

Tax: Contributing to a Sustainable Arts Industry

Report #1:

The current Australian tax treatment of the arts industry

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Disclaimer:

The information and opinions in this Report were prepared for general information only, and do not constitute advice nor the promotion of any particular course of action or strategy. The Report is based on the Australian income tax law as at the date of this Report. Given the general nature of this Report, it is important that people seek their own independent taxation advice, specific to their own circumstances.

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1 Executive Summary

This Report contains an overview of the current Australian tax treatment of the arts industry. To assist with this analysis, the art sector is divided into three broad categories: artists, art bodies and contributors. The Report highlights a number of mechanisms in the Australian tax system which relate to the arts – some which assist and some which do not.

Briefly, the major observations are:

- Employee-artists are subject to similar rules as those that apply to other Australian employees.
- For business-artists:
 - a) If trading as a sole trader (contractor), the business-artist may be deemed an 'employee' for Superannuation Guarantee purposes. This assists business-artists to accumulate superannuation savings for their retirement.
 - b) To smooth out income fluctuations, there is the ability to average income in a year when there is above-average professional income.
 - c) They could be regarded as a 'small business', and thereby access a number of tax concessions, such as small business capital gains tax (CGT) concessions.
 - d) Rules can quarantine artistic tax losses, so the losses cannot offset other income, such as part-time wages. There is a carve-out for some artists if their non-artist income is less than \$40,000 per annum.
 - e) Rules can attribute personal service artistic income directly to artists even though a business structure (such as 'company') has been interposed between artists and their clients.
- For Art Bodies:
 - a) The constitution of the Art Body may enable it to be exempt from income tax.
 - b) The Art Body may be eligible to register as a Deductible Gift Recipient (DGR). Status, as a DGR means that donations to the Art Body may be tax deductible for taxpayers.
 - c) If the Art Body is not exempt from income tax, then its tax treatment will depend on the business form utilised.
- For Individuals (alive) the tax treatment of their contributions to the arts vary:
 - a) Donations of cash or property to non-DGRs would normally not be deductible for taxpayers. However, this can be altered if the individual donates through an intermediary DGR (such as the Australian Business Arts Foundation), which then can forward the contribution to a non-DGR. Donations through an intermediary DGR will be tax deductible for the taxpayer.
 - b) The 'net inflated amount' may be tax deductible when there is a minor benefit received in return for donations to DGRs, such as charity dinners and charity auctions.
 - c) Deductions for cultural goods are available for donations to certain cultural institutions.
 - d) Deductions for donations to DGRs of other non-cultural goods and land can be available. However, the taxpayer could have a deemed capital gain for the donation, which may negate the benefit of the tax deduction for the donation.
 - e) Volunteering of time and services (including expenses incurred in doing volunteer work) is unlikely to be tax deductible for volunteers.
 - f) The purchase of art work is likely to be subject to restrictive CGT rules that either limit the cost base or quarantine subsequent capital losses on disposal of the art.

- For Individuals who make testamentary donations, these will normally not be tax deductible unless the donation is of cultural goods (in very limited circumstances).
- For enterprises purchasing or supporting the arts, they may be able to claim a tax deduction for advertising received in connection to the support. However, such a deduction could be denied or reduced if the purchase includes 'entertainment'.
- Individuals can set up their own DGRs by creating a Prescribed Private Fund (PPF), a non-profit trust which itself contributes to other DGRs which may include Art Bodies.
- New film tax offset incentives have been introduced which replace the prior deduction system.

After providing an overview of the Australian tax system, this Report analyses the tax treatment of Artists, Art Bodies and Contributors. The Report also canvasses the new tax offset concessions for the film industry, and then outlines some concluding observations about potential reforms that will be further developed in Report #4.

2 Tax System Overview

To understand the discussion in this Report it is important to have an understanding of the basic framework of Australia's income tax system.¹

A taxpayer in Australia will be liable for income tax calculated as follows:

$$\text{Tax payable} = [(\text{Assessable Income} - \text{Allowable Deductions}) * \text{tax rate}] - \text{Offsets}$$

"Assessable income" includes:

- receipts that are ordinary income (such as salary, interest, royalties, business income); and
- statutory income (such as capital gains, dividends and the imputation gross-up).

For an amount to be an "allowable deduction" there needs to be a connection between the payment and the derivation of assessable income by the taxpayer. Deductions can include payments or liabilities incurred that are:

- immediately deductible (such as work-related telephone expense);² or
- deductible over time (such as depreciation for work-related equipment).

Also there are certain 'statutory deductions' that the legislation provides for. A common example referred to in this Report is donation deductions, which would not be deductible unless there was a specific provision providing for it.³

The "tax rate" applying to a taxpayer will depend upon who the taxpayer is. If a taxpayer is an individual (such as an employee, sole trader, shareholder of a company or beneficiary of a trust), then individual marginal tax rates apply (with a maximum tax rate of 45% for taxable income in excess of \$180,000), plus the

¹ The main tax legislation in Australia is the *Income Tax Assessment Act 1997* (Cth) (referred to as '*ITAA 1997* (Cth)'), and the *Income Tax Assessment Act 1936* (Cth) (referred to as '*ITAA 1936* (Cth)').

² Certain payments are excluded from being immediately deductible, such as outgoings of a capital or private nature.

³ *ITAA 1997* (Cth), Division 30.

Medicare levy. For a taxpayer operating as a company, the applicable tax rate is 30%. For a taxpayer who is tax exempt, so the effective tax rate is nil.

“Offsets” include certain amounts that taxpayers can claim to directly offset their tax payable. A common offset are the imputation credits on the receipt of franked dividends from an Australian resident company. The new film concessions provide for an offset for eligible film investments.

The tax considerations for each of the board categories of the parties involved in the art sector (artists, Art Bodies and Contributors) are detailed below, within this basic framework of understanding.

3 Artists

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 in 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.

3.1 Employee-artist

If an artist is employed by an organisation (employee-artist), then the artist’s salary and wages is assessable income. Generally, the employer is obliged to withhold tax from such wages and remit this to the Australian Tax Office (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. Examples of deductible expenses for an employee-artist could include work-related travel and work-related telephone expenses. Normally, travel between home and work is not ‘work related travel’, however, if an artist has to carry heavy equipment then a tax deduction may be available.⁴

For employee-artists, employers are required to contribute an additional 9% of their salary as a guarantee superannuation contribution. This superannuation contribution is not assessable directly to the employee-artist; instead, it is assessable to the superannuation fund at 15%.⁵

If employee-artists receive fringe benefits from their employer, the employer (not the employee) can be liable for fringe benefits tax (FBT). 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 \$2,000.

⁴ *FCT v Vogt* 75 ATC 4073.

⁵ This is on the assumption that it is a complying superannuation fund.

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.

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'.

3.2 Business-artist

For artists who undertake their artistic endeavours in their own capacities, a fundamental question for tax purposes is whether their artistic endeavours amount to 'carrying on a business'. 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'.⁶ The Tax Office has released *Tax Ruling TR 2005/1*, which details the Commissioner of Tax's opinion of what constitutes 'carrying on a business of a professional artist'. Such factors include (a) significant commercial purpose, (b) intention to make a profit, (c) regularity of activity and (d) 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 conducting a business (referred to as a 'business-artist') in the artist's own name (sole trader/independent contractor) then:⁷

- Assessable income will include the sales of artistic work, grants, awards, royalties, commissions, endorsements, advertisements and money for interviews; and
- Deductions (either immediately or over time) for certain expenditure incurred in the artistic endeavours will be available.⁸ These could be:
 - a) Immediate deductions: agent fees, consumable (i.e. paints), equipment costing \$300 or less, costume for performances, coaching classes for existing skills, work-related travel, research expenses for upcoming roles, seminar fees and professional publications. Also superannuation contributions, if regarded as 'self employed', can be claimed as a tax deduction.⁹

⁶ Tax Ruling TR 2005/1, at paragraph 7

⁷ If the artist conducted the art business through a company then it would be the company that would have the income tax consequences.

⁸ See Taxation Ruling TR 95/20 for a comprehensive listing of potential deductible and non-deductible amounts for artists.

⁹ ITAA 1997 (Cth), section 290-160.

- b) Over time deductions: depreciation on work-related equipment costing greater than \$300 (such as computers, software, answering machines and mobile phones).

Deductions would require proportioning if there was a percentage of private use with the expenditure. Also, substantiation rules can require documentation to be maintained to verify the deductions.¹⁰ Generally, certain payments will not be deductible if they are private in nature or if they are excluded by the tax act. 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 resources 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,¹¹ where the payer will withhold a certain amount and remit this withholding to the Tax Office on behalf of the contractor.

After the lodgement 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.¹²

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%.¹³

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 they must be GST registered.¹⁴ 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.¹⁵ 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

¹⁰ For individuals trading in their own names or through a general partnership: *ITAA 1997* (Cth), Division 900.

¹¹ *Taxation Administration Act 1953* (Cth), Schedule 1, section 12-55.

¹² *Taxation Administration Act 1953* (Cth), Schedule 1, Division 45.

¹³ *Taxation Administration Act 1953* (Cth), Schedule 1, section 12-190.

¹⁴ 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), Division 23.

¹⁵ *A New Tax System (Goods and Services Tax) Act 1999* (Cth), section 11-5. Referred to as GST input tax credit.

has the option of claiming tax deductions for their own contributions to superannuation.¹⁶ However, there is an exception to this general rule for some business-artists, as the definition of 'employee' under the Guarantee Superannuation legislation¹⁷ 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.

This means for such business-artists that their clients can be liable to pay the additional superannuation guarantee amount.¹⁸ 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. If artists have to finance their own superannuation, due to constraints this may lead to under funding for the artist's retirement.

3.2.1 Averaging income

A problem confronted by business-artists is that income from their artistic endeavours can be 'lumpy'. That is, in one year an artist may have little income, and then in the next year the artist's income can be substantial. This fluctuation of income 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 four years when their income from their artistic endeavours is large.¹⁹ The averaging is available to Australian resident 'special professionals'²⁰ whose 'taxable professional income' is greater than \$2,500 for the current or the prior year. Essentially, this mechanism determines the average rate of tax that would have applied to 1/5th of the above-average amount²¹ if it had been the top slice of the taxpayer's taxable income.²² This average tax is then applied to the above-average professional income for the year.

¹⁶ A deduction can be claimed on these superannuation contributions, provided the taxpayer has less than 10% of their income from employment activities: *ITAA 1997* (Cth), section 290-160.

¹⁷ *Superannuation Guarantee (Administration) Act 1992* (Cth), section 12(8).

¹⁸ This extended definition of 'employee' does not include all artists. Reword this if you want to keep the whole list in the main text (to avoid too much repetition): 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.

¹⁹ *ITAA 1997* (Cth), section 405-25.

²⁰ This is defined to mean 'authors of literary, dramatic, musical or artistic works, inventors, performing artists, production associations and sport persons'.

²¹ The 'above average amount' is determined by comparing the current year professional earnings to the four years prior.

²² Note there are special rules for first-time artist in calculating their average income.

Another way a business-artist could reduce the effect of fluctuations is by claiming a tax deduction for contributions to superannuation.²³

3.2.2 Losses

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, such as interest or wages from part-time or casual employment.²⁴ This loss deduction can be beneficial for the artist, as it means that s/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'.²⁵ 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
- the art-business had profit three out of the last five years; or
- the art-business uses real property of at least \$500,000 value; or
- the art-business uses other assets worth at least \$100,000.²⁶

There is a carve-out from these loss quarantining rules for 'professional arts businesses',²⁷ provided that their other (non-artistic work) income (i.e. wages) is less than \$40,000 for the year. This '\$40,000' figure has not altered since these loss quarantining rules were introduced in July 2000.

3.2.3 Business forms

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 (i.e. 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.²⁸ The artist could be an employee of this company, and be paid a modest wage from the company with guarantee superannuation contributions.²⁹ In

²³ 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.

²⁴ Statistics indicate that many artists have part-time employment to supplement their art businesses.

²⁵ *ITAA 1997* (Cth), Division 35.

²⁶ 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.

²⁷ *ITAA 1997* (Cth), section 35-10(5) defines as 'author of literary, dramatic, musical or artistic works, performing artist or production associate'.

²⁸ 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.

²⁹ Furthermore, the artist could receive dividends as a shareholder of the company.

these circumstances, it would be the company itself which would be directly commissioned by clients to provide the artistic services or products.

However, if the company³⁰ has only a limited client base, then this business structure may not be effective for tax purposes. This is because any personal services income³¹ derived by the company may be directly attributed to the artist for tax purposes regardless of the company being interposed between the artist and the client.³² To ensure such tax attribution does not occur one of a number of tests needs to be satisfied; which essentially ensure that an employment relationship has not been disguised as a contractor.

3.2.4 Small business tax concessions

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:

- Small Business CGT Concessions;³³
 - a) 15 year retirement exemption;
 - b) Further 50% reduction;
 - c) \$500,000 retirement concession;
 - d) Roll-over concession.
- Simpler Depreciation Rules;³⁴
- Simplified Trading Stock Rules;³⁵
- FBT car parking exemption;³⁶
- Deducting certain prepaid expenses immediately;³⁷
- Accounting for GST on a cash basis;³⁸
- Annual apportionment of input tax credits for acquisitions and importations that are partly creditable;³⁹
- Paying GST quarterly instalments;⁴⁰

³⁰ Or other business forms of discretionary or unit trusts or partnerships.

³¹ The explanatory memorandum accompanying this legislation cites an entertainer and a graphic designer as examples of personal services income earners.

³² These rules are found in Division 84 to 87 *ITAA 1997* (Cth). For this direct attribution of income not to occur, one of the following tests needs to be satisfied: (a) Results Test: the business-artist is paid to achieve a specified result, has to supply own plant and equipment and is liable for the cost of rectifying defective work; (b) Unrelated Client Test: the business-artist receives personal services income from providing services to two or more clients who are not related to them, to the entity or to each other, and the services are provided as a direct result of making offers or invitations to the public; (c) Employment test: the business-artist engages others (other than companies, partnerships or trusts that are their associates) to perform work and these others perform at least 20% by market value of the principal work, or the business-artist employs an apprentice for 6 months; or (d) Business Premises test: the business-artist or the entity maintains and uses premises of which they have exclusive use, and at which the personal services activities are conducted. See: *ITAA 1997* (Cth), sections 87-18, 87-20, 87-25 and 87-30.

³³ *ITAA 1997* (Cth), Division 152.

³⁴ *ITAA 1997* (Cth), Subdivision 328D.

³⁵ *ITAA 1997* (Cth), Subdivision 328-E.

³⁶ *FBTAA 1986* (Cth), section 58GA.

³⁷ *ITAA 1936* (Cth), sections 82KZM and 82 KZMD.

³⁸ *A New Tax System (Goods and Services Tax) Act 1999* (Cth), section 29-40.

³⁹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth), section 131-5.

⁴⁰ *A New Tax System (Goods and Services Tax) Act 1999* (Cth), section 162-5.

- PAYG Instalments based on GDP-adjusted notional tax;⁴¹ and
- Having a two-year time limit for the amendment of assessments by the Commissioner.

A business-artist will be regarded as 'small' if the aggregated turnover is less than \$2 million.⁴² 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.⁴³

4 Art Bodies

The term 'Art Bodies' 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 Bodies may be companies, associations, trusts or quasi-government bodies.

For companies and incorporated associations, the default income tax treatment is that they are taxed as a company, with a tax rate of 30%. Any tax losses generated would be trapped within the company and subject to carry-forward rules.⁴⁴ However, this general tax treatment will be altered if the Art Body is non-profit and exempted from income tax. Needless to say, such tax exemption is a major tax advantage for an Art Body. However, if this exemption does not apply, then the normal tax rules apply to the Art Body.

4.1 Non-profit status

To be regarded as a non-profit organisation, the Art Body'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 non-profit organisation.

4.2 Exempt status

If it is determined that an Art Body is a non-profit organisation, it then may be possible for that organisation to be exempt from income tax. Relevant to this Report, exemption from income tax is possible if the Art Body is established for musical purposes, or for the encouragement of art, literature or music.⁴⁵ 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 Body that is income tax exempt, other tax concessions may be available, including the concessional calculation of FBT for benefits provided to

⁴¹ *Taxation Administration Act 1953* (Cth), section 45-130 of Sch 1.

⁴² *ITAA 1997* (Cth), section 328-110.

⁴³ *ITAA 1997* (Cth), section 152-15.

⁴⁴ *ITAA 1997* (Cth), Division 165.

⁴⁵ *ITAA 1997* (Cth), section 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.

employees.⁴⁶ However, even if exempt from income tax, the Art Body may be required to be GST registered if its annual turnover exceeds \$150,000.⁴⁷

4.3 Deductible gift recipient

A related but separate issue is status as a 'deductible gift recipient' (DGR). In terms of the art industry, a DGR can be:

- a public library, museum, art gallery or a fund organised for a charitable purpose;⁴⁸ or
- an organisation registered as a Cultural Organisation.⁴⁹ An Art Body 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.'⁵⁰

The status as a DGR means that taxpayers may be encouraged to 'donate' to the Art Body as they may be entitled to claim a tax deduction. The tax treatment of donations is discussed in detail below.

5 Contributors

The third sector of the Arts Industry considered in this Report 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);
- Enterprises/Companies; and
- Prescribed private funds.

⁴⁶ This is because such exempt Art Bodies would be entitled to the FBT rebate to reduce their FBT liability. Availability of this rebate is subject to certain caps per employee.

⁴⁷ 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.

⁴⁸ 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.

⁴⁹ 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 (known as 'ROCO'), which was established in 1991.

⁵⁰ ITAA 1997 (Cth), section 30-300. Other requirements for non-profit status are that a public fund is maintained to receive gifts for principal purpose, provides information every six months on donations and is subject to periodic reviews.

5.1 Individuals (alive)

A person while alive 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 contributions will depend upon the following factors.

5.1.1 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.⁵¹

If an Art Body is registered as a DGR, then it is possible for people 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.⁵²

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 five years, thus providing greater potential to fully utilise the deduction.⁵³

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.⁵⁴

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 will be available.⁵⁵

⁵¹ *ITAA 1997* (Cth) Division 30.

⁵² Taxation Ruling TR 2005/13 contains examples of what the Tax Office considers material and immaterial benefits.

⁵³ *ITAA 1997* (Cth), section 30-247. This five-year spread applies to donations of cash and property to DGRs, PPFs, Australiana Fund, public art galleries, museums, libraries, archives and the Artbank.

⁵⁴ 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.

⁵⁵ 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.

5.1.2 Intermediary DGR

While Art Bodies may be registered as DGRs, many individual artist or artistic companies will not be. This means donations directly to these non-DGR artists or artistic companies will not be deductible. 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),⁵⁶ with which artists and artistic companies can register. The eligibility requirements for artists or artistic companies to register with the AbaF are:

- The registrant is either
 - a) A bona fide not-for-profit Art Body; or
 - b) An arts practitioner AND
- The funds are to be used to further Australia's cultural life.

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.⁵⁷

5.1.3 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 fund raising 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 (i.e. a dinner) and therefore it is non-deductible. However, recent tax amendments now allow individuals to claim the net inflated amount as a tax deduction,⁵⁸ when:

- the value of the contribution is greater than \$150; and
- the minor benefit received in return is no more than the lower of:
 - a) \$150; or
 - b) 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 will be deductible for an individual when:

- the value of the contribution is greater than \$150; and
- market value of the goods bid for is no more than the lower of:
 - a) \$150; or
 - b) 20% of the value of the contribution.⁵⁹

⁵⁶ 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.

⁵⁷ Recall that for a contribution to be a donation there cannot be any conditions attached to it.

⁵⁸ The 'net inflated amount' is the amount that the contribution exceeds the actual value of the benefit received.

⁵⁹ Note that it is not possible to spread the donation deduction over five years.

5.1.4 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:

- Cultural goods;
- Non-cultural goods; or
- Land (or interest in land).

5.1.4.1 Cultural goods

There are special tax rules that govern the tax treatment of 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.

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.⁶⁰ Furthermore, the cultural good must be accepted for inclusion in a collection (either maintained or being established). If these conditions are satisfied, for the contributor the amount of the tax deduction depends upon how long the cultural good has held:

- If greater than 12 months: the tax deduction is the average GST market value plus valuation fees.⁶¹
- If less than 12 months (unless inherited): the tax deduction is the lesser of:
 - a) Purchase price; or
 - b) Market value plus valuation fees.

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 five years, thus allowing the potential to offset income over an extended period.⁶² A variation to the normal tax donation rules is that for cultural goods, it is possible for the donor to retain some control of the cultural goods.⁶³ However, if some control is retained over the cultural goods, then the value of the tax deduction will be decreased to represent this.⁶⁴ In the circumstances that the donor is an artist or an art dealer, then the amount of the tax deduction will vary.⁶⁵

⁶⁰ Artbank is non-profit government agency founded in 1980 to acquire contemporary Australian art for rental to public and private sector clients.

⁶¹ Note that there are strict time frames and that valuers that need to be appointed. For example, two written valuations by valuers approved by Secretary of the Dept of Communications, Information Technology and the Arts are required within 90 days of the donation.

⁶² *ITAA 1997 (Cth)*, section 30-247.

⁶³ Normally, for a 'donation' to exist, the donor must relinquish all control over the donated goods or money.

⁶⁴ 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.

⁶⁵ 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

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.⁶⁶

If the donation does not satisfy these conditions, 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.⁶⁷

5.1.4.2 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 \$5,000; or are shares in a public company.

The amount of the tax deduction depends upon the circumstances:

- for goods valued at greater than \$5,000, Tax Office valuers determine market value;
- for goods acquired within 12 months, the deduction is the lesser of:
 - a) Purchase price; or
 - b) Market value.

In addition to the tax deduction, when a taxpayer donates non-cultural goods, the taxpayer may have a capital gain due to the transfer of ownership in the goods. The taxpayer is deemed for CGT purposes to have received the market value of the asset transferred,⁶⁸ 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 for the donation that the taxpayer is entitled to should be greater than their net capital gain on transfer.⁶⁹ However, this deemed capital gain reduces the benefit of the tax deduction claimed. It should be appreciated that it is important that the entity to which the taxpayer is donating is a DGR; otherwise there will be no tax deduction available, but rather a resulting capital gain to be assessed on.

5.1.4.3 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 that the land has been held:

- Land held less than 12 months: deduction is the lower of cost or market value;
- Land held greater than 12 months: deduction is the market value determined by Tax Office valuers.

art dealers trading stock, then the deduction will be cost of acquiring the good or the cost of producing the item.

⁶⁶ *ITAA 1997* (Cth), section 118-60.

⁶⁷ *ITAA 1997* (Cth), section 116-30.

⁶⁸ *ITAA 1997* (Cth), section 116-30(1): known as the 'market value substitution rule'.

⁶⁹ If the CGT asset has been held by an taxpayer who is an individual and it has been held for greater than 12 months, the taxpayer should be entitled to a 50% discount: *ITAA 1997* (Cth), Division 115.

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

5.1.5 Donations of time (volunteering)

Another way individuals could contribute to the arts is by volunteering their time, services or goods. 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. Neither could the volunteer 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 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 for.⁷⁰ 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.

Note that if a volunteer donates money or goods, then the donation rules discussed above apply.

5.1.6 Purchasing services or goods

Another way that a person could support the art 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 deduction⁷¹ or be depreciated over time,⁷² as for a private individual there is unlikely to be a connection between the outgoing and the derivation of assessable. 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.⁷³

If art work is purchased, then this art work is classified as a 'collectible CGT asset' when it is used mainly for the personal use and enjoyment of the taxpayer.⁷⁴ Classification as a collectible CGT asset means that it is subject to different tax rules compared to other CGT assets.

⁷⁰ Taxation Ruling TR 2005/13, example 18.

⁷¹ 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.

⁷² An exception to this is the 'inflated prices' for charity dinners and auctions.

⁷³ ITAA 1997 (Cth), section 70-36, deduction for difference between opening and closing stock.

⁷⁴ ITAA 1997 (Cth), section 108-10.

The unique rules that apply to collectible CGT assets are:

- 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.⁷⁵ 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:
 - a) Any capital losses made on its subsequent disposal are quarantined and are available only to offset other collectible CGT asset gains. For example, a collectible capital loss could not be used to offset capital gains the taxpayer has on the sale of listed shares.
 - b) 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.⁷⁶ 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.⁷⁷ 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.

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 will apply.

5.2 Individuals (dead) – testamentary donations

A person through their will may direct that certain contributions known as 'testamentary donations' be made to artists or art bodies. These testamentary donations are only tax deductible when there is the donation of 'cultural goods',⁷⁸ and the following conditions apply:

- the recipient is a DGR: the Australian 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.⁷⁹ The potential capital gain or capital loss on the transfer of this cultural good is disregarded for tax purposes.⁸⁰

⁷⁵ *ITAA 1997* (Cth), section 108-10(1).

⁷⁶ *ITAA 1997* (Cth), Division 115. Also, the indexation method could be available if the CGT asset was acquired prior to 21 September 1999: *ITAA 1997* (Cth), Division 114.

⁷⁷ A capital gain is determined by capital proceeds less then cost base.

⁷⁸ Refer to the prior definition of 'cultural goods'. Note the term does not include money.

⁷⁹ Recalling that a donation deduction cannot create a loss.

⁸⁰ *ITAA 1997* (Cth), section 118-60.

Generally, cash donations made pursuant to a will are not tax deductible even if the recipient is a DGR.⁸¹ 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.⁸² 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.⁸³

5.3 Enterprises/Companies

For taxpayers who are enterprises contributing to Art Bodies 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 nexus between the outgoing and deriving assessable income.⁸⁴ 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. Also, it means that enterprises are not limited to contributing to DGRs 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.⁸⁵ Exceptions to this non-deductibility of entertainment include:

- If the entertainment expense constitutes a fringe benefit to employees. However, the employer is then likely subject to FBT.
- 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.⁸⁶

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.

⁸¹ *ITAA 1997* (Cth), section 30-15(2).

⁸² *ITAA 1997* (Cth), section 118-60. This CGT exemption applies even if the value of the property is less than \$5000.

⁸³ *ITAA 1997* (Cth), section 116-30.

⁸⁴ *ITAA 1997* (Cth), section 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.

⁸⁵ *ITAA 1997* (Cth), Division 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.

⁸⁶ Another exclusion is if the taxpayer's business consists of providing entertainment to paying clients.

If art work is purchased by an enterprise, then the enterprise may be able to claim a deduction or depreciation if the art work is utilised 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.⁸⁷

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.⁸⁸

6 Prescribed Private Fund and Public Funds

Prescribed Private Funds (PPFs) are another type of body that can potentially support the arts, as it is estimated that 10% of PPFs support culture. PPFs are essentially non-profit trusts established either while a person is alive or via their will.⁸⁹ PPFs are similar to Public Funds, except that, unlike Public Funds, there are no invitations to the public to contribute money, as the only contributors are the initial donor and associates of the donor. While a PPF can accumulate some income,⁹⁰ PPFs must bestow funds to other DGRs.

For tax concessions to apply to PPFs (and Public Funds), the PPF must be operated on a non-profit basis and money must not be distributed to members (except for proper reimbursement and remuneration),⁹¹ and the PPF must get Treasurer's approval.⁹² A PPF that satisfies these conditions will be a DGR and be exempt from income tax.⁹³

If the PPF is a DGR, then donations to the PPF will potentially be deductible pursuant to the rules described above.

7 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.⁹⁴ Replacing this deduction

⁸⁷ 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).

⁸⁸ *ITAA 1936* (Cth), section 73D.

⁸⁹ There are over 600 PPFs in Australia, with a combined wealth of \$1 billion. The majority are private family PPFs; 10% supporting culture. \$300,000 has been suggested as the minimum investment, with legal and tax costs of \$2000 to \$5000. PPFs began in July 2001.

⁹⁰ Generally, 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.

⁹¹ The rules in Taxation Ruling TR 95/27 that apply to Public Funds must be complied with by PPFs.

⁹² The controlling body of the PPF must include at least 'one responsible person' who is usually prominent and not associated with the donor/settlor.

⁹³ *ITAA 1997* (Cth), section 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.

⁹⁴ *ITAA 1936* (Cth), Division 10B and 10BA. Allows resident taxpayers immediate deductions for capital expenditure incurred in producing or contributing to the production of an Australian

concession is the new Screen Production Incentive Scheme, which involves three offsets: producer offset, location offset and post digital visual offset.⁹⁵ When available, these offsets directly reduce a taxpayer's taxable income.

The 'Producer Offset' provides a refundable tax offset of 40%⁹⁶ for qualifying expenditure incurred for a feature film, or 20% for film and television programs.⁹⁷ The 'Location Offset' of 15% is designed to attract offshore film and TV production to undertake work in Australia.⁹⁸ 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.⁹⁹

8 Concluding observations

Given the overview of the Australian tax treatment of the arts industry in this Report some initial observations can be made:

- The tax legislation would be clearer if there was a consistent definition of 'artist' used throughout it. At the moment there are a number of different definitions used, which can add to the complexity and the compliance cost for taxpayers to ensure whether certain 'artist' rules apply to them.
- A particular issue for artists is whether their activities amount to 'carrying on a business'. Given the technical nature of this determination, it may be beneficial if artists were given a 'tax offset' for seeking professional tax advice in the first five years of their operation. This offset could be capped to a certain amount, such as \$2,000. This offset could provide artists the incentive to get tax advice early, which should minimise incorrect treatment.
- The exclusion of some artists from the deemed 'employee' status for Guarantee Superannuation purpose seems to be a technical oversight and should be rectified.
- The carve-out of \$40,000 'other income' for the non-commercial loss rules has not been altered since its introduction in July 2000. Given inflation, it would make sense that this carve out was at least increased by the CPI since its introduction.
- Consideration should be given to the non-deductibility of volunteers' expenses incurred in undertaking their volunteer activity. It is suggested that the donation provisions could be altered, so that if a volunteer incurs expenses in doing volunteer work for a DGR, then these expenses could be deductible.

film. From 25 September 2007 applications for certificates under Division 10B and 10BA will not be accepted.

⁹⁵ *ITAA 1997* (Cth), Division 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 Limited.

⁹⁶ For expenditure incurred on or after 1 July 2007.

⁹⁷ 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.

⁹⁸ The eligibility requirements include: minimum expenditure \$15 with some additional qualifications when the budget is below \$50m. For TV series, at least \$1m per hour of the series.

⁹⁹ The minimum expenditure on PDV is \$5m.

- Since not all Art Bodies are registered as DGRs, greater use of intermediary DGRs (such as AbaF) should be made. However, consideration should be given to relaxing the 'direction' prohibition to meet the technical meaning of 'donations'. This relaxation would give greater assurance to contributors that their artist or art body of choice will receive their donation. The benefit for the Government is that it would reduce the number of bodies having to register as a DGR, as intermediaries instead could be used. The Tax Office would have to monitor only these intermediary bodies.
- With the donations of goods, there can be a deemed capital gain which can reduce the benefit of any tax deduction claimable. To provide a real net tax benefit to taxpayers, the capital gain or loss on donated goods to DGRs should be disregarded for tax purposes.
- The tax deductibility of testamentary donations is very restricted. Consideration should be given to whether broader tax deductibility of testamentary gifts should be allowed.
- Consideration should be given to whether 'artistic performances' should be excluded from the non-deductibility of entertainment expenses for taxpayers.
- Consider broadening the concessional tax treatment of research and development by companies to on research in the social sciences, arts and the humanities.