

## Taxation, a driver for the Art Market

*Art is the most eternal thing we have  
and what makes us truly human.*

Damien Hirst

The Italian art market grows poorly and, in any case, more slowly than the world market.

One of the reasons for this stagnation is undoubtedly the presence of an anachronistic tax legislation that seems to respond to mere revenue logics.

By contrast, an equal and forward-looking tax system of the art market could be instrumental in making a significant contribution to circulating works of art and offering new growth opportunities.

Tax policies may be an effective instrument to support the cultural activities of individuals or entities by means of incentives and a favourable tax regime. If the main purpose of a tax system is to earn revenues, this does not prevent the governments from lawfully pursuing objectives not having a strictly fiscal character but rather a social or an economic nature at the same time.

The tax regime of the art market gives origin to different issues in accordance with the diversified nature of acts and situations (purchases, supplies or possession of the works of art) taken into consideration by the legislator as well as with the legal form of the interested parties (natural or legal persons, VAT taxpayers or not, and so on).

The main issues concern VAT, inheritance tax and income taxation.

### Value Added Tax

The supplies of artworks are subject to VAT if they are carried out in the course of a business, a professional or an artistic activity, whereas the transactions between private individuals are not subject to the tax.

As for the rates applicable, the supplies of artworks carried out by their creator or by his heirs or legatees are subject to the reduced rate of 10 %. The same rate is applied to the importations of works of art and antiques.

In the other cases, for instance for the supply of works of art by a gallery to a private buyer, the supplies are taxable with the standard rate of 22 %.

It is known that, being the VAT a European tax, the member countries of the EU, for the purposes of determining the applicable rates in the country, must consider the provisions of the Council Directive 2006/112/EU on the common system of value added tax, and subsequent amendments.

In this respect, the general rules on VAT rates provide for the application of a standard rate of not less than 15 % and an option to apply up to two reduced rates of at least 5 % to a restricted list of goods and services (in addition, a number of reduced rates, including lower than 5 %, are allowed in certain Member

States according to “standstill derogations”: in the case of Italy is also provided the reduced rate of 4 % for an exhaustive list of goods).

In particular, pursuant to art. 103 of the Directive, member States may provide that the reduced rate, or one of the reduced rates, is to apply to the importation of works of art, collectors’ items and antiques.

If Member States avail themselves of this option, they may also apply the reduced rate to the supply of works of art by their creator or his successors in title, and to the supply of works of art, on an occasional basis, by a taxable person other than a taxable dealer, where the works of art have been imported by the taxable person himself, or where they have been supplied to him by their creator or his successors in title, or where they have entitled him to full deduction of VAT.

Italy has made use of this option by providing for the reduced rate of 10 % for importations and supplies by the creator or his successors in title, **but the national legislator could further reduce the taxation rate** to 5 %, in line with other countries (for instance, U.K. applies 5%, France 5,5%, Holland and Belgium 6%, Germany 7%). In fact, this measure was provided for in a recent draft of law that wasn’t carried on by the Italian Government. The reduction could be a first substantial measure to support the national art market.

As for the standard rate of 22 % applicable in Italy to the other supplies of works of art, this is one of the highest rates in Europe.

In our opinion, it is necessary **to reconsider the taxation system of art market at EU level**. As the European Commission observed in the Communication on an action on VAT dated 04/07/2016 (COM 2016 – 148 final), the current rules on VAT rates, designed over two decades ago, are becoming obsolete and make it slow and difficult for the Member States to extend reduced-rate treatment to new areas, as all decisions have to be taken unanimously. In the opinion of the European Commission, a reform giving more freedom to Member States would enable them to take the tax policy decisions they want more rapidly.

At this aim, the Commission outlines two main different options for the future: 1) an extension and regular review of the list of goods and services eligible for reduced rates; and 2) the abolition of the list, allowing the Member State greater freedom on the number of reduced rates and their level.

Whatever the choice may be, this could be an opportunity for Europe to launch a new fiscal policy for the art market and culture, celebrating the 2018 European Year of the Culture with a new concrete proposal for development of the market.

It is high time the tax legislator stopped considering works of art as luxury and unnecessary goods and regarded them as artistic expressions, in the same way as books or other cultural products or services which have been granted tax benefits.

With regard to the taxable base, the harmonized VAT system provides the “margin scheme” for transactions involving second-hand goods, works of art, collectors’ items and antiques. In order to avoid all forms of double taxation, for sales of works of art made by taxable dealers (who purchased artworks from “privates”), galleries and public auctions, VAT is charged not on the basis of the full value of the artwork but on the profit margin, i.e. the difference between the selling price and the buying price.

## Inheritance and gift tax

In Italy the inheritance tax is levied on the worldwide assets of residents and on assets existing in Italy if the deceased was not resident in Italy.

Tax is applied on the net share of the inheritance at different rates depending on the relationship between the deceased and the beneficiary. The rates vary from 4% to 8%, but for the spouse or linear relatives a tax-exempt threshold of 1 million euros for each heir is provided (100.000,00 euros for brothers or sisters; 1,5 million euros for disabled recipients).

The art works declared “cultural goods”, according to the Italian Code of Cultural Goods and the Landscape (Decreto Legislativo 22 gennaio 2004, n. 42), before the death of the owner, are not included in the hereditament on condition that obligations of preservation and protection have been fulfilled. If the work of art was not declared “cultural good” before the death of the owner, a reduction of the tax equal to 50 % of the value shall apply.

In order to benefit from relief from inheritance tax, heirs must submit an inventory to the local authority of the Minister of Cultural Goods and Activities enlisting the cultural goods likely to be tax exempt. The authority certifies the qualification of cultural good and the fulfillment of the obligations of preservation and protection. The certification must be presented to the Tax Authority in annex to the inheritance declaration.

With regard to the inheritance taxation on works of art, a specific rule provides that “money, jewels and furniture” are deemed to be included in the taxable estate for an amount equal to 10 % of the estate’s value even though they are not declared or are declared in a lesser amount, unless a different amount results from an inventory drawn up in accordance with the Italian civil code. For this purpose, “furniture” is meant to be all furniture intended to be for use or ornament of the house.

This is conducive to **an unequal treatment** between art works belonging to the deceased that were intended for ornament of the home, benefiting from the legal presumption of 10 %, and artworks located in gallery spaces, museums, exhibitions or kept into the vaults of a bank, to which the abovementioned presumption does not apply.

It is clear that this obsolete rule drives art collectors to use the works of art as aesthetic ornament of their houses, and it therefore strongly limits free movement of art works.

The gift tax applies to donations of works of art with the same rules and rates as the inheritance tax. Nevertheless, the abovementioned presumption of 10 % of existence of money, jewels and furniture is not applicable to donations. If the donation concerns works of art formally declared cultural goods, a fixed tax of 200 euros instead of the proportional tax shall be applied.

## Income tax

In principle, trading of works of art made by collectors does not involve taxation if the collector is not acting in the course of a business activity, namely if he is not practicing “as usual profession” one of the activities listed under Art. 2195 of the Italian civil code, included the activity of intermediation in the circulation of goods.

In this regard, we distinguish the category of the “collector”, that purchases and sells works of art to satisfy his interest to expand and change his collection of works of art, from the “art dealer”, that invests professionally in works of art to make profit by acquisition and sale on the market.

The case law has drawn up a number of circumstances in which we can assume that buying and selling works of art constitute a commercial activity: for instance, continuous character of the activity, relevance of the business, lack of other incomes of the collector, short lapse of time between the acquisition and the sale, implementation of acts aimed at increasing the value of the good.

The earnings achieved by the collector as a “private”, and not in the course of a business, are fiscally irrelevant.

Nevertheless, it may happen that – despite the absence of a real activity organized in the form of an enterprise – the trading of artworks made by the collector represents an “**occasional**” **commercial activity**, generating the so called “Redditi diversi” (Miscellaneous incomes) subject to personal income tax (IRPEF), according to Art. 67, lett. i), of the Italian Income Tax Code (TUIR), as “revenues deriving from commercial activity not habitually pursued”.

Considering the general wording of the article, the realization of this circumstance must be checked on a case-by-case basis having regard to the characteristics of the operation and taking into account the interpretative criteria developed by administrative practice and case-law.

Firstly, the mere operation of disposal of works of art received as a result of inheritance or donation does not involve an occasional commercial activity.

In fact, in order to have “activity of intermediation in trading of goods” it is necessary that the good sold was previously bought against payment. In this regard, it seems irrelevant that the purchase has been laid down or not for the subsequent sale.

Although the wording of the article makes reference to an “activity”, the condition of “business activity” shall be deemed to be fulfilled also in case of making a single deal, provided that it is marked by complexity of organization, plurality of acts and relevant income. Even the presence of an activity of enhancement of the good made by the collector during the holding period could lead to consider the business occasional activity outstanding.

In a recent meeting in Milan about taxation of artworks, a managing director of the Italian Revenue Service has provided a list of facts that could be **circumstantial evidences of the commercial character of the collector’s activity**, such as: preparatory acts to find funds useful to purchase artworks, the initiatives carried out to check the authenticity and evaluation of the collection, or preservation and restoration of the good, or the stipulation of a policy, the custody in a vault, the cataloguing, or the promotion with lending in exhibitions. In a nutshell, all acts that lead to an increase in wealth, aiming to adding value to the goods themselves.

However, taxpayers may request in advance a tax ruling to clarify the application of tax measures to transactions if objective uncertainty exists regarding the qualification of the actual case.

According to Art. 71 of the Italian Income Code (TUIR), the income from an occasional commercial activity results from the difference between the amount received in the tax period and the expenditures related to the production of income. However, the amount of these expenditures shall not exceed the proceeds received.

The vagueness in legislation and the uncertainties in interpretation has brought someone to ask for the introduction of specific rules, which take peculiar elements into account like the period of time between purchase and sale of the artwork, the expenditures incurred by the collector affecting the amount of income, that are often difficult to document.

As for the measure of taxation, someone has asked for a treatment similar to the taxation of capital gains from the sales of securities or capital gains from the sale of real estate, these latter taxable if the sale occurs within five years after the date on which the property was purchased or built.

## **Artistic or professional activities**

For individuals that perform an artistic or professional activity in Italy the expenses for the acquisition or importation of artworks are considered entertaining expenses, even though these goods are used as capital goods for the activity. As a consequence, these expenses benefit from a limited deduction from income, the depreciation of the relevant cost is not allowed and capital gains are fiscally irrelevant.

## **Corporate collections**

For corporates not having the trading of artworks as core business, and which purchase works of art for investment purposes, these goods, intended to be put in durable use, represent fixed assets recorded in the balance sheet at invoice cost.

Being goods with undefined useful life, they may be not depreciated; in fact, in process of time they are not subject to deterioration, they rather tend to increase their value.

The expenses incurred by the company to purchase artworks do not seem to be considered entertaining expenses according to the Italian tax system.

Being goods related to the company, different from commodity goods, the supply of artworks originates taxable capital gains.

## **Conclusions**

In conclusion, we trust that the tax legislator will provide for a few appropriate regulatory changes in order to encourage the development of the art market.

In fact, the Italian legislator has shown interest in the art world, with the reform on the circulation of artworks and the proposal for reform of the crimes against the artistic heritage.

With specific regard to taxation, last autumn there has been a lot of discussion about a proposed amendment (later withdrawn) of the Budget Law; however, it looked like that was aiming at earning revenues rather than achieving fair taxation in the trading of artworks.

Namely, the amendment provided for an indiscriminate taxation of the trading of artworks which equated sales made by mere speculators and transactions carried out by pure collectors, and considering “commercial” even the simple act of disposal of the artworks received as a result of inheritance or donation which the Italian Revenue Service had always considered “not commercial”.

We wish that such a harmful approach is definitely given up and further measures are connoted with an actual orientation to the legal certainty and a fair taxation.

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