valuation fees. If less than 12 months (unless inherited): the tax deduction is the lesser of: (a) purchase price; or (b) market value plus valuation fees. Note that there are strict time frames and valuers need to be appointed. For example, two written valuations by valuers approved by the Secretary of the Department of Communications, Information Technology and the Arts are required within 90 days of the donation.

128 ITAA s 30-247.

129 Normally, for a 'donation' to exist, the donor must relinquish all control over the donated goods or money.

130 This alternative will occur if the DGR receiving the cultural goods does not get immediate custody, unconditional right to retain control, or unencumbered legal title.

131 For example, if the cultural good has been held by the artist for greater than 12 months, then the deduction will be the market value. If, however, the cultural good is part of the artist or art dealer's trading stock, then the deduction will be the cost of acquiring the good or the cost of producing the item.

132 ITAA s 118-60.

133 Ibid, s 116-30.

Non-cultural goods

For the donation of goods that are not regarded as cultural items, such as shares in a company or units in a unit trust or equipment, a deduction is allowed for contributions to a DGR. However, the goods must have been acquired more than 12 months earlier unless they are worth more than \$5000, or are shares in a public company.

While a taxpayer might be eligible for a tax deduction,¹³⁴ when a taxpayer donates non-cultural goods, the taxpayer may have a capital gain due to the transfer of ownership in the goods. This is because the taxpayer is deemed for CGT purposes to have received the market value of the asset transferred,¹³⁵ even though in fact nothing was received. Such a deemed market value could exceed the taxpayer's cost base of the asset transferred. However, the tax deduction the taxpayer is entitled to should be greater than the net capital gain on transfer.¹³⁶ Consequently, this deemed capital gain reduces the benefit of the tax deduction claimed. It should be appreciated that unless the entity to which the taxpayer is donating is a DGR, there will be no tax deduction available; just a resulting capital gain to be assessed on.

Land (or interest in land)

If a taxpayer donates land to a DGR, then the amount of the tax deduction is dependant on the length of time the land has been held. If the land has been held less than 12 months, the deduction is the lower of cost or market value. In other circumstances, the deduction is the market value determined by tax office valuers.

Similar to non-cultural goods, the taxpayer could have a resulting capital gain due to the deemed receipt of market value for the land, thus increasing a taxpayer's assessable income. However, the deduction for the donation should offset this increase.

Donations of time (volunteering)

Another way individuals could contribute to the arts is by volunteering their time or services. It should be recalled that two-thirds of those involved in the arts are essentially volunteers, as they receive no payment: Figure 1. Even if the recipient of the volunteer's 'time or services' is a DGR, it is not normally possible for the volunteer to claim a tax deduction for expenses incurred in doing the volunteer work. Such non-deductible expenses for the volunteer could be the cost of travel, the cost of clothing, and telephone expenses. In addition, the volunteer cannot claim a deduction for 'notional expenses', such as the amount that an accountant could have charged for pro bono work. The reason for this non-deduction of 'time or service' is that there is no transfer of 'property' from the volunteer to the DGR. It is this 'transfer of property' that is necessary for a donation at law to exist.

However, one way this rule can be circumvented is if volunteers are

134 The amount of the tax deduction depends upon the circumstances: (a) for goods valued at greater than \$5000, tax office valuers determine market value; (b) for goods acquired within 12 months, the deduction is the lesser of purchase price; or market value: *ibid*, s 30-15.

135 *Ibid*, s 116-30(1): known as the 'market value substitution rule'.

136 If the CGT asset has been held by a taxpayer who is an individual and it has been held for greater than 12 months, the taxpayer should be entitled to a 50% discount: *ibid*, Div 115.

reimbursed by the DGR for the expenses that they incur. If the volunteer then 'donates' back this reimbursed amount to the DGR, there has been the necessary property transfer for the volunteer to claim a tax deduction.¹³⁷ For example, a volunteer incurs \$10 in travel costs which is reimbursed by the DGR. The volunteer can then 'donate' back the \$10 to the DGR and claim a tax deduction of \$10.

Purchasing services or goods

Another way that a person could support the arts sector is by attending events or purchasing artistic works. For private individuals, it is unlikely that the purchase of services or goods could either be claimed as an immediate tax deduction¹³⁸ or be depreciated over time,¹³⁹ as for a private individual there is unlikely to be a connection between the outgoing and the derivation of assessable income. However, if the art work is purchased by an art trader, then the purchase may become part of the art trader's trading stock, and be deductible as such.¹⁴⁰

Purchased art work will be classified as a 'collectible CGT asset' when it is used mainly for the personal use and enjoyment of the taxpayer.¹⁴¹ Classification as a collectible CGT asset means that it is subject to different tax rules compared to other CGT assets.

If the collectible CGT asset cost \$500 or less to purchase, then any capital gain or capital loss on subsequent disposal is disregarded for the taxpayer.¹⁴² This means that any capital growth in value is exempt from tax. However, if the collectible decreases in value, then this loss cannot be used to offset a taxpayer's other capital gains.

If the collectible CGT asset cost greater than \$500 to purchase, then any capital losses made on its subsequent disposal are quarantined and are available only to offset other collectible CGT asset gains.¹⁴³ Any capital gains made on its subsequent disposal are potentially assessable to the taxpayer, although an individual may be able to access the 50% CGT discount to reduce this gain.¹⁴⁴ However, unlike other CGT assets, the taxpayer cannot include in the collectible's cost base certain 'non-capital cost' items that stem from ownership. This exclusion means that the potential capital gain is greater, and thus the tax payable is also greater.¹⁴⁵ Examples of non-capital cost of ownership excluded from a collectible CGT asset's cost base would include insurance of the art work, repairs, interest on borrowings to purchase the art work, and storage costs.

137 Taxation Ruling TR 2005/13, example 18.

138 Such a purchase could not be a 'donation' as there is a material benefit received. Outside the donation rules, for the taxpayer to be able to claim some deduction then there would have to be the connection between the purchase and the derivation of assessable for the taxpayer.

139 An exception to this is the 'inflated prices' for charity dinners and auctions.

140 ITAA s 70-36: deduction for difference between opening and closing stock.

141 Ibid, s 108-10.

142 Ibid, s 108-10(1).

143 For example, a collectible capital loss could not be used to offset capital gains the taxpayer has on the sale of listed shares.

144 ITAA Div 115. Also, the indexation method could be available if the CGT asset was acquired prior to 21 September 1999: Div 114.

145 A capital gain is determined by capital proceeds less then cost base.

If the art work is not used ‘mainly for the personal use and enjoyment’ of the taxpayer, then the art work will not be a collectible CGT asset, and instead the normal CGT rules would apply.

Individuals (dead) — testamentary donations

A person through their will may direct that certain contributions known as ‘testamentary donations’ be made to artists or art organisations. These testamentary donations are only tax deductible when there is the donation of ‘cultural goods’,¹⁴⁶ and the following conditions apply:

- the recipient is a DGR, the Australiana Fund, a public art gallery, museum, library, archives, or the Artbank; and
- the gift is accepted by the recipient for inclusion in a collection (or one to be established); and
- there was in force a certificate from the minister approving the donation and specifying the value.

In these restricted circumstances, a tax deduction can be claimed in the deceased’s last tax return and, if there is a remainder deduction, in the executor’s first tax return for the estate. If there is any additional ‘excess’ deduction, this excess is lost.¹⁴⁷ The potential capital gain or capital loss on the transfer of this cultural good is also disregarded for tax purposes.¹⁴⁸ However, this system (while not repealed) is in a state of hiatus, as no further certificates from the minister have been issued since 30 June 2000.¹⁴⁹

Generally, cash donations made pursuant to a will are not tax deductible even if the recipient is a DGR.¹⁵⁰ Testamentary donations of non-cultural goods will also be non-tax deductible. However, the potential capital gain or capital loss on the transfer of the non-cultural goods by the executor to the recipient may be disregarded, provided it would have been deductible if the donation had occurred while the person was alive.¹⁵¹ If the transfer of the non-cultural good would not have been deductible prior to the death of the deceased, there is the potential for a capital gain or loss by the executor of the estate. The potential to have a capital gain arises because the executor is deemed to have received the market value of the property on the transfer, even though no money is received.¹⁵²

Enterprises/companies

For taxpayers who are enterprises contributing to art organisations or artists, there could be the material benefit of advertising for the contribution. While this means the contribution is not deductible as a ‘donation’, it may nevertheless be available to the enterprise as a general deduction, due to the

¹⁴⁶ Refer to the prior definition of ‘cultural goods’. Note that the term does not include money.

¹⁴⁷ Recalling that a donation deduction cannot create a loss.

¹⁴⁸ ITAA s 118-60.

¹⁴⁹ M Stewart and M Flynn, *Death and Taxes: Tax-Effective Estate Planning*, Thomson, Sydney, 2007, para 5 220.

¹⁵⁰ ITAA s 30-15(2).

¹⁵¹ *Ibid*, s 118-60. This CGT exemption applies even if the value of the property is less than \$5000.

¹⁵² *Ibid*, s 116-30.

nexus between the outgoing and deriving assessable income.¹⁵³ For example, the sponsorship of a writers' festival could be deductible due to the acknowledgement and promotion of the enterprise during the festival. This means that such an enterprise does not have to satisfy the strict meaning of 'donation' to get a deduction. It also means that enterprises are not limited to contributing to DGRs in order to obtain a tax deduction.

However, a tax deduction for a contribution to the arts could be denied if it is regarded as an 'entertainment expense' for the enterprise. For example, the attendance by employees and clients at a theatrical event is likely to be regarded as 'entertainment' and therefore not deductible.¹⁵⁴ Exceptions to this non-deductibility of entertainment include if the entertainment expense constitutes a fringe benefit to employees, although the employer is then likely subject to FBT. Another exception is if the entertainment expenses are incurred to promote or advertise to the public the taxpayer's business, and the entertainment is made generally to the ordinary members of the public.¹⁵⁵

If the entertainment non-deductibility applies to a contribution, it may be necessary for the enterprise to pro-rata the contribution into deductible advertising and non-deductible entertainment.

If art work is purchased by an enterprise, the enterprise may be able to claim a deduction or depreciation if the art work is used in connection with the business. For example, an enterprise could hang a painting in its office foyer and claim depreciation for tax purposes. Alternatively, an enterprise may lease an art work for inclusion in its foyer with such lease payments tax deductible for the business.¹⁵⁶

Note that the concessional tax treatment of research and development by companies does not extend to expenditure on research in the social sciences, arts or the humanities.¹⁵⁷

Prescribed Private Fund and public funds

PPFs, which are now to be known as Private Ancillary Funds, are another type of body that can potentially support the arts, as it is estimated that 10% of PPFs support culture.¹⁵⁸ PPFs are essentially not-for-profit trusts established either while a person is alive or via their will.¹⁵⁹ PPFs are similar to public

153 Ibid, s 8-1: regarding sponsorship–business relationships, generally involving cash in exchange for branding/hospitality. Note that this will not normally be a 'donation', as either there is a material benefit back to the company or there are conditions imposed, such as the use of banners. For private individuals it is unlikely that such a nexus would be able to be established.

154 Ibid, Div 32. Note that for journalists and entertainment critics, their attendance at relevant events is not likely to be entertainment and is instead regarded as part of their work: Taxation Ruling TR 98/14.

155 Another exclusion is if the taxpayer's business consists of providing entertainment to paying clients.

156 Note that if there is an option to purchase in the lease, it may be regarded as a contract to purchase, which will mean that the lease payments will not be deductible: IT 2215.

157 ITAA 1936 s 73D.

158 For the new guidelines, see N Sherry (Assistant Treasurer), *Private Ancillary Fund Guidelines 2009: Taxation Administration Act 1953*, commencing from 1 October 2009.

159 There are over 600 PPFs in Australia, with a combined wealth of \$1 billion. The majority are private family PPFs. \$300,000 has been suggested as the minimum investment, with legal and tax costs of \$2000 to \$5000. PPFs began in July 2001.

funds, except that, unlike public funds, there are no invitations to the public to contribute money; the only contributors are the initial donor and associates of the donor. While a PPF can accumulate some income,¹⁶⁰ it must bestow funds to other DGRs.

For tax concessions to apply to PPFs (and public funds), the PPF must be operated on a not-for-profit basis and money must not be distributed to members (except for proper reimbursement and remuneration),¹⁶¹ and the PPF must get treasurer's approval.¹⁶² A PPF that satisfies these conditions will be a DGR and be exempt from income tax.¹⁶³ If the PPF is a DGR, then donations to the PPF will potentially be deductible pursuant to the rules described above.

While the previous data referred to indicated a high level of funding through PPFs, it has been observed that Australia's high level of volunteerism and negative perception of self-promotion through donations may inhibit the extent to which this system is used.¹⁶⁴

Film tax concessions

The production of films is an artistic endeavour that receives particular tax concessions. For expenditure incurred prior to 25 September 2007, there was a 100% deduction for investors in qualifying productions.¹⁶⁵ Replacing this deduction concession is the new Screen Production Incentive Scheme, which involves three offsets: producer offset, location offset and post digital visual offset.¹⁶⁶ When available, these offsets directly reduce a taxpayer's payable tax.

The 'Producer Offset' provides a refundable tax offset of 40%¹⁶⁷ for qualifying expenditure incurred for a feature film, or 20% for film and television programs.¹⁶⁸ The 'Location Offset' of 15% is designed to attract

160 Previously, investment income can only be accumulated within the PPF at a rate equivalent to the Consumer Price Index, with the excess needing to be distributed.

161 The rules in Taxation Ruling TR 95/27 that apply to public funds must be complied with by PPFs.

162 The controlling body of the PPF must include at least 'one responsible person' who is usually prominent and not associated with the donor/settlor.

163 ITAA s 50-60. For a PPF to be regarded as a charity, it must undertake its activities in Australia, and only make distributions to other DGRs.

164 Crimm, above n 14, at 101.

165 ITAA 1936 Divs 10B and 10BA. Allows resident taxpayers immediate deductions for capital expenditure incurred in producing or contributing to the production of an Australian film. From 25 September 2007, applications for certificates under Divs 10B and 10BA will not be accepted.

166 ITAA Div 376. Furthermore, there is the creation of the Australian Screen Authority on 1 July 2008 to replace the Australian Film Commission, Film Finance Corporation and Film Australia Ltd.

167 For expenditure incurred on or after 1 July 2007.

168 Main eligibility requirements: a commercial cinema release for the film is guaranteed, formats other than film must show evidence that it will be distributed; expenditure outside Australia may now qualify. Additionally, there are minimum expenditure thresholds: Feature Films — \$1m, documentaries average minimum of \$250,000 per hour; TV series — \$1m and average of \$500,000 per hour; telemovies — \$1m and average of \$800,000 per hour; and short form animation — \$250,000 and average of \$250,000 per quarter hour.

offshore film and TV production to undertake work in Australia.¹⁶⁹ To encourage post, digital and visual effects (PDV) production in Australia, the 'PDV Offset' allows an offset for qualifying post production work in Australia, regardless of where the production is shot.¹⁷⁰

In summary, it can be appreciated that the Australian tax system already has a number of concessions that either directly or indirectly benefit the arts. However, there are some provisions that are inhibiting, such as the non-commercial loss provisions, entertainment expenses and collectible CGT asset rules. How does this compare to foreign jurisdictions, particularly given the calls for reform? I will now consider tax concessions introduced in a number of foreign jurisdictions to assist the arts.

Summary of the comparison

Rather than providing a detailed analysis of each jurisdiction's tax system, I focus on particular tax concessions that have been introduced to assist the arts. The aim is to identify models or mechanisms from these international comparisons that could be informative for Australia. It is important to appreciate that with any international tax comparison, characteristics unique to a jurisdiction may fundamentally influence the effectiveness of a tax concession. These unique characteristics may relate to features of the tax system overall,¹⁷¹ or to the jurisdiction's taxpayers themselves.¹⁷² Where relevant, some of these nuances are highlighted.

Table 3 summarises the tax concessions provided to the arts in the jurisdictions studied, outlining such mechanisms as deferred gifts to charities and testamentary gifts. This treatment may directly benefit artists, or indirectly benefit them through assisting art organisations or donors. Reference is also given to the current Australian tax treatment. It is evident from this table that there are a number of concessions provided to the arts sector. To develop a greater understanding, potential reforms will now be discussed in detail — in particular, exempt income for artists, tax credits for artists, transfers of art in lieu of payment of tax, and deferred gifts.

169 The eligibility requirements include: minimum expenditure \$15m with some additional qualifications when the budget is below \$50m. For TV series, at least \$1m per hour of the series.

170 The minimum expenditure on PDV is \$5m.

171 For example, the presence of estate or inheritance tax, or tax imposed at both state and federal level.

172 For example, cultural differences may be instrumental in whether taxpayers donate.

Table 3: Summary of Tax Treatment of Artists in Various Jurisdictions¹⁷³

| Tax treatment | Australia | United Kingdom | United States | Canada | Ireland | Other |
|---|--|--|---------------------------------------|--|--|---|
| Directly affecting artists | | | | | | |
| Exempt income for artists | Not for artist (but art organisations may be exempt) Film | No | At state level on some income Film | At state level on some income music, digital media, film, magazine and television | Creative exemption income tax (capped) | |
| Tax credits for artists to reduce tax payable | | Film | | At state level: book, music, digital media, film, magazine and television | | |
| Income averaging by artists | Yes | Yes | No | No | No | Germany and the Netherlands |
| Transfer of art in lieu of payment of tax | No | Acceptance of cultural good in lieu of inheritance tax | | | Acceptance of cultural good in lieu of income tax, corporate tax, and capital acquisition tax for heritage items | Mexico: artist can pay income tax through donated art to the Tax Office |
| | | | | | | Netherlands: transfer of cultural goods to reduce inheritance tax |

| Tax treatment | Australia | United Kingdom | United States | Canada | Ireland | Other |
|---|---|---|--|--------|-------------------------------|--|
| Affecting art organisations | | | | | | |
| Concessional GST (Value Added Tax - VAT) treatment for artist | Fundraising activities can be input taxed | Zero rate applying to books, publishing and fundraising | At state level exemption from sales tax | | Concessional or zero rate | Germany: reduced rate of VAT for sales of art objects and copyright income |
| Intermediary bodies to facilitate donations to the arts | The Australia Cultural Fund administered by the AbaF | Donor Advisor Funds | Donor Advisor Funds | | Donations to Minister Finance | |
| | Prescribed Private Funds Public Funds | Charitable bank accounts Private Foundations Institute of Fundraising | Social venture partners Venture philanthropy Private Foundations | | | |
| Affecting donors or donations | | | | | | |
| Deductions for inflated prices for goods or services | Charity dinner and auction: net deduction if minor benefit less than \$150 or 20% value of contribution | Minor benefit allowed under Gift Aid | Net value of gift deductible if amount paid > \$75 | | | |
| Donation of cultural goods to charity | Cultural bequest program (deduction and CGT exemption) (alive and in limited circumstance via will) | No deduction but exempt from CGT and inheritance tax | Tax deduction to donor (quantum depends upon whether revenue or capital account) | | | Japan: donation of cultural goods |
| | | In situ donation of cultural goods possible | | | | |
| | | Douceur system for private sale of art to museum | | | | |

| Tax treatment | Australia | United Kingdom | United States | Canada | Ireland | Other |
|--|--|--|--|----------------|---------|-------|
| Affecting Donors/Donations | | | | | | |
| Deferred gifts to charity | Cultural (including donor being able to retain some control) | Conditional exemption for pre-eminent quality goods | Fractional gifts possible (to be fully gifted within 10 years) | | | |
| | | | Retained life interest | | | |
| | | | Charitable remainder trust | | | |
| | | | Charitable lead trust | | | |
| | | | Pooled income Fund | | | |
| Tax deduction for a gift of cash to not-for-profit/charity | Yes (not for deceased estates) | Yes – reduces donor's tax payable Charity can get a top-up payment under Gift Aid | Yes | 20% tax credit | | |
| Payroll giving to facilitate donations | Yes | Yes | Yes | Yes | | |
| Tax return giving | No | Yes | | | | |

| Tax treatment | Australia | United Kingdom | United States | Canada | Ireland | Other |
|---|--|---|--|---|---------|---|
| Donation of non-cultural goods to charity | Tax deduction – but possible CGT (includes listed shares and land) | Tax deduction and CGT exemption for listed shares and land. | Tax deduction and CGT exempt for listed shares and land | Reduced capital gain calculation on donated listed shares | | |
| Volunteering | No deduction for volunteer work or expenses associated with | Employer can claim a tax deduction for wages paid to employees who volunteer in work time | Tax deduction for market value of clothes and house hold goods Deduction for volunteer's expense incurred in the course of volunteering | | | |
| Purchasing art | CGT asset (likely collectible CGT asset) | Normal rules | Normal rules | | | Netherlands: interest free loan to purchase art Singapore: public art double tax deduction |
| Testamentary gifts to charities | No tax deduction unless cultural bequest program | Exempt inheritance tax | Decreases estate tax | | | |
| | | | Life estate of land is tax deductible; decrease estate tax | | | |
| | | | Life insurance and Super contribution | | | |

Exempt income for artists

In most jurisdictions, if art organisations qualify as not-for-profit or a charity, then tax concessions will apply to contributions received, particularly donations, and to the level of income tax paid. For example, income earned can be exempt and donations to the art organisation may be deductible for the contributor. However, a number of jurisdictions also provide that income earned by an artist can be exempt from income tax or sales tax. Of course, exemption from paying tax contributes to sustainability of artists, as artists then have greater financial resources to fund their artistic endeavours. In Australia, artists are not provided any tax exemption for income they earn in their capacity as artists,¹⁷⁴ although there is an income tax free threshold, and low-income offset can decrease all taxpayers' tax liability. Indeed, the combined effect can mean that a taxpayer earning \$14,000 will not have to pay income tax.¹⁷⁵ Given the data about the level of income earned by artists, this may mean that there is relatively little or no tax being paid by them.

In comparison, a number of states in the United States provide support to artists through the exemption of their income from state taxes.¹⁷⁶ However, these exemptions do not apply to federal taxes.¹⁷⁷ In Rhode Island, artists can be exempt from state tax on income from the sale of their work;¹⁷⁸ from 1998, there has been an exemption from state sales tax for artists who live in one of nine designated art districts in the state. In particular, there is an exemption from sales tax on the sale of works created within the district by artists who live and work there, and the sale of original, one-of-a-kind works of art by galleries located within the district (regardless of the origin of art work).¹⁷⁹

To encourage the creation of cultural hubs in the state of Maryland, the following tax incentives are available to areas designated 'arts and entertainment':

- state income tax subtraction for artistic work sold by qualifying residing artists;

173 Part of this data is compiled from C McAndrew, *Artists, Taxes and Benefits: An International Review*, 2002, pp 10–11.

174 Of course, if an artist is regarded as only carrying on a 'hobby', compared to a business, then any receipts derived will not be assessable income.

175 For the 30 June 2009 year, the tax-free threshold for resident taxpayers is \$6000. The low income offset is \$1200 for taxable income below \$30,000.

176 The state of Kentucky offers tax credits to individual artists willing to relocate to the town of Paducah to buy and rehabilitate historic structures for live/work spaces. See <<http://www.paducaharts.com.au>> (accessed 29 July 2009). The state of Hawaii excludes from an individual's taxable income royalties derived from patents, copyrights or trade secrets from 'performing art products'. However, the term 'performing art products' is narrowly defined and includes only audio files, video files, audio/video files, computer animation, and other entertainment products perceived by or through the operation of a computer, as well as commercial television and film products: Payne, above n 5, p 10.

177 Department of Finance, *Budget 2006: Review of Tax Schemes: Volume III: Internal Review of Certain Tax Schemes*, 2006, p E30.

178 The exemption applies to income received from the sale of work created by artists who live and work within the district: Taxation State of Rhode Island General Laws § 44-30-11.

179 Ibid.

- property tax exemptions for up to 10 years provided to developers who renovate or construct space for artists and/or arts-related enterprises; and
- exemption from the admissions and amusement tax.¹⁸⁰

In the Canadian province of Quebec,¹⁸¹ copyright income for certain artists (writers, artists, filmmakers, musicians and performers) is tax-exempt.¹⁸² This exemption works on a sliding scale with a cap of \$60,000 CAN.¹⁸³ The justification for this exemption is that it provides some equivalency to the tax concessions given to ‘research and development’, and supports cultural innovators who take risks in developing new work.¹⁸⁴

This exemption is available only to copyright income of ‘creators’ of original literary, musical or artistic works. Performing artists are not able to access this concession on the basis that they are generally paid on performance, although this exclusion is not without criticism.¹⁸⁵

Since 1969,¹⁸⁶ Ireland has provided tax-exempt status to Irish resident¹⁸⁷ self-employed ‘creative artists’ deriving income from the sale or copyright fee for books and writing, plays, musical compositions, paintings or other pictures, or sculptures.¹⁸⁸ However, to access this exemption, the work must either be both creative and original,¹⁸⁹ or have cultural or artistic merit.¹⁹⁰ The Revenue Commission of Ireland is empowered to make a determination whether or not this is the case. This may appear to be a strange function for a revenue collecting authority, and it may be questionable to what extent it has the expertise to do this.

Similarly to Canada, the Irish exemption does not cover all artists, and

180 Maryland Code, Title 9 Property Tax Credits and Property Tax Relief §§ 9-240 and 4-104. Payne, above n 5, p 10.

181 The province of Nova Scotia also has an exemption from tax rates for artists: Department of Finance, above n 177, p E30.

182 Known as the Quebec Bill 108, amending the Income Tax Act 1995.

183 2001 figure.

184 Standing Committee on Canadian Heritage, *A Sense of Place, A Sense of Being*, Canada, 1999. McAndrew, above n 173, p 23: ‘creators take the most risks as they carry out research and development for which there is no payment in time, and no assurance that there will be any remuneration upon completion’.

185 McAndrew, above n 173, p 23.

186 Pursuant to the Finance Act 1994.

187 Residency status as defined by the Finance Act 1994, which includes a number of tests such as ‘ordinary resident’ and ‘183 days’.

188 Under s 195 of the Taxes Consolidation Act 1997, this income tax exemption also includes Arts Council Bursaries, Cnuas payments (annuities paid to artists), and payment from sales outside Ireland. While income tax exempt, they will still be subject to Pay-Related Social Insurance (known as PRSI) of 5%.

189 ‘Original and creative’ encompasses any unique work that is brought into existence for the first time as an independent entity by the use of the creator’s imagination. This can exclude non-fiction work unless certain further requirements are met. Also excluded would be books to be used by students in a course of study, advertising (written/musical). See Citizens Information Board, *Exemption From Income Tax for Artists*, Public Service Information, 2008 <http://www.citizensinformation.ie/categories/money-and-tax/tax/income-tax/exemption_from_income_tax_for_artists> (accessed 29 July 2009).

190 A work has cultural merit if its contemplation enhances the quality of individual or social life as a result of its intellectual, spiritual or aesthetic form and content. A work has ‘artistic merit’ when its combined form and content enhance or intensify the aesthetic apprehension of those who experience or contemplate it.

excluded are actors, musical performers and dancers. Of course, if these artists actually wrote a piece of work, then their royalty income from a play or song could be exempt.

Previously, there was no cap to the Irish income tax exemption. This led to concerns about the amount of tax revenue lost and whether the exemption was really helping low-income artists.¹⁹¹ In 2001, the following income levels of artists benefiting from the scheme were identified:

- 50% had earnings averaging 5213 Irish pounds;
- 48% had earnings between 10,000 to 50,000 Irish pounds; and
- 2% had earnings in excess of 50,000 Irish pounds (however, this 2% of artist derived 58% of all the exempt income).¹⁹²

In response to concerns, from 1 January 2007 a partial cap of 250,000 Irish pounds was introduced. This means there is full exemption for artistic income up to 250,000 Irish pounds; for income in excess of this cap only 50% of the excess income is exempt.¹⁹³

While the exempting of artists' income has been implemented in a number of jurisdictions, particularly Ireland, such a system can increase complexity and create inequities among taxpayers. It should be recalled that Australia allows artists to average their income to smooth out their income.¹⁹⁴ This assists in ensuring that artists are not unduly burdened by Australia's progressive marginal tax rates when their income varies from year to year. Given the lack of extension of Australia's research and development concessions to artistic endeavours, it is uncertain whether the Australian government would be convinced to allow the exemption of copyright income as a de facto 'R & D concession'. However, the exemption of copyright income earned by artists would have the appeal of simplicity compared to the more involved research and development process.

Tax credits for artists

Broadly, tax credits can be distinguished from 'tax deductions' in that the former directly offset the tax payable by a taxpayer. In contrast, tax deductions generally reduce the part of a taxpayer's taxable income to which their applicable tax rate applies. This means that \$1 credit will directly save the taxpayer \$1 in tax, whereas a \$1 deduction will save the taxpayer 30 cents in tax, assuming the taxpayer's tax rate is 30%. Accordingly, the value of a tax credit for a taxpayer is greater than a tax deduction.

While Australia has recently introduced a tax credit system for investments into the film industry, there is no tax credit system broadly available for other artistic work.

Within Canada, the Province of Ontario provides a range of tax credits that can directly offset the Ontario taxes otherwise payable in six cultural

¹⁹¹ McAndrew, above n 173, p 44: 'The incentive also offers most to artists who are already commercially successful, as they sell more works and earn more copyright income, when these are arguably the artists who need it the least. It also means that those possibly most able to pay for public welfare through taxation avoid doing so, leaving the rest of the economy (locally and regionally) to the pay the difference.'

¹⁹² The Arts Council, *Artists' Exemption Scheme: Budget 2006*, The Arts Council, 2005, p 1.

¹⁹³ Tax Consolidation Act 1997 s 195.

¹⁹⁴ ITAA 1936 s 405-25.

industries, including books, music and digital media.¹⁹⁵ However, these tax credits do not go to the artist directly, but instead support the art organisation producing their work.

For example, there is a refundable tax credit available for Canadian-controlled Ontario-based book publishing companies that publish works by first-time Canadian authors.¹⁹⁶ Expenditures that qualify for the credit include 100% of pre-press and promotion costs and 30% of costs related to production, with a maximum credit of \$30,000 per book.¹⁹⁷

In terms of music, there is a 20% refundable tax credit for certain expenditures¹⁹⁸ incurred by a qualifying corporation¹⁹⁹ in the production of 'eligible Canadian sound recordings' by 'emerging Canadian artists or groups'.²⁰⁰ For interactive digital media, there is a 20% refundable tax credit for Ontario labour expenditures incurred in developing interactive digital media products for commercial exploitation in Ontario.²⁰¹

The availability of tax credits can be more valuable than the availability of deductions. A way that tax credits could be introduced in Australia is by expanding the film production offset to other artistic endeavours, such as in the Canadian system. While this would apply to art organisations producing such work, artists should benefit through greater production of their work due to lower costs. There could also be a compliance cost advantage by having the credits apply to art organisations, which by their nature should be larger and fewer in number, compared to individual artists.

Value added tax concessions

A number of countries provide for a concessional rate of VAT or GST to apply to certain artistic endeavours. For example, in Germany, instead of the normal VAT rate of 15%, a reduced rate of 7% applies to the sales of art objects and

195 Other cultural industries eligible for tax credits include film, magazine publishing, and television.

196 Payne, above n 5, p 17.

197 Taxation Act 2007 Ch 11 Sch A ss 94–95. Ontario Media Development Corporation, *Ontario Sound Recording Tax Credit (OSRTC): Information/Application Package*, Ontario, 2006, p 33. The maximum credit prior to 2000 was \$10,000.

198 T Lloyd, *A Guide to Giving*, Philanthropy UK (Ed), London, 2005, p 2: 'Qualifying expenditures include recording production costs, such as artists' royalties, musicians' session fees, graphics, digital scanning, programming and testing, production costs for music video.'

199 Ibid, p 2:

An eligible sound recording company is a Canadian-controlled corporation having carried on a sound recording business in Ontario for at least 12 months as a corporation or, prior to incorporation, as a sole proprietorship or partnership if the corporation's taxation year ends after 11 May 2005 . . . must earn more than 50% of its taxable income in Ontario for the preceding taxation year and more than 50% of the company's business must be related to sound recording activities.

200 Taxation Act 2007 Ch 11 Sch A s 94. Ontario Media Development Corporation, above n 197, p 33. Lloyd, above n 198, p 3:

An individual is an emerging Canadian artist if, at the time they signed the recording contract, they are a Canadian citizen or permanent resident ordinarily resident in Canada and if they have not had a gold recording as an individual or as part of a group in the USA and either Canada, UK, France, Germany, Asia or Latin America. A group is an emerging Canadian group if at least 75% of its members are emerging Canadian artists.

201 Taxation Act 2007 Ch 11 Sch A s 93. Ontario Media Development Corporation, above n 197, p 35.

copyright income.²⁰² Australia does not provide any direct GST concessions for artists or art organisations, although fundraising events can elect to be input taxed rather than subject to GST.²⁰³ In addition, the threshold for mandatory GST registration is greater for not-for-profit bodies, while for other businesses it is \$75,000.

In the United Kingdom, the regular rate of VAT is 17.5%. However, supplies of books, publications and posters have a zero VAT rate. Fundraising events can also be exempt from VAT.²⁰⁴ Additionally, museums and galleries that do not charge admission fees are able to claim the VAT back on their expenses.²⁰⁵

In Ireland, artists receive a number of concessions, rather than using the normal 21% VAT that applies there.²⁰⁶ A reduced rate of 12.5% applies to sales of artistic works from a registered trader, and to admissions to artistic and cultural exhibitions.²⁰⁷ Furthermore, a zero VAT rate applies to the sales of books, periodicals and exhibition publications, and to the promotion of, or admission to, live theatrical performances.²⁰⁸

It should be highlighted that an adverse consequence of allowing such concessional VAT or GST treatment is the potential increase in complexity, putting pressure on raising the overall rate due to a narrower base. Australia currently has a low rate of GST compared to other countries, and the deeming of artistic supplies as GST-free would narrow the tax base and put pressure to raise the overall GST rate and add to the overall complexity of the system. Furthermore, artists and art organisations would still be required to be GST-registered to be able to claim back the GST input tax credits in their expenses. Given the successive Australian Federal Governments' view to not substantially amend GST legislation, it is unlikely that this amendment would be considered favourably.

Transfer of art in lieu of payment of tax

A number of jurisdictions allow taxpayers to transfer property, including works of art, in lieu of payment of different taxes, such as estate tax. Such in lieu of payment systems can be beneficial to taxpayers, as they effectively act as a 'tax credit' system compared to a 'tax deduction' system, and thus are more valuable.²⁰⁹ Australia does not currently provide for in lieu of payment transfers, although if an artist donates a piece of their work as a cultural good, the artist may be entitled to a tax deduction for the cost of the work (as opposed to its market value).²¹⁰ As a deduction compared with an offset, the value of the tax saving is not dollar for dollar, but is instead at the taxpayer's marginal tax rate.

202 VAT Act (Umsatzsteuergesetz) (Germany).

203 A New Tax System (Goods and Services Tax) Act 1999 (Cth) s 40-160.

204 VAT Act 1994 (UK).

205 VAT Act 1994 (UK) s 33A.

206 Even if an artist's income is income tax exempt, this does not mean such income will not be subject to VAT.

207 Value Added Tax Act 1972.

208 Ibid, Sch 3. Exhibition publications have to be less than 8 pages in length.

209 Refer to the prior explanation of the difference between a tax deduction and tax credit.

210 For example, if the artist has held the cultural good greater than 12 months, then the

In the United Kingdom, the acceptance in lieu system²¹¹ enables taxpayers to transfer works of art and other heritage objects²¹² into public ownership in full or part payment of inheritance tax.²¹³ In 2006, the United Kingdom gained art works and heritage items to the value of 25.5 million GBP under this scheme.²¹⁴

Another way that transfers of art to galleries are encouraged in the United Kingdom is via the *douceur*²¹⁵ system, which exempts private sales²¹⁶ of pre-eminent heritage items to listed galleries or museums from CGT and inheritance tax.²¹⁷ Due to tax not applying to such a private sale, the seller can sell for a lower price. For example, if the sale were going to be subject to tax, then the seller would demand a higher price to fund their tax liability. For the acquiring gallery or museum, the *douceur* system is advantageous, as they do not have to fund a higher price. Interestingly, it is the practice that this 'tax saving' on price is shared between the seller and buyer, with the buyer paying a slightly higher price than otherwise. Generally, the buying museum gains by paying the market price less 75% seller's tax saving. Sellers gain, as the amount they receive is not liable to tax, which means they are ahead, compared to selling at market and having to pay tax.²¹⁸

A similar *douceur* system does not apply in Australia. If a piece of art is sold, as opposed to donated, then it is likely to be an assessable capital gain, depending upon its acquisition cost.²¹⁹ Indeed, as a collectible CGT asset, certain expenditure is excluded from the cost base, thereby resulting in more tax being paid.²²⁰ However, if the artwork was donated rather than sold, then a tax deduction may be available for the donation of goods to a charity or DGR.

Ireland has a broad system that allows for the payment of a number of taxes (such as income tax, corporate tax, CGT or capital acquisition tax) through the

deduction will be the market value. If, however, the cultural good is part of the artist or art dealer's trading stock, then the deduction will be the cost of acquiring the good or the cost of producing the item.

211 N Goodison, *Goodison Review: Securing the Best for Our Museums: Private Giving and Government Support*, Norwich, 2004. Recommendations 26 and 27: that the system be extended to offset all forms of tax liability and not just tax liability on deceased estates; and that owners of objects, during their lifetimes, be able to arrange offers in lieu of tax liabilities following their deaths.

212 The scheme covers land, objects that are individually pre-eminent or form part of pre-eminent collections, and objects that are or have been kept in certain buildings.

213 Inheritance Tax Act 1984 (UK) ss 230 and 231. Previously known as capital transfer tax or estate duty.

214 Similarly, since 1 January 1997, Dutch inheritance tax can be paid by transferring art objects either of cultural significance to the Netherlands or whose sale outside the Netherlands would mean a cultural loss to the country. For such artwork transferred to the government, the reduction of inheritance tax is 120% of the value of the artwork.

215 The term 'douceur' refers to the tax saving benefit shared between the buyer and seller.

216 It must be a private treaty sale, in that the owner agrees to sell to one buyer rather than putting the item up for auction.

217 Referred to as Schedule 3 Bodies, such as national galleries.

218 Goodison, above n 211, p 76.

219 If the piece of art is considered as a 'collectible CGT asset' and it cost \$500 or less to purchase, then any capital gain or capital loss on subsequent disposal is disregarded for the taxpayer: ITAA s 108-10(1).

220 Refer to the prior discussion of this.

donation of heritage items to certain approved bodies.²²¹ Furthermore, Ireland provides that works of art on display in public places become exempt from the inheritance and CGT after 7 years.²²²

The Mexican tax system allows artists such as painters and sculptors to pay their annual tax obligations with their own artwork. For an artwork to be accepted in lieu of payment of tax, it must meet a quality test determined by a panel of experts.²²³ Accepted works are then either displayed at the Finance Ministry's museum in Mexico City or at other museums in the country. A benefit of this system is that it can help museums fund the purchase of modern art work; it has been observed that the bequest of artworks is 'absolutely essential to museums' as they lack significant acquisition funds.²²⁴

There is some appeal in the transfer of art in lieu of payment of tax, although if made via the tax office this could increase the administrative and compliance cost burden. This would be exacerbated if the tax office had to assess the cultural significance of the piece. An alternative is that artists could donate their work directly to a gallery and then claim the market value of the donated piece as a tax offset (or a tax deduction). The current system used to ascertain market value of cultural goods via the tax office could be used. This system would have less of an administrative burden and galleries could choose whether to accept a piece or not. This could address the issue that currently in Australia there is little incentive for artists or art dealers to donate their work held as trading stock, as their denotation deduction is limited to the cost of the piece rather than its market value.

Deferred gifts

Some overseas jurisdictions have mechanisms that allow for either deferred or fractional gifts to occur over a period. These deferred gifts can occur while taxpayers are alive, or after death through their estates. The closest Australia has to a deferred gift is the suspended Cultural Bequest Program through a will, as it requires pre-approval by the Minister for Communications and Arts.²²⁵ Under the Cultural Bequest Program, a fractional gift can be made which reduces the quantum of the tax deduction.²²⁶

221 Taxes Consolidation Act 1997 Sch 26A s 1003. However, there are caps that apply, as the market value from a single donor must be at least 75,248 Irish pounds but not greater than 3 million Irish pounds.

222 Ibid, s 606. Goodison, above n 211, p 58.

223 In 2003, only 128 art works were accepted under this system. If an artist's work is rejected three times, then the artist must pay their tax in cash. J Lyons, 'Sculpture or Tax Loophole? Mexico Demands More of Artists in "Pay in Kind Program"', *Wall Street Journal*, 6 April 2004, p 14.

224 J Lyon, Reflections on Deductibility of Items of Tangible Personal Property to Museums, 2007, <<http://www.pgdc.com/pgdc/article/2007/02/reflections-deductibility-contribution-items-tangible-personal-property-museums>> (29 July 2009).

225 ITAA s 30-230(5). Refer to the prior discussion of this provision. However, the Cultural Bequest Program was only administered for 3 years to the end of 30 June 2000, and is currently suspended. However, holders of certificates issued by the Minister prior to suspension can claim a deduction. See: Stewart and Flynn, above n 149, para 5 220.

226 This alternative will occur if the DGR receiving the cultural goods does not get immediate custody, unconditional right to retain control, or unencumbered legal title. A variation to the normal tax donation rules is that for cultural goods, it is possible for the donor to retain some

Fractional or deferred gifts to charities can be advantageous for both donor and recipient. In addition to tax benefits, the deferred gifts can provide some certainty or income for donors while they are still alive.²²⁷ Furthermore, donors are able to claim tax deductions during their lifetime, which they could not do if the donation was made via their estate.²²⁸ For the donee, such deferred gifts can increase certainty, as many of the deferred gifts are irrevocable.²²⁹ In comparison, if gifts are made via taxpayers' wills, it is possible for taxpayers to alter their will prior to death.

The United States has a number of fractional gift or deferral mechanisms operating: fractional gifts, retained life estates, charitable remainder trusts and charitable lead trusts.²³⁰

A fractional gift describes when the taxpayer retains some right or interest in the property donated. For example, a taxpayer may initially donate one-quarter of a piece of art to a gallery; meaning that the piece of art is displayed for 3 months a year at the gallery and for the remaining 9 months is part of the taxpayer's private collection at home.

For such a fractional gift in the United States, the donor can claim a tax deduction in the initial year, provided the art work is fully transferred on the earlier of 10 years or the donor's death.²³¹ From 2006, the tax deduction for the donor follows each fractional gift:

- Initial fractional gift: percentage of fair market value of the artwork gifted.
- Subsequent fractional gifts: percentage of the lesser of:
 - fair market value at date of initial gift; or
 - fair market value at date of subsequent fractional gift.²³²

If the time limits imposed to fully gift the artwork are not met, then the value of earlier fractional interest deductions are recaptured (plus interest).²³³

Alternatively, a mechanism to make a deferred gift is retained life estates. A retained life estate is a contract under which the donor transfers property to a charity on the proviso that the donor (or other named beneficiary) should

control of the cultural goods. However, if some control is retained over the cultural goods, then the value of the tax deduction will be decreased to represent this.

227 The ability to generate some income back to the donor can be particularly beneficial for taxpayers who are asset rich but income poor.

228 Another benefit is that the donor sees the benefit of the gift while alive: R John, R Davies and L Mitchell, *Give and Let Give: Building a Culture of Philanthropy in the Financial Services Industry*, Policy Exchange, London, 2007, p 55.

229 So once the donation is made, the donor cannot change his or her mind.

230 Note that there is also a deferral mechanism in the United Kingdom. It is possible to get conditional exemption from inheritance tax and CGT in the United Kingdom, where qualifying heritage 'pre-eminent' assets are given public access (known as '*in situ*'). In these circumstances any tax is 'deferred', as opposed to totally exempted. In the circumstances that the owner sells the asset or ceases to observe the conditions, then the deferred inheritance tax become payable. Goodison, above n 211, p 73.

231 If the donor does not meet the timeframe then the prior deduction for the fractional donations is recaptured, plus interest plus 10% tax: Pension Protection Act 2006 (US). In addition, the donor must initially own 100% of the artwork.

232 This means that if there is an increase in market value of the art since the initial fractional gift the donor will not be able to claim an 'extra' deduction to recognise the increase in value.

233 Internal Revenue Code 1986 (US) § 170(O)(3)(A).

remain in the residence for life. If the donor can claim the property as a personal residence, then the donor is allowed to claim an immediate tax deduction to the value of the charitable remainder interest. Also, as the donor's estate has been reduced, the estate tax on death is reduced.²³⁴

Another deferral mechanism in the United States is a charitable remainder trust. This is established by transferring assets to a trust, with the donor (or other beneficiary) receiving income from the trust for life or up to 20 years. At the death of the donor or last income beneficiary, the corpus²³⁵ of the trust is distributed to a charity.²³⁶ These can be constructed as either annuities²³⁷ or unit trusts.²³⁸

On the establishment of a charitable remainder trust, the donor receives a charitable income tax deduction equal to the net present value²³⁹ of the remainder interest to the charity.²⁴⁰ Any excess deduction can be carried forward for 5 years. There is also CGT deferral on the appreciated assets contributed to the trust.

While beneficiaries are assessable on the distributions from the charitable remainder trust, the likely estate tax on the taxpayer's death is decreased due to the lower amount of assets held. However, there are concerns about abuse of this system and the complexity that it can involve.²⁴¹

Another trust used in the United States to facilitate deferred gifts is known as a charitable lead trust. This type of trust arises when there is an irrevocable transfer of assets to a trust that pays income annually to a charity during the life of the trust. At the end of the trust (which is usually after 10 to 25 years)

234 Crimm, above n 14, at 100.

235 Corpus describes the capital property (assets) of the trust, compared to the 'income' which may be generated by this capital property. At least 10% of the fair market value of each contribution of property of the trust must be set aside as the remainder interest in such property held by the trust at the date of contribution: Internal Revenue Code 1986 (US) § 664.

236 Note that the donor can reserve the right to terminate a beneficiary's interest prior to the term stated in the trust. AEA Consulting, *The Maecenas Initiative: A Review of Charitable Giving Vehicles and Their Use in the US and Canada*, AEA Consulting, New York, 2004, p 20.

237 This describes an irrevocable donation of cash or securities to a trust for which the donor (or nominated beneficiaries) receives, in return, income payments (monthly or quarterly) for a certain term or for life. The amount of the income is determined at the time the annuity is set up (this is determined on the basis of payout rates with reference to charitable gift annuity rates, taking into account mortality, a residuum of at least 50% of initial gift, interest, expenses and other beneficiaries), and may either start straight away or be deferred: *ibid*, Pt 2, p 17.

238 Unit trust: which provides a variable income based on a fixed percentage of at least 5% to no more than 50% of the net fair market value of the trust's assets.

239 This 'net present value' will equal net fair market value of property transferred less present value of the annuity.

240 In the year of transfer of assets to the trust, the donor is able to claim a charitable income tax deduction of between 30 and 70%, depending upon an actuarial calculation based on the donor's age and payout rate. This can be a complex calculation as it involves discounting the net fair market value of the assets transferred by the present value of the income that will be distributed to the beneficiaries of the term of the trust. There are unisex Treasury tables that assist in this discount calculation. Also a probability test applies to prevent tax deductions in the circumstances that the trust's assets will be exhausted before the remainder interest is transferred to the charity. The deduction is allowed, up to 50% of the donor's AGI if cash or 50% if appreciated property.

241 John, Davies and Mitchell, above n 228, p 56.

the corpus plus retained income reverts to the donor, or the donor's beneficiaries.²⁴²

The donor establishing a charitable lead trust is entitled to a charitable income tax deduction for the present value of the total income the charity will receive.²⁴³ The trust itself may have CGT liability on any asset transferred from it. In Australia, individual taxpayers making donations each year while alive could achieve this. The only real difference is the lack of certainty for the charity, as an individual may alter year to year the quantum of donations made, or the recipient thereof.

The implementation of a deferral and/or of fractional gifts could be a viable reform for Australia to pursue, as this allows taxpayers to implement a gift during their lifetime while still enjoying part of the gifted asset. This can provide some certainty to the taxpayer, such as receiving income while alive and some acknowledgement of the gift. While the incentive to reduce estate or inheritance taxes does not exist in Australia, fractional gifts and charitable remainder trusts deserve greater scrutiny in Australia, particularly given the extent of the intergenerational wealth transfer that will occur over the next few decades.²⁴⁴ However, it is important that there is some mechanism to ensure that the market value of the deferred or fractional gift is not manipulated. This may be facilitated by having the tax office vetting or establishing the market value.

Donations of time (volunteering)

The statistics referred to earlier demonstrate that approximately two-thirds of those involved with the arts in Australia are volunteers. In Australia, the ability for volunteers to claim tax deductions for volunteer work is extremely restricted. This is because the 'provision of service' is not regarded as a 'transfer of property', and in Australia, it is this 'transfer of property' that is necessary for a donation at law to exist.

While the actual time spent by a volunteer in the United States cannot be claimed as a tax deduction, some of the out-of-pocket expenses incurred during the course of charitable volunteering, such as petrol costs or overnight accommodation, can be claimed.²⁴⁵ While people in the United Kingdom cannot claim their time volunteering as a tax deduction, if they volunteer as an employee, then their employer will be able to claim the wages paid as a business expense.²⁴⁶ Given the level of volunteering in Australia, it would appear to be reasonable to allow some claiming of expenses as a tax deduction; this would provide some equity between those who volunteer time and those who volunteer money. However, the potential cost to tax revenue could be of concern to the Australian government, as well as the substantiation of such expenses.

242 AEA Consulting, above n 236, p 21.

243 Internal Revenue Code 1986 (US) §§ 170, 2522 and 2055.

244 The coming transfer to wealth between generations from the post-War generation is expected to be the largest in history: AEA Consulting, above n 236, p 6.

245 Internal Revenue Code 1986 (US). John, Davies and Mitchell, above n 228, p 122.

246 B Campbell, *Making Giving Go Further: The Definitive Guide to Tax-Effective Giving*, Institute of Fundraising (Ed), 5th ed, Institute of Fundraising, London, 2008, p 45.

Purchasing services or goods

Another way that people can support the arts is through the purchase of goods and services. In Australia, the purchase of art work is likely to be classified as a collectible CGT asset and thereby subject to special rules that quarantine losses and exclude certain non-capital costs from being added to the cost base.²⁴⁷

In Singapore, the Public Art Tax Incentive Scheme encourages more private organisations and individuals to participate in the areas of donating, commissioning, displaying and maintaining public art.²⁴⁸ Under this scheme, a double tax deduction is available for the donation of public art or commissions to an approved recipient on the appraised value of the artwork. Alternatively, individuals or corporations can adopt existing public art belonging to the state. The adopters have to pay for the maintenance of the artwork, but can claim a double tax deduction for this expenditure. In addition, a double tax deduction is available for the installation and maintenance costs for the display of owned artwork. Such a system is similar to the increased deduction for research and development in Australia.

A non-tax measure that has been implemented in a number of jurisdictions is a loan system to facilitate the purchase of art. For example, the government in the Netherlands provides for interest-free loans for the purchase of modern²⁴⁹ Dutch works of art from selected art galleries.²⁵⁰ The artwork must cost between 1000 NLG and 15,000 NLG. This scheme has been praised for assisting artists' economic situation and being cost-effective for the government to administer. However, it has been criticised on equitable grounds, as generally it is used by high-income taxpayers.²⁵¹ Indeed, similar loan schemes have been recently introduced in the United Kingdom²⁵² and Tasmania.²⁵³ This may indicate that a loan system has more of a direct influence, in comparison to 'blunt' measures employed through the tax system.

Given the experience overseas, it is argued that there could be greater incentives provided for the purchase of art in Australia, such as the alteration of the CGT collectible asset rules so they are treated on a similar basis to other CGT assets, or the provision of low cost loans to facilitate the purchase of art. A middle ground could be to allow interest paid on a loan to purchase art to be added to the cost base of the collectible CGT asset.

247 ITAA s 108-10.

248 For detailed information about the scheme, see <http://www.business.gov.sg/EN/HowToGuide/GovernmentAssistance/gp_patis_nhb_how.htm> (29 July 2009).

249 The work of art must have been produced after 1945.

250 The gallery must have acquired the Dutch work of art directly from the Dutch artist. Galleries must have been in existence for at least 3 years, be open daily, achieve minimum sales of 75,000 NLG per annum, and must hold exhibits at least six times a year.

251 McAndrew, above n 173, p 56.

252 Known as 'Own Art', which has Hitachi Capital Consumer Finance as the credit provider. The subsidised value of the loan is GBP 2000.

253 Known as 'Collect Art Purchase Scheme' providing subsidised loans between AUD 750 to 7500 interest free for 12 months, with a rate thereafter of 13%. See <<http://www.collect-art.com.au/about.html>> (accessed 29 July 2009).

Testamentary donations

In Australia, gifts made via a deceased's estate normally are not tax deductible²⁵⁴ unless they are part of the suspended Cultural Bequest Program. This means that if income or capital gains are realised during the administration of the deceased's estate, they cannot be reduced by deductions for donations made pursuant to the deceased's wishes.

A number of other jurisdictions do allow deductions, as well as such donations reducing the imposition of inheritance taxes. For example, in the United Kingdom gifts to charities made via a will are exempt from inheritance tax. In the United States a charitable bequest²⁵⁵ to a charity via a deceased's will means that the deceased estate is entitled to a tax deduction for estate tax purposes.²⁵⁶ In addition, in the United States a taxpayer can designate that a charity is the owner and beneficiary of the taxpayer's life insurance. Therefore, on the death of the taxpayer, the charity receives a payment under the life insurance policy, and allows the deceased's estate to claim a tax deduction.²⁵⁷ Furthermore, it is possible for a taxpayer to name a charity as a beneficiary of a remainder interest in their superannuation savings.²⁵⁸ This enables an income tax deduction and a reduction of the estate subject to estate duties.

The operation of estate taxes and death duty can be considered as pivotal, in some overseas jurisdictions, to acting as a catalyst for gifting, to reduce the exposure to such taxes (although this is not certain).²⁵⁹ Table 4 illustrates the level of giving as a percentage of GDP in 12 countries included in the Organisation for Economic Co-operation and Development (OECD). While the United States is held up to be an exemplary nation of givers (as their charitable giving is about 1.69% of GDP), it needs to be appreciated that there are characteristics of the United States that are unique. For example, a large

254 Generally, cash donations made pursuant to a will are not tax deductible even if the recipient is a DGR: ITAA s 30-15(2). Testamentary donations of non-cultural goods will also be non-tax deductible. However, the potential capital gain or capital loss on the transfer of the non-cultural goods by the executor to the recipient may be disregarded provided it would have been deductible if the donation had occurred while the person was alive: s 118-60. This CGT exemption applies even if the value of the property is less than \$5000.

255 The transfer of either money or property.

256 Internal Revenue Code 1986 (US) §§ 2055(e) and 2522(c)(3).

257 The amount of the donor's charitable tax deduction depends upon to what extent the policy is paid up: (a) if fully paid up, amount is the lesser of (i) donor's cost basis of the policy, or (ii) how much it would cost to purchase an identical policy (this is known as the 'replacement value' (up to 50% of donor's AGI and any excess can be carried forward for 5 years); (b) if partly paid up, amount is the lesser of (i) donor's cost basis of the policy, or (ii) interpolated terminal reserve of the policy (up to 30% of donor's AGI and any excess can be carried forward for 5 years). AEA Consulting, above n 236, p 26: 'The interpolated terminal reserve equals an amount slightly larger than the cash surrender value of the policy plus a portion of the last premium paid before the gift is made.'

258 In the United States this is known as 'retirement plans' and includes employee benefit plans, individual retirement accounts, corporate saving plans, pension and profit sharing plans and annuities.

259 For example, plans to entirely phase out the federal estate tax in the United States are estimated to reduce charitable bequests by 22%: The Performing Artists Alliance, *Tax Incentives for Nonprofit Charitable Giving 2005*, 2005, <http://theperformingartsalliance.org/performingarts/tax_issue_center.html> (accessed 29 July 2009).

proportion of giving in the United States goes to religion, as it is the most religious of all western nations.²⁶⁰ Furthermore, this is coupled with the realisation that the United States is not a welfare state, and therefore reliance on private donations is critical for public goods to be made available.²⁶¹

There are a number of jurisdictions, such as the United Kingdom, Ireland, the Netherlands and Japan, which also impose estate taxes or inheritance taxes on inter-generational transfers of property.²⁶² The lack of an estate tax in Canada (similarly to Australia) has been identified as a potential reason why charitable giving is lower in Canada compared to jurisdictions with estate taxes.²⁶³ However, the validity of such conclusions is questionable, given that both Canada and Australia have levels of giving similar to that of the United Kingdom, and greater than those of Ireland and the Netherlands, all of which have estate taxes (refer to Table 4).

Table 4: Charitable Giving in 12 OECD Countries in 2005²⁶⁴

| Countries | Individual giving as a percentage of GDP |
|--------------------------|---|
| United States of America | 1.67 |
| United Kingdom | 0.73 |
| Canada | 0.72 |
| Australia | 0.69 |
| South Africa | 0.64 |
| Rep of Ireland | 0.47 |
| Netherlands | 0.45 |
| Singapore | 0.29 |
| New Zealand | 0.29 |
| Turkey | 0.23 |
| Germany | 0.22 |
| France | 0.14 |

All Australian states abolished estate taxes in the 1970s and 1980s. The closest Australia now has to an estate tax is CGT, which commenced in 1985. However, for assets transferred via a taxpayer's will to beneficiaries, any

260 Giving USA Foundation, Giving USA 2004, The Trust for Philanthropy of the American Association of Fundraising Counsel/The Center on Philanthropy at Indiana University, 2004: 36% goes to religion, 16.5% to health and human services, 13.1% to education; and 5.4% to the arts. In comparison, in the United Kingdom only about 16% of donations go to religion.

261 John, Davies and Mitchell, above n 228, p 9.

262 This liability may fall either on the estate itself or on the beneficiary who is receiving the inherited good. In the United States, the top estate tax rate is currently in the vicinity of 48%, which will decrease to 45% in 2009. For 2004, the unified credit is \$555,880 toward an applicable lifetime exclusion of \$1,500,000. The United Kingdom also has an inheritance tax (replacing the previous estate tax and capital transfer tax), with all estates taxed at 0% for the first 312,000 GBP, and then at 40% for the value above this.

263 AEA Consulting, above n 236, p 14.

264 Source: CAF, International Comparison of Charitable Giving, 2006.

potential exposure to CGT is deferred.²⁶⁵ It is not until the beneficiary disposes of the inherited asset (which could be a number of years) that a CGT obligation will arise. Therefore, unlike some of the foreign jurisdictions studied with estate taxes, the tax triggering point in Australia does not arise at death. Rather than introducing an estate tax in Australia,²⁶⁶ the way CGT applies to inherited assets could be altered so that CGT liability could arise when assets are transferred to a beneficiary. Bringing this taxing liability forward may then trigger charitable donations to reduce the beneficiary's tax exposure.²⁶⁷ The alteration of CGT in Australia in this way would be a politically sensitive reform. Nevertheless, the interaction that taxes have on a person's estate needs greater consideration, to ascertain whether reforms could be implemented to improve donations. For example, allowing executors tax deductions for donations to charities and DGRs would improve consistency and horizontal equity between when a person is alive and after they have died.

Conclusion

The arts sector can be plagued by characteristics that make its sustainability difficult. There are some economical arguments that this can be addressed through the tax system. Indeed, some have argued that tax mechanisms used overseas should be adopted in Australia.

I have sought to provide greater analysis of these potential reforms by considering some of the data about the size of the Australian arts sector and the justification for tax concessions. The current tax provisions that can either directly or indirectly affect the arts were considered prior to analysing some of the foreign concessions advocated. I argued that reforms altering the tax treatment of transfers of art by artists and art dealers, deferred gifts, volunteer expenses and testamentary gifts warrant greater consideration.

In particular, the concept of exempting copyright income of an artist may be an effective de facto mechanism to allow artists to have an equivalent research and development concession. However, such a reform would be politically sensitive, and the inclusion of a cap to the exemption may be required. In addition, the concept of extending the current film offset to other producers of Australian works, such as books and music, may be a viable option. Further consideration should be given to allowing artists to claim the market value of an accepted donation of their work to galleries. Given Australia's relatively low GST rate, applying a reduced or nil GST rate to art related goods or activities would not be a worthwhile reform to follow.

265 ITAA ss 128-10 and 128-15. Unless the executor sells the asset and distributes the resultant money to the beneficiary.

266 Which has been advocated by others on the presumption that donations to the arts would reduce the estate tax: Recommendation 8.27 of Australia 2020 Conference: *Towards a Creative Australia*.

267 Note that all assets transferred to a beneficiary will necessarily expose the beneficiary to CGT. For example, if the beneficiary inherits the deceased's main residence then this retains its exempt status for up to 2 years from date of death: ITAA s 118-195. If the deceased's asset was acquired prior to 20 September 1985, then the beneficiary cost base is the market value at date of death: s 128-15. If the asset was acquired by the deceased on or after 20 September 1985, then the beneficiary inherits the deceased's cost base of the CGT asset at date of death: s 128-15.

Greater consideration should be given to fractional or deferred gifts. This is particularly the case given that it is predicted that the largest intergenerational transfer of wealth will occur over the next few decades.²⁶⁸ This could be complimented by altering the CGT rules to provide that tax liability is crystallised on a taxpayer's death, rather than being deferred if the asset is transferred to a beneficiary pursuant to the deceased's will. Extending a deduction for donations made by executors would also improve the overall horizontal equity of the Australian tax system.

While there can be economic reasons to justify such treatment, it needs to be acknowledged that any preferential or alternative tax treatment of the arts needs careful consideration, as it is possible that unintended consequences could arise. One particular concern is the potential of adding to an already complex tax system. Indeed, a preferable alternative may be to simplify the tax system for all taxpayers compared to introducing specific rules or carve-outs.

An important way that this could be determined is by further research into how the arts sector interacts with the tax system and ascertainment of evaluations of the potential reforms. It is only through such thoughtful consideration that reforms to assist the arts to become more sustainable will be achieved in any meaningful way.

²⁶⁸ B Brill, 'Preparing for the Intergenerational Transfer of Wealth: Opportunities and Strategies for Advisors' (2003) *Jnl of Practical Estate Planning* 25; J Havens and P Schervish, 'Why the \$41 Trillion Wealth Transfer Estimate is Still Valid' (2003) 7(1) *The Jnl of Gift Planning* 11.