

THREE IMPACTFUL REFORMS

1. Remove taxation on prizemoney to celebrate Australia's most successful artists

It can take many years – or even decades – as an established artist to win a prize such as the coveted \$100,000 Archibald. And yet, while prizemoney donors receive a tax concession, artists carry a tax burden. In the words of past Archibald Prize winners:

- “If you place a bet on who will win the Archibald, you don’t have to declare those winnings in your next tax return.” – Mitch Cairns, 2017 winner
- “It’s completely insane inequality.” – Ben Quilty, 2011 winner
- “It is unfair and irrational that artists have to pay tax on prizes. How can this be justified?” – Wendy Sharpe, 1996 winner

The average income received by Australian artists for their creative work alone is less than the poverty line: just \$18,100 according to Australia Council research. Winning awards and prizes is a rare achievement, earned after many years of self-funded labour.

- Introduce a tax exemption for all artist prizes, fellowships, scholarships, awards and government grants.

2. Harmonise income averaging arrangements between the ATO and Centrelink

Artists find it almost impossible to get their professional status as an artist recognised by Centrelink when they require assistance. If they do receive benefits, they risk losing them when they receive an artist fee, materials or production fee, a grant or scholarship, or when they win an art prize.

However, these types of payments are likely to be a ‘one-off’ for the creation or presentation of artwork, rather than a contribution to living expenses.

- Centrelink should adopt an annual averaging process for income from artists’ fees and awards similar to ways this type of income is handled by the ATO under the [Tax Ruling: carrying on business as a professional artist](#).

3. Restore artwork investment for self-managed super

In the 12mo following the 2011 changes to SMSFs, the commercial art market was decimated and artists’ careers have suffered – with a disproportionate impact on First Nations artists. The majority of commercial galleries in Perth and Adelaide closed and some \$200m left the market nationally in that year. The downward trend continues. While classed together, artworks are different to collectibles and exhibition is different to “display”; unlike mint condition coins, locking an artwork away won’t increase its value.

- Add an “exhibition” provision to SMSF legislation so that investment artworks can be seen, kickstarting the commercial market and propelling artists’ careers.

Tax law advice follows, prepared by Arnold Block Leibler as pro bono legal advisers to NAVA.

Each of these reforms will have significant stimulatory effect at this time – most notably, for professional artists accessing JobSeeker: ensuring that Centrelink acts on the ATO’s ruling.

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1: UNTAXED PRIZES AND AWARDS

How are artists taxed on prizes and awards?

- 1 Generally, receipts of prizes and awards by artists are subject to income tax. This is because section 6-5 of the *Income Tax Assessment Act 1997 (ITAA1997)* renders income according to ordinary concepts assessable.
- 2 This briefing sets out the existing income tax framework as it applies to the taxation of artists when undertaking artistic endeavours in the artist's own name (including for example as a sole trader/independent contractor), rather than artists who are employed by an organisation to produce art.
- 3 In determining whether an arts prize or award constitutes ordinary income, and is therefore assessable, the fundamental question is whether the artist's endeavours amount to 'carrying on a business'. This determines which receipts must be declared as income, and accordingly, which outgoings can be claimed as a tax deduction.
- 4 In accordance with Taxation Ruling TR 2005/1, relevant indicators of 'carrying on a business of a professional artist' include, but are not limited to:
 - (a) A commercial purpose or character;
 - (b) The intention to make, or prospect of making a profit;
 - (c) The repetitiousness of the activity; and
 - (d) Whether the activity is carried out in a business-like manner.
- 5 Though arts activities can be carried on as hobbies or recreation, a professional business is to be distinguished from such activities. The ATO acknowledges that this distinction is 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'.¹ Nevertheless, a commercial purpose or character is just one indicator. In the absence of such a motive, artists are still likely to be 'carrying on a business' and subject to taxation where they are regularly producing and selling their artwork in a manner that is inconsistent with mere hobby.
- 6 Where an artist is 'carrying on a business', their assessable income will include grants, royalties, and commissions, in addition to awards and prizes. Therefore, income tax must be paid on these amounts.
- 7 If an artist is not regarded as carrying on a business, none of the receipts from the sale of the artist's work is assessable as income. However, in this scenario the artist is also unable to claim deductions for any expenses incurred due to the artistic endeavours; including materials, studio rent, protective clothing and exhibition costs.

Circumstances under which prizes and awards are untaxed

- 8 Division 51 of the ITAA1997 sets out the circumstances under which ordinary or statutory income is exempt from being assessable as income tax. While it is beyond the scope of this briefing to examine all the circumstances under which a prize or award may be 'untaxed', the following examples have been considered for comparative analysis:
 - (a) The Prime Minister's Literary Awards;
 - (b) Tax treatment of amateur sportspeople; and
 - (c) Gameshow winnings.

Prime Minister's Literary Award

¹ ATO, *Income Tax: Carrying on a Business as a Professional Artist* (TR 2005/1, 12 January 2005) [7].

- 9 The Prime Minister's Literary Awards (the **Awards**) were introduced as an initiative to celebrate the contribution of Australian literature to the nation's cultural and intellectual life. The Awards are held annually and currently provide a prize of \$80,000 in each of its four categories. The Awards are specifically exempt from income tax under section 51-60 of the ITAA1997.
- 10 By comparison, the Archibald Prize is a major Art prize for the best portrait, preferentially of some man or woman distinguished in Art, Letters, Science or Politics, painted by an artist resident in Australia. The winning artist receives \$100,000 from a total prize pool of \$200,000. By contrast with the Awards, Archibald prize winnings are taxed as ordinary income.
- 11 These examples illustrate that not all awards that celebrate the contribution of artistic endeavours to Australian culture are treated equally for income tax purposes, with inexplicable obvious consequential inequities.

Income of Sportspeople

- 12 Taxation Ruling TR1999/17 addresses the income tax treatment of both professional and amateur sportspeople. This provides:
- (a) Income received by a sportsperson, including prizes and awards, from carrying on a business of participating in sport is assessable. This includes the exploitation of personal skills in a commercial way for the purpose of gaining reward.
 - (b) Money and other benefits received from the pursuit of a pastime or hobby are not assessable income. However, any related expenses are not allowable deductions from those receipts.
- 13 Whilst TR1999/17 ostensibly treats sportspeople in the same way as TR 2005/1 treats artists, the income tax system may particularly incentivise artists to treat their pursuits as a business, which is simply not apt as very few artists would consider what they do to be the exploitation of their personal skills in a commercial way for the purpose of reward.
- 14 Yet this is what an artist is forced to do, otherwise there would be no opportunity to claim as deductions their overhead costs (including materials, studio rent, exhibition expense and protective clothing). The alternative, of being required to treat their artistic pursuits as a mere hobby, is equally unsatisfactory and demeaning.

Gameshow Winnings

- 15 Guidance from the ATO suggests that winners of game shows need only declare prizes where regular appearance fees or winnings are received.²
- 16 Compared to winning an artistic prize, gameshow winnings are less dependent on skill and more random in nature. Nevertheless, attaining a prestigious prize like the Archibald has often been described as a once in a rare, lifetime opportunity for the successful artist. In its rarity, it is arguably similar to gameshow winnings, yet artistic prizes and awards continue to be classified as ordinary income.
- 17 The above examples illustrate inconsistency in the current income tax regime as it applies to artists compared to other prize winners and/or income earners.
- 18 **NAVA proposes introducing a tax exemption for all artist prizes, fellowships, scholarships, awards and government grants.**

² ATO, Other Income <<https://www.ato.gov.au/Individuals/Income-and-deductions/Income-you-must-declare/Other-income/?anchor=Forms>>.

BRIEFING 2: HARMONISED INCOME AVERAGING BETWEEN ATO AND CENTRELINK

Income averaging by the ATO

- 1 Division 405 of the Tax Act provides for a scheme that enables 'special professionals' – including artists – to apply an average tax rate over a four-year rolling period. The Scheme is available to artists who are Australian residents and have 'taxable professional income' exceeding \$2500 for the current or the prior year.³
- 2 This ATO Scheme is particularly beneficial where the artist receives an uncharacteristically large amount of income in any one particular year. It has the effect of 'smoothing out' income spikes and lowering the overall tax paid.

Purpose of income averaging

- 3 The Scheme recognises that certain professional endeavours may result in income that is subject to a high level of yearly fluctuation. For example, an artist may generate little income from the proceeds of their sales one year but receive substantial income the next year from winning a prestigious award or selling a significant work.
- 4 But for this ATO concession, an artist who operates as a sole trader would be disproportionately burdened by the annual progressive marginal income system of taxation for individuals, compared to a professional earning a comparable, but consistent amount of income over the same period of many years.

Assessment of income by Centrelink

- 5 Centrelink applies tests, including income and asset limits, in assessing eligibility for social security payments. In assessing eligibility under the income tests, Centrelink applies many of the same concepts as the ATO, including 'income', 'assessable income' and 'exempt income'.
- 6 However, unlike the ATO, Centrelink requires fortnightly reporting of income earned by both the recipient and the recipient's partner. Where income for a reporting period exceeds the specified threshold, payment of benefits may be reduced or stopped. In addition, where income is not reported every two weeks, payments will also be stopped.⁴
- 7 This system of reporting income at fortnightly intervals does not adequately cater for long term cash flow considerations and significant fluctuations of the kind generally faced by artists. It therefore places professionals whose incomes are subject to heavy fluctuation – particularly artists – at a significant disadvantage. For instance, artists are vulnerable to losing their social security benefits in the aftermath of receiving income in the form of an award. This is despite the often-singular and rare nature of this income. The effect is to disincentivise artists from pursuing awards.

Disharmony between Centrelink and the ATO

- 8 The fact that Centrelink does not have a scheme that mirrors the ATO's income averaging shows a fundamental disharmony in income assessment for artists. This differing treatment of the same person's income by two areas of government administration inevitably leads to disparate results in the assessment for income tax and social security.
- 9 This in turn has a disastrous effect on artists and other professionals who earn an income subject to heavy fluctuation.
- 10 **NAVA proposes that Centrelink adopt an annual averaging process for income from artists' fees and awards, similar to ways that this type of income is handled by the ATO.**

³ *Income Tax Assessment Act 1997*, s 405-10.

⁴ Services Australia, How to report and manage your payment

<<https://www.servicesaustralia.gov.au/individuals/services/centrelink/jobseeker-payment/how-report-and-manage-your-payment>>.

BRIEFING 3: ARTWORK INVESTMENT INCENTIVES FOR SMSFs

Can SMSFs invest in artwork?

- 1 A Self-Managed Super Fund (**SMSF**) can invest in Collectables and Personal Use Assets if permitted by its trust deed or governing rules and investment strategy.
- 2 Collectables include artworks within the meaning of the *Income Tax Assessment Act 1997* (Cth), such as paintings, sculptures, drawings, engravings and photographs.
- 3 However, subsection 62(1) of the *Superannuation Industry (Supervision) Act 1993* requires each trustee of a SMSF to ensure that the SMSF is maintained solely for the purpose of providing retirement savings (together with certain approved ancillary benefits).
- 4 This means that investment in artwork by SMSFs must be for genuine retirement purposes, not to generate any present-day benefit for members.

2011 amendments

- 5 While the sole purpose test has always applied to SMSF investments in Collectables, significant changes were introduced from 1 July 2011.⁵
- 6 These changes introduced new legislative standards with which SMSFs must comply to continue to make, hold and realise investments in Collectables. In general terms, these six rules are as follows:
 - (a) Collectables cannot be leased to a related party (**leasing rule**);
 - (b) Collectables cannot be stored in the private residence of a related party SMSF (**storage rule**);
 - (c) the decision to store a Collectable asset must be documented (**trustee storage decision rule**);
 - (d) the Collectable asset must be insured in the name of the SMSF (**insurance rule**);
 - (e) Collectables cannot be used by a related party (**no use rule**); and
 - (f) transfer of a Collectable to a related party of the SMSF requires an independent valuation (**valuation rule**).⁶
- 7 A related party of a SMSF includes fund members, relatives (including in-laws) and companies and trusts these members and relatives control or are deemed to control.⁷
- 8 The new Collectable rules applied to assets acquired after 1 July 2011. Following a transitional period, the rules applied to assets acquired before this date with effect from 1 July 2016.
- 9 It is a strict liability offence for a trustee to fail to comply with these rules and the penalty is 10 penalty units (presently \$2100).
- 10 These rules do not prevent the leasing of a SMSF held artwork to a gallery on an arm's length basis for exhibition (provided the gallery is not owned by a related party). However, in accordance with the insurance rule the insurance for the artwork must be in the name of the SMSF, even if the gallery exhibiting the work has insurance covering artwork leases.
- 11 According to the ATO, a SMSF can store (but not display) Collectables in premises owned by a related party, provided it is not their *private* residence. An artwork therefore need not be stored at a storage

⁵ *Tax Laws Amendment (2011 Measures No.2) Act 2011* (Cth); Superannuation Industry (Supervision) Regulations 1994 (Cth).

⁶ Regulations, Division 13.3, rule 13.18AA.

⁷ *Superannuation Industry (Supervision) Act 1993*, s 10(1) definition of related party.

facility. It could be stored at the business premises of a related party, but not displayed (as this would breach the no use rule).⁸

Background to 2011 amendments

- 12 These measures were announced in 2010 by the Labor Government as an election commitment, following the recommendations of the Super System Review (**Cooper Review**).
- 13 The Cooper Review recommended that SMSFs (that are not APRA regulated funds) should be prohibited from investing in Collectibles and Personal Use Assets (Recommendation 8.14). According to the Cooper Review, while artworks may appreciate over time and investors can profit from the investment in artworks, Collectable investments pose issues in relation to the application of the sole purpose test as SMSF may be tempted to display and enjoy art works.
- 14 We understand that at the time of the Cooper Review the arts sector raised concerns that the Australian art market would be significantly damaged by this recommendation.
- 15 Rather than introducing a blanket ban and prohibit SMSFs from investing in Collectables and Personal Use Assets, the Government decided to maintain investment choice but introduced the tightened rules set out in paragraph 6 above.

Consequences of 2011 amendments for Australian arts sector

- 16 The Australian arts sector is concerned that the 2011 changes have resulted in a significant increase in the cost of owning artwork through a SMSF.
- 17 According to the ATO's SMSF statistical report, the value of investments in Collectable and Personal Use Assets fell from \$442 million in June 2014 to \$371 million in March 2019. The greatest fall of \$68 million was between March and June 2016 (when the transitional period ended and the 2011 rules applied to all Collectables).⁹
- 18 **NAVA recommends the addition of an "exhibition" provision to SMSF legislation so that investment artworks can be seen.**

Other Reform options

- 19 Rather than classing artworks together with all Collectable and Personal Use Assets, new, targeted rules could be made specifically for investment grade artworks as a unique asset class in recognition that unlike other collectables (such as mint condition coins or antique furniture) displaying and exhibiting artwork increases its value. Of course it also has the added benefit of assisting to raise the profile and reputation of living artists whose work would be displayed and exhibited.
- 20 In particular, the 'no use rule' for artworks could be amended to allow storage and exhibition in premises owned by a related party. Arguably, any pre-retirement benefit would be outweighed by the increase in value and added retirement benefits for SMSF members, as well as to the important benefits that would flow to practising artists.
- 21 Target rules for this asset class could also address valuation, maximum portfolio exposure and other compliance issues.

⁸ ATO, Collectables and Personal Use Assets <<https://www.ato.gov.au/Super/Self-managed-super-funds/Investing/Restrictions-on-investments/Collectables-and-personal-use-assets/>>.

⁹ ATO, Self-managed super fund quarterly statistical report <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-fund-quarterly-statistical-report---March-2019/#Assetallocation>>.