
57 Tax concessions

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Introduction¹

Taxation measures aiding the donation of gifts or bequests to the arts are applied on a major scale in the United States. Some of these measures have formed the cornerstone of government policy towards the arts in the United States since the beginning of the twentieth century and they are defended vehemently to this day. In contrast, while such measures exist in some countries in Europe they have rarely been used on any significant scale. Despite this, there are many who call for more of a United States-type tax policy in Europe, and such calls appear to have increased in number and volume in recent years. There have, however, been trenchant criticisms of the US tax policy measures in relation to charitable contributions as they apply to the arts, the most authoritative and comprehensive of these being that by Feld *et al.* (1983). Despite the force of the arguments to the contrary, few involved in the arts or policy making in the United States appear today to question this tax policy as a means of channelling public money to the arts. Weil (1991) in particular, in an elegantly argued piece, defends these tax policies over direct government grants and bemoans the diminution of the scale of the tax incentive resulting from tax changes in the United States. Simon (1987) also defends tax concessions over government grants in a very comprehensive review of the tax treatment of non-profit organizations in the United States.

It must be noted, however, that there are tax expenditures on the arts in Europe which, although much smaller in magnitude than those for charitable contributions in the United States, and more elusive, are fiercely defended by the arts communities there and apparently matter greatly. In particular the concessions in relation to value-added tax (VAT) have been subjected to considerable public debate. Besides this, the important property tax exemption is prevalent in both Europe and the United States.

Key policy questions

What precisely are these tax measures? What is the cost of these measures to the taxpayer? What are the effects of these measures on art institutions? What are their effects on the level and composition of arts inputs and output? These are the questions that matter in relation to tax expenditures and some of them will be examined briefly here.

In deciding on which of the measures deserve most examination, we could choose those measures that incur the greatest tax expenditure in practice or we could choose the tax measure that has the greatest impact on arts institutions and artists. Alternatively, we could choose some other criterion, such as the tax concession for which there is the most information in terms of data, or that with the most interesting analytical features. The latter considerations predominate in discussions of tax policy in general, despite the fact that, from a policy point of view, the tax has no practical significance. The criterion that will most influence the discussion here is the one which places emphasis on tax revenue forgone, although other considerations will also be considered.

Main tax expenditures

In the United States the charitable contribution deduction is by far the most important in terms of tax forgone, and it is followed by the property tax exemption and the capital gains tax remission of gifts to arts institutions in this regard: for example, Feld *et al.* (1983) estimate that the individual charitable deduction concession is, in terms of tax forgone, around twice that of the property tax exemption, and almost three times that both of the corporate charitable deduction and of the capital gains tax and gift/estate tax concession combined.² Most of the tax measures in the United States have particular relevance for art museums and as a result they appear to be the most favoured arts institutions in this regard.

In Europe the picture is very different, although one must be careful not to overgeneralize because of the large number of independent states involved. A related problem in commenting on the European experience is that it is very difficult to obtain up-to-date descriptions of the tax situations that actually apply in relation to the arts: much of the discussion therefore in relation to Europe has, of necessity, to refer to work that is quite dated.

Tax expenditures associated with charitable contribution deductions appear to be small, judging from the evidence that is available, one of the reasons for this perhaps being that similarly favourable tax exemptions do not appear to apply to gifts or bequests of property, the main reason being that, independent of tax concessions, Europeans may see charitable contributions as a function of their much higher general tax rates and not as something that they are expected to pay in addition to their taxes.³ The major effective tax concession in fact is the preferential VAT treatment of the consumption of the output of the arts sector, but no estimates appear to have been made of the cost of this tax concession. This is a tax concession that would favour in particular the performing arts, as it usually applies to the output of all performing arts organizations, not just the publicly funded institutions, which also receive notable levels of direct public

assistance. Property tax exemption for arts institutions is also widespread in Europe, but again there has been remarkably little discussion, at least in the English language literature, of this aspect of arts policy. In contrast, the tax concessions that apply in some large European countries in relation to relief from estate duty/capital transfer taxes have been analysed in detail despite the fact that the tax expenditures associated with these concessions are small: the reason appears to be more to do with the interesting analytical and practical issues that the policy entails, as well as the very high level of public controversy that has accompanied the sale of artefacts which are seen as part of the national patrimony, situations that these taxes are sometimes designed to address.⁴

Lack of recognition of cost to the state of tax breaks

It appears odd that so many people still do not associate a cost (that is, a tax expenditure) with a tax break in relation to the arts and that so many governments have still so few data relating to the precise cost of various tax concessions to the arts. Why is this? The first reason is that tax expenditure analysis in general, especially its inclusion in the budget process, is of recent origin and is still not formally included in budget accounts for many countries. Part of this has to do with the fact that many different tax expenditures are extremely difficult to estimate, both for data reasons and because the estimation depends on what behavioural assumptions about the key players are made by the analyst.⁵ Second, in relation to the arts, some have argued that the main tax break, the charitable contribution deduction, does not involve a tax expenditure at all, on the grounds that income devoted to a charitable cause (which is how a contribution to the arts is classified) is not available to the person for his or her own consumption, but for the consumption of all, and should not be taxed to him or her.⁶ There are very few, though, in the economics or legal profession who appear to support this argument. Third, tax expenditures are rarely designed for the arts specifically, but are established in relation to some much wider target group, such as charities in the United States, of which sector the arts is only a tiny component. Even if estimates of the tax expenditure for the sector were available, it is unlikely that they would be available for every small sub-component. Fourth, it may be that the very obscurity of a tax expenditure removes the pressure to quantify it. The state's contribution to a local wealthy individual's gift to his or her local museum is never identified as such by the individual or the museum. The donor is treated in every official version of this transaction, and by the media, as the sole source of the funds. Likewise, what local government computes the value of a property tax exemption to a local theatre? If its value is unknown it appears as a costless subsidy, especially since no money actually changes hands. Yet this

exemption is in many respects equivalent in financial terms to the local government providing a tied direct grant to the local theatre, the value of which would of course be known and debated in public.⁷

It is this very obscurity that provided the driving force for the Feld *et al.* treatise, as they see it as the principal defect of the tax break system to the arts, preventing it from looming in the consciousness of arts administrators, scholars and the public alike. Whatever the controversy may be over the tax expenditure associated with taxation policy, it is clear that these tax breaks are highly valued by the arts community (judging at least from the reaction when there is a proposal to abolish them) as each and every one of them bestows favours on the arts sector, even though it may be very difficult to quantify the exact magnitude of the implicit subsidy involved. A related point is that, even if the implicit subsidy could be accurately calculated, proposals to replace it with a direct and explicit subsidy are mostly rejected by the arts community on the understandable grounds that there is no guarantee that, once the tax concession is abolished, governments will not subsequently renege on their promise to replace it fully with a direct subsidy.

An examination of specific tax breaks illustrates most clearly the nature of the tax expenditure involved. Nowhere is this truer than in relation to the deductions that can be claimed against income tax in the United States, the most important and significant tax that applies to the arts anywhere, and the VAT concessions applying in Europe.

Individual charitable contribution deductions in the United States

The federal income tax code in the United States accounts for three significant income tax expenditures for the arts: individual charitable income tax deductions, corporate income tax deductions and capital gains tax forgone on gifts of property. The charitable contribution deduction, as seen earlier, accounts for the vast bulk of the tax expenditure under this heading, though, and is the cornerstone of indirect federal aid to the arts in the United States (for a discussion of the other two, see O'Hagan, 1998).

Since 1917, individual taxpayers in the United States have been allowed to deduct contributions to non-profit, charitable institutions, including arts institutions, when computing their income taxes, at both federal and state level (see Fullerton, 1991). Although the basic principles of the charitable contribution deduction are in operation in several European countries, the charitable contribution system in practice is of little significance, in terms of take-up, to the arts in Europe, although this may be changing.

The tax deduction clearly changes the price to the donor of a charitable gift to the arts. Specifically, the deduction reduces the net cost to him or her of channelling a fixed sum to an arts institution and thereby could induce

donors to provide even more than they would in the absence of the tax concession. Thus, for example, if a donor wanted to give \$500 to a museum before the tax concession and the marginal tax rate of this donor was 50 per cent, the effect of the tax concession would, first, be to reduce the after-tax cost to the donor to \$250 and, second, to induce some response to this by the donor, in particular to increase the initial gift. If the donor increased the gift to \$1000, the net cost would be \$500, the same as the individual was prepared to donate before the tax concession. The magnitude of this induced giving, that is the price elasticity with respect to charitable giving to the arts, is central to the economics of the charitable contribution deduction.

One key feature of the charitable contribution deduction to note is that the tax expenditure depends on the marginal tax rate of the donor, ranging from zero, for those who are not liable for income tax, to the top rate times the value of the gift, for those in the highest income bracket (for illustrative purposes, assume that the top rate is 50 per cent: the top marginal rate at the federal level has in fact varied very considerably in the United States over the last 70 years). Thus, the higher a person's marginal tax rate, the more the gift will be subsidized by the state: a gift of \$500 from those on the zero rate will cost the state nothing, and the donor the full \$500, whereas a gift from a donor on a marginal rate of 50 per cent will cost the donor only \$250, the state paying the rest of the bill of \$250. This feature of the charitable contribution deduction has come in for the most criticism.

Value-added tax (VAT) concessions in Europe

The VAT concession on the consumption of the output of the arts applies only in Europe and, as mentioned previously, may involve a large tax expenditure in relation to the arts, both in absolute terms and in relation to direct funding to such institutions.

In principle, the VAT is a pure revenue-raising tax, the intention being that a uniform rate would apply to all goods and services, thereby leaving relative prices and, therefore, the choices of individuals in the market place unchanged. This, and its administrative simplicity, at least in a computerized economy, were seen as the major advantages of the tax. The practice is rather different. In particular, different rates of VAT now apply to different goods, thereby providing a tax incentive to the sectors with the lower rates.

Practice varies considerably between the countries of the European Union, with regard both to the standard rate and to the rates that apply to outputs of the arts sector. The level of the standard rate is important, as it is in relation to this that the tax expenditure associated with the lower rates would be calculated.⁸ It is clear that in Europe the intention is to have a

lower rate of VAT for the arts sector, as the Sixth European Council Directive of 1977 committed the member states eventually to exempt theatre, concerts and other cultural events, the reason being the public interest.

The tax forgone associated with the concession is likely to be very sizeable, as it would amount to 15 to 20 per cent of box office income of all performing arts companies, not just the non-profit institutions. This assumes, though, that attendance would not drop significantly if VAT were imposed on the performing arts sector. As mentioned, reduced VAT rates apply to all arts institutions, which makes this tax concession a very unfocused funding device for the government.

Notes

1. For a fuller discussion on the topics discussed here, see O'Hagan (1998); see also Schuster (1999).
2. In total this came to around 2.5 times the total direct aid to the arts (Feld *et al.*, 1983).
3. A further reason may be related to the more unequal distribution of income in the United States, and the higher per capita incomes there, which, together, would mean many more very wealthy people than in Europe.
4. See O'Hagan and McAndrew (2001) for a discussion of these.
5. For example, if the tax concession of a zero VAT rate on theatre admissions was abolished, what assumption would be made about the level of attendance resulting from the higher price? If, say, it dropped by 50 per cent, is the tax forgone calculated on the basis of attendance after or before the tax is imposed?
6. Simon (1987) provides a very useful discussion of this issue. The essence of the argument is that 'an item of revenue received by a taxpayer and then given away to charity during the same period does not increase the taxpayer's net worth' (p.73). It applies also, Simon argues, to the estate tax charitable deduction, in that the definition of wealth for estate tax purposes should refer to those assets available only for private accumulation or consumption of private goods (and not public or semi-public goods such as the output of an art museum). While Simon argues that these points should not be rejected, he does appear to recognize that the general view, both in legal and in economic circles, is that such deductions do constitute a tax expenditure or indirect subsidy.
7. Simon argues that the property tax exemption may not be an exemption at all, in that property tax should not apply anyway to many arts institutions since they do not form part of a correctly defined property tax base (Simon, 1987). However, this is a view that is difficult to sustain.
8. Or more correctly, perhaps, the rate that would apply if there were a single rate applied to all goods and services.

See also:

Chapter 16: Corporate arts sponsorship; Chapter 43: Non-profit organizations; Chapter 50: Public support.

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