# Acquiring **Art Tax** Effectively

ACCOUNTANT TO THE ART WORLD **TOM LOWENSTEIN** OUTLINES THE KEY CONSIDERATIONS IN DECIDING WHICH IS THE BEST INVESTMENT VEHICLE TO USE WHEN PURCHASING ART TAX EFFECTIVELY.

Which is the most tax effective way to purchase art: as an individual, via your company or via your superannuation fund? Bearing in mind income tax, capital gains tax, fringe benefits tax, state land tax, GST, superannuation regulations, Division 7A problems, debit loan accounts, ultimate beneficiary provisions and a number of other potential pitfalls, this question no longer has a simple answer.

The considerations regarding choice of investment vehicle in relation to art acquisitions are a little different to the considerations that need to be taken into account for any other investment. But one significant difference I should note here is that the acquisition of art, in most situations, will not generate significant income (the only avenues being the hire or lease of art works). Historically most income from art has been generated from the capital gain made as a result of the sale of artwork. So the big tax issue for art purchases is all about the capital gain.

Let's look at the tax consequence of each option.

## Entity One: Individuals Or Partnerships

Income tax on any income generated by the work is payable at the marginal rates of the individual from zero tax on the first $6,000 to a maximum of 48.5% on accounts in excess of $60,000.

In paying capital gains tax a 50% exemption is available to individuals (provided that they have held the work for at least 12 months) thus reducing the maximum tax payable to 24.25 % of the capital profit made.

## Entity Two: Discretionary family trusts

If the income or capital gains are distributed to individuals, the same principles apply to both income tax and capital gains tax as above. If the income is accumulated in the trust, tax is payable at the maximum rate of 48.5% and there is no 50% discount on the capital gain, thus taxing the full gain at maximum rates.

## Entity Three: Companies

Income earned from the work is taxed at 30% and there is no discount available on capital gains, consequently tax is payable at 30% on the whole capital gain. However, if the capital gain is retained by the company, no tax is payable.

If a distribution is made to shareholders, tax could become payable, as the dividends paid carry with them a 30% franking credit, and if the recipient is at the highest marginal rate, a further 18.5% could be payable on top of the 30 per cent franking credit. Bringing both income and capital gain to a 48.5% level.

## Entity Four: Superannuation Funds

Income earned from the work is taxed at 15% and capital gains (provided the asset is held for at least 12 months) are discounted by one third and taxed at 10%.

So, taking into account the fact that most income from art is generated from the capital gain made as a result of the sale of art work, the benefits of the 50% exemption in the hands of individuals and partnerships (entity one), or the one third discount to superannuation funds (entity three) usually outweigh other considerations.

Let us look at an example:

| | | |
|---|---|---|
| Purchase of artwork | 10,000 | |
| Sale (after 12 months) | 26,000 | |
| CAPITAL PROFIT: | $16,000 | |
| **CAPITAL GAINS TAX PAYABLE** | | |
| • SUPERANNUATION FUND | | |
| | $16,000 @ 10% | |
| | $1,600 | |
| • INDIVIDUAL | | |
| Maximum | $8,000 @ 48.5% | |
| | $3,880 | |
| Minimum (the individual earns no other income) | $ 340 | |
| • COMPANY | $16,000 @ 30% | |
| | $4,800 | |
| if distributed as dividend | $16,000 @ 18.5% | |
| | 2,960 | |
| | $7,760 | |

So, as evident from the chart, the best investment vehicle is an individual earning no other income. The second best is your superannuation fund. However there are some limitations on superannuation funds acquiring works of art – as discussed in my article in issue 21.

The next most preferred option is to acquire the artwork in a discretionary family trust (an option which also allows for greater flexibility in the distribution of capital gains upon the sale of the work).

However if the capital profit is made by a discretionary family trust, subject to complying with the trust deed, circumstances permitting, it could be distributed to beneficiaries who are not at the maximum tax rate, thus reducing the potential tax liability.

Naturally, as with all advice, it has to be tailored to meet the needs of the individual.

Consideration has to be given to some other factors, such as:

What entity has the cash available to buy the work of art? You may wish to acquire the work as an individual, however if the funds required for the purchase are held in a company, the cost of declaring dividends in order to transfer these funds to the individual may make the proposition a lot less desirable.

What is the value of the investment? You may wish to acquire the work in a superannuation fund or in a discretionary family trust but if you don't already have these vehicles the costs of setting them up and maintaining them may outweigh the benefits.

If you have capital losses in an entity, they could be offset against future capital profits made on the sale of the work. Although the benefit of the 50% exemption is lost, it is still more tax effective to recover these losses.

In some instances there may be benefits in looking at the alternative method of valuing capital gains by the indexation provisions. ■

Note: This is not advice. Readers should not act solely on the basis of the material contained in this article. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that formal advices be sought before acting in any of the areas covered in this article.