Art tax law: a double-hedged sword | London art law firm Crefovi

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London art tax law firm Crefovi publishes some proprietary research on art tax law.

How art tax law is a decisive tool to promote, or demote, global art market hubs.

The art market is booming. It only took 18 months for it to recover from a severe contraction, from October 2008 to the summer of 2009.

The powerful surge by China, combined with a rise in fine art sales, particularly in the Modern and Contemporary sectors, led to a continuing strengthening in the fine art market worldwide. Sales in 2011 rose by 7% to €46.1 billion, an increase of 63% from the market crisis of 2009.

Since 2010, China has become the world leader in fine art auction sales and four Chinese artists are now among the most sought-after artists in the world at the very top of the artists' ranking by annual auction revenues for fine art (prints, photographs, paintings, drawings, sculptures and installations). China overtook the US for the first time in 2011 to become the largest art and antiques market worldwide, with a share of 30% based on both auction and dealer sales[1].

This rise of China in the art market is to the detriment of established art market hubs, such as the US (which, until 2010-11, was still the number one art market place worldwide with a global share of 37%), the UK (which was knocked by China from second spot to third place as a global market for antiques and arts in 2009, with a global share of 22%) and France (which third place in the global art market was snatched by China in 2007). These facts may come as a shock to many in the fine art world, as the US and the UK have prevailed since the 1950s in this market, which was previously dominated by France in the 19th and early 20th centuries: in just around four years, China has moved up from third place (having relegated France to fourth place) to first place, ahead of London and New York that were considered out of reach.

One of the most important economic features of the art market is that it is essentially supply-driven, with a limited amount of high quality art being produced by living artists and a limited amount of fine art being sold, each year. Consequently in such a supply-driven market, increased demand cannot necessarily raise supply and, instead, elevates prices, narrowing down the available offer to only extremely wealthy, astute or well-connected collectors.

As a result, there is a rising debate, in the Western art world and amongst Western governments, on the following key issues: how to increase art supply produced inland and how to retain art demand and art works within the Western world?

One of the key instruments that policy makers have at their disposal, in order to find pragmatic answers to such key concerns, is art tax law. Indeed, Western governments are now seriously considering the implementation of additional tax and legal incentives, to promote and protect the art industry, works and markets in their respective countries. For artists, art galleries, museums and collectors based in Europe and the US, this favourable legal and fiscal trend may be a bonanza worth exploring, with art assets, investments and transactions being so far sheltered from the post-recession tightening fiscal policies currently being implemented throughout the West.

Some Western countries, such as the US and the UK, seem to have better understood what is at stake, using art tax incentives liberally, while others, such as France, still seem too inwardly conflicted about the social impact of explicitly promoting ownership of art works, to implement a coherent set of incentivising art tax rules.

1. Tax incentives to protect artists: room for improvement

France and, to a lesser extent, the US, have been actively implementing fiscal incentives to nurture and promote artists. In particular, *droit de suite* (artists' resale right), which is the right granted to artists or their heirs to receive a fee on the resale of their works of art, has been a long-standing fixture of French art tax law.

According to Renaud Donnedieu de Vabres, *droit de suite* was created in France following the sale of Millet's 1858 painting, the Angélus, after the First World War: the owner of the painting made a huge profit from this sale, whereas the family of the artist lived in poverty.

In France, *droit de suite* is in force through article L122-8 of the Code of intellectual property and was reformed during the implementation of the Resale Rights Directive 2001/84/CE, which extended the *droit de suite* to all member-states of the European Union.

While the *droit de suite* is undeniably advantageous to artists, putting painters, sculptors and photographers on the same level of economic equality than writers, musicians and composers who have long benefited from copyright royalties, many in the European art community have reacted negatively to it. Especially now that the scope of duty to pay this royalty has been extended to artists' heirs and estates within 70 years of the artists' deaths, European dealers complain that this sliding levy (from 4% of the sale price of cheaper items to 0.25% of the most expensive, with a €12,500 cap) has created a competitive disadvantage since other art market hubs such as New York, Hong Kong and Geneva do not pay it.

US states do not have artists' resale rights, with the notable exception of California, which imposed a *droit de suite* in 1977. A bill, entitled "Equity for visual artists act of 2011", was introduced in Senate in December 2011 to widen the scope of artists' resale rights to a federal level. It was received with caution and has not yet come into force while, on 17 May 2012, a ruling by the US District Court in the Central District of California struck down the California Resale Royalty Act as unconstitutional, ending a 35 year run that entitled Californian artists to royalty rights under certain circumstances. This ruling is pending appeal in the 9th Circuit Court of Appeal. In September 2012, the US Copyright Office published a "notice of enquiry" regarding establishing an artist's "resale royalty right" in the US, asking for comments before 5 December 2012.

It remains to be seen whether, in spite of aggressive competition from Chinese art markets, US policy makers will favour the financial wellbeing of American artists by imposing additional tax on American art sales.

Other notable tax incentives to promote artists are the French VAT regime, which allows VAT-registered artists to charge only 5.5% VAT on direct sales of their art works to collectors, as well as the French capital gain flat fee tax of 5% (including 0.5% due for the *contribution au remboursement de la dette sociale* or CRDS) on the sale of art works and antiques. Mandatory payments of this capital gain tax are exempted on sales lower than €5,000.

With such an idyllic art tax law backdrop, France seems to be the all-time winner in incentivising art on its soil.

However, this impeccable French tax track record in sustaining artists has to be weighted against other tax rules overtly pursuing private owners and collectors of art works.

2. Tax incentives to promote private collections: adapted fiscal measures finally coming of age

All Western countries have come to the conclusion that, no matter how much the state intervenes to keep art works, artefacts and antiques on its soil and in its museums, the first and irreplaceable preserver of the national estate is the private owner. Art tax law has therefore become instrumental in promoting the creation, consolidation and expansion of private collections and patronage.

Both the US and France grant hefty tax relief to companies which buy works of art to constitute corporate art collections. For example, article 238 bis AB of the French General Tax Code provides that companies can deduct, from their taxable turnover, the acquisition price of original art works produced by living artists, over a period of five years. Another Gallic example is the tax cuts granted to French companies that make donations to public bodies which main activity is to present contemporary art fairs to the public. The UK has been at the forefront of incentivising individuals to buy art: the Own Art scheme, launched by the Arts Council England in 2004, allows British middle classes to borrow up to £2000, to be repaid in ten monthly instalments without interest, for the acquisition of art works through 250 art galleries affiliated with the Own Art scheme.

The VAT regime, applicable in the European Union, seems also cut out for the globalisation of the art market: imports of art works and antiques coming from outside the European Union are subject to a reduced VAT rate (5% in the UK and 7% in France), paid by the importer on the price of the work. This reduced VAT rate on imports is an excellent incentive to bring new art works in the European Union, hence ensuring a healthy rotation of stock in European art galleries and fairs. However, a ruling published in December 2010 by the European Commission has, somehow, given bad publicity to the European VAT regime on art imports.

The European Commission decided that art pieces by late American sculptor Dan Flavin, who was famous for installations using fluorescent strip lights, were classified as light fixtures, rather than art, for import duties purposes and therefore liable to the full VAT rate. The same European ruling applied a similar reasoning to the work of American artist Bill Viola whose six video pieces had also been imported by the Haunch of Venison gallery in London in 2006, along with a light sculpture by Dan Flavin.

Such ruling, which applies to all member-states of the European Union, sent wrong messages to the art world, handicapping European art markets, and London in particular, and giving ground to other art market hubs such as Hong Kong, Beijing, New York or Geneva. In a similar vein, while France art tax law protects and encourages artists in an effective way, it often sends mixed messages to art owners and collectors.

The latest French "PR blip" was the intense debate, in October 2012, over the inclusion of art works worth above €50,000 in the tax base of the *impôt de solidarité sur la fortune* (ISF) (French wealth tax). In addition to a new 75% income tax rate paid by the wealthiest proportion of French residents, many economists and politicians have warned that such inclusion of art works in the ISF would trigger the departure of major art owners and collectors away from France.

When tax decisions or proposals go against the financial interests of art owners, collectors and private galleries, they also indirectly affect the wellbeing of leading public cultural institutions. The heads of seven of the top Paris museums – including the Louvre, the Musée d'Orsay, the Pompidou Centre and the palace of Versailles wrote jointly to the French culture minister in October 2012, demanding that the proposal be dropped as they were concerned that the ISF on art works would prompt owners to hold back from lending art works for fear of being identified, or to sell or move abroad their art works.

3. Tax incentives to maintain and enlarge public collections: moving in the right direction

The main tax incentive adopted by both France and the UK, to enlarge public collections and prevent exports of art works, is the *dation en paiement* (acceptance-in-lieu scheme).

Through this tax mechanism, an individual subject to a hefty tax bill can pay his or her taxes by providing works of art to the nation. The acceptance-in-lieu scheme, which was introduced a century ago in the UK, only enables objects to be accepted by the nation in settlement of inheritance tax. In other words, the donor has to be dead and the tax break will be solely on the inheritance tax bill. In France, the *dation en paiement*, introduced by the Malraux law of 31 December 1968, can be used to settle an inheritance tax bill, as well as an ISF tax bill. In 2003, the French government introduced provisions in the French General Tax Code that made tax incentives available to encourage support for the arts and corporate giving to public collections. For example, insurance company AXA supported the acquisition of "cultural works which present a major interest for the national estate from an historical, artistic or archaeological standpoint" for some of the country's leading museums, including the Louvre and the Musée du Quai Branly, in exchange of tax reductions on AXA's corporate tax bill.

Further to the lobbying of major art figures such as Tate Director Nicholas Serota, the British government has recognised the importance of providing reductions on income tax, capital gain tax or corporate tax, in exchange of donations of qualifying gifts of pre-eminent property to be held for the benefit of the public or the nation. A new scheme entitled "gifts of pre-eminent objects and works of art to the nation" was introduced on April 2012, in order to boost philanthropy by living individuals and corporations. The annual reduction in tax liability, accepted under both the acceptance-in-lieu scheme and the "gifts of pre-eminent objects and works of art to the nation" scheme, cannot exceed £30 million in each tax year.

To conclude, while certain Western countries, such as the US and the UK, still have room to improve their respective tax regimes applicable to protect and nurture artists, in particular in relation to *droit de suite*, reduced VAT rates and tax-efficient art donations, other Western countries, such as France, need to seriously rethink their tax approach towards the protection of art works and art markets.

In particular, France's traditional defiance against tax evasion and wealth has conducted its tax authorities to put in place such complex and convoluted tax rules that, while these are, all-in-all, quite favourable to the circulation and conservation of art works, these French tax regulations are perceived by collectors and dealers as being the main cause of impoverishment of French estate of art assets and of its decline in the international art markets. Collectors who are tax residents in the UK or France are well advised to make the most of the tax incentives to investing in art in their respective countries and to diversify their portfolios and investment strategies by starting to buy art works in other art market hubs such as Beijing and Hong Kong, where well-established art galleries such as Emmanuel Perrotin and the White Cube have recently set up shop.

First art investments in China should be gradual, and initially be made for reasonable amounts of money, in a reputable gallery for a private sale or through some of the largest and well-established Chinese auctioneers, Poly International Auction (owned by the Chinese government) and China Guardian for auctions. Such art investments in China should only be made after having sought thorough Chinese-law advice on customs levies on works of art which are exported from China, necessary authorisations to obtain from Chinese authorities to export art works from China, applicable VAT rates and any other taxes due on art sale transactions done in China.

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[1]These figures were set out in the report entitled "The international art market in 2011: observations on the art trade over 25 years", commissioned by The European Fine Art Foundation (TEFAF) to Dr Clare McAndrew from Art Economics, and published on 16 March 2012.

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