



KPMG Guide on Taxation of art

Foreword

This is the first part of a KPMG series dedicated to taxation of certain less common alternative investments. This edition is dedicated to taxation of art and it also includes an overview of the contemporary art market, by one of the specialists in this field.

Investing in art may have certain tax implications, and a detailed understanding of these implications is as important as the actual selection of the works of art. The KPMG Guide on Taxation of Art helps

art enthusiasts, as well as experienced art collectors assess the tax implications of dealing with art.

KPMG's Guide on Taxation of Art also aims to help private art collectors and investors navigate the current art market environment in Romania and the world and potentially identify early-stage emerging trends for art acquisition opportunities. Stay tuned to the latest market trends that might have an impact on your next investment decision.





1

The art of taxing art

Investing in art has tax implications one should be aware of. Understanding these implications can make the difference between a good and a bad investment. What is important to know is that each transaction should be considered independently. There is no standard recipe and your specific situation is key to determining whether the transaction you are about to enter into will generate tax liabilities or not.

In most cases, the answer to the “What are the tax implications?” question is again “It depends”. On what? There are a number of factors involved and a series of questions you should ask yourself:

This is not an exhaustive list, it is just a hint as to the criteria that may affect the customs duties applicable, your VAT obligations or your personal/corporate income tax liability.

Am I an individual investor or a corporate investor?



Where am I buying from?



Where am I tax resident?



With what purpose?
What do I plan to do with this piece of art?



Who am I buying from and what is their tax regime?





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Customs duties and art

The customs authorities treat artwork like any other commodity, irrespective of its aesthetic value. Nevertheless, pictures and paintings, created entirely by hand in any medium and on any material, which are more than 50 years old and do not belong to their originators, are considered “cultural goods”.

As long as the acquired artwork holds its EU goods customs status (i.e. goods obtained, produced or released for free circulation in the customs territory of the European Union) it **can move freely between Member States.**

However, if investors intend to dispatch artwork acquired from Romanian art galleries outside the customs territory of the EU, the goods will have to be placed under the **export customs regime**. The export of cultural goods outside the customs territory of the European Union is subject to the presentation of an export license, in addition to an export declaration, when the customs export formalities are carried out.



1.2 VAT and the art market



Dealing with VAT is never simple and for any person/company (hereinafter called “investor”) that carries out transactions involving works of art, whether occasionally or on a regular basis, this topic can get even more complicated.

For those operating on this market, the VAT rules differ from general VAT rules. A so

called **special VAT regime** (or “the margin regime”) may be applicable. This regime is mandatory in certain situations and optional in others. Under this regime, the investor selling art works does not pay VAT on the actual price received from the client. The VAT is instead charged on the profit that arises from a transaction, calculated as a difference between the selling price charged by the investor and the purchase price for the related goods/services, using the gross-up method. At the same time, input VAT incurred for the acquisitions made cannot be deducted.

The invoices issued by the investor must not indicate any VAT separately, but merely include a reference to the fiscal provisions relating to “the margin scheme”.

All of the above are applicable in the case of taxable persons, meaning a company or individual carrying out this type of activity on a **continuous basis**, and which is already fiscally registered.



Now, what happens with an individual carrying out transactions involving works of art?

The standard answer would be: *It depends how often these transactions are carried out.*

And this is the reality. However, even if this is the case, neither European legislation, or Romanian legislation specifically provides clear guidelines as to when an individual making sales of goods is considered to be carrying out economic activities and thus, when the individual should register from a VAT point of view.

Generally speaking, according to the law, an individual carrying out these types of transactions **on a continuous basis** would become a taxable person for VAT purposes and might be required to register for VAT purposes (if the registration thresholds are exceeded). However, the legislation does not clearly define what a “continuous basis”

means, and thus it is a question of debate whether carrying out two, three, ten, etc. transactions would transform an individual into a taxable person required to register for VAT purposes. Thus, determining whether an individual should register for VAT purposes or not might prove a complex analysis, as each individual's case should be analysed by considering its specific circumstances.

However, even for an individual who does not fall under this category, who only acquires works of art that are not intended for resale, VAT might still play an important role in the acquisitions that the individual makes, as it might influence their price.

For example, an individual participating at an international fair in Switzerland (outside the European Union) and intending to buy a work of art and to bring it to Romania should also pay VAT to the customs authorities (currently 19%).

1.3 Personal income tax implications for individual art investors

Income tax implications for individual investors may arise when the work of art is sold.

If art is sold from the individual's personal ownership, **as a one-time event** or happens rarely enough so as to constitute an occasional activity, the transaction is deemed a transfer of ownership of movable property, and is consequently non-taxable.

However, if art is sold for the purpose of obtaining profit and this activity is carried out on a **regular basis**, possibly as a (main) source of income, then this income would be categorised as taxable income from independent activities, subject to 10% income tax and 35% social security contributions (25% pension insurance contribution and 10% health insurance contribution).



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Let's talk tax facts

2.1. I am an individual investor, a Romanian tax resident, and I have just purchased a work of art from a Romanian gallery.
What do I have to do, tax wise?

From a customs point of view, there are no requirements for acquiring artwork locally, as long as it holds European Union goods status.

The simple acquisition of a piece of art in Romania should not generate any VAT implications. However, things might change if you intend to sell that piece of art on, especially if this is not the only sale that you carry out.

At the time of the purchase there are no personal tax implications (meaning that you do not have to pay income tax or any social security contributions). Income tax implications may arise if the work of art is sold, but only if sale of art is a regular activity for you. Otherwise, if this is a one-off sale, it would not generate taxable income.

2.2. I am an individual art investor, a Romanian tax resident, and I plan to make an acquisition from a Swiss gallery. What are my tax obligations?

Non-EU goods are subject to a customs declaration upon their entry into the European Union. Failure to comply with this obligation may represent a criminal offence as it can be considered smuggling.

Investors should also be aware that, in order to carry out customs related operations in the EU (i.e. lodge a customs declaration), individuals or companies must obtain an EORI (Economic Operator's Registration and Identification) number from the customs authorities. The EORI number is valid throughout the European Union. Usually, the lodging of a customs declaration is made through a customs broker who can directly/indirectly represent the importer in relations with the customs authorities. Customs duties become due at the time of acceptance of the customs declaration, as appropriate.



Authorities from the customs office of entry into the European Union might ask the buyer to present the purchased goods, together with documents, such as the original commercial invoice or the document certifying the payment.

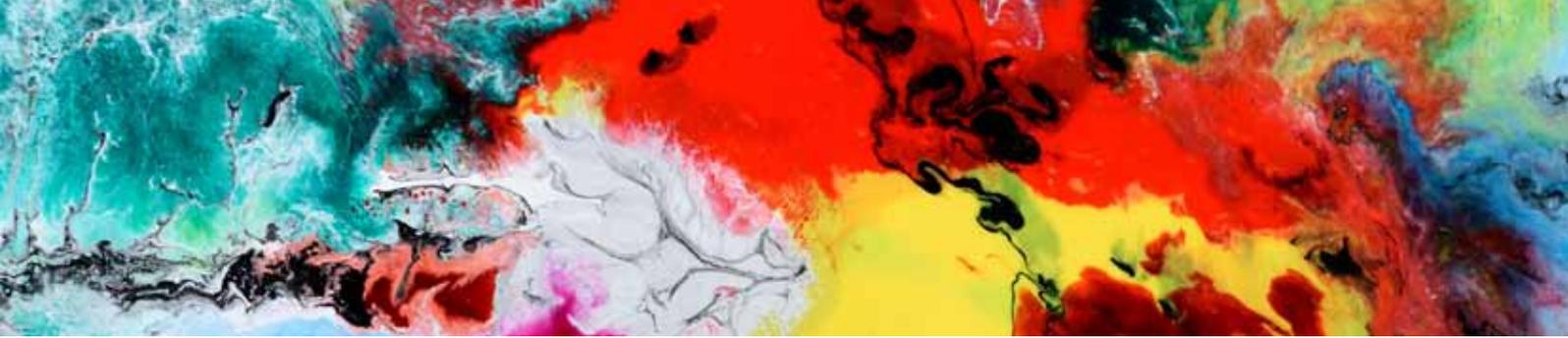
From a VAT perspective, you would need to pay VAT at the customs office, after completing a customs declaration. Moreover, one should pay careful attention to the VAT implications that might be generated if you intend to sell this piece of art on. Although the

simple acquisition does not generate any VAT registration liabilities for one individual, further use of the goods acquired might create certain VAT liabilities.

At the time of purchase, no personal income tax or social security is payable. Similarly, at the time of sale, if it is a one-off sale, this would not constitute taxable income. However, if sale of art is a regular activity for you, the sale constitutes taxable income, subject to income tax and social security contributions.

What if the acquisition is made online?

From a customs, VAT, personal income tax and social security perspective the tax treatment described above remains applicable.



2.3. I am an individual art investor, a Romanian tax resident, and I plan to make an acquisition from a French gallery. What should I do, tax wise?

From a customs perspective, given that all Member States are part of the European Customs Union, art, as long as it holds European Union goods status can, in principle, be transported across EU borders without any customs restrictions.

VAT would not be mentioned separately on the invoice as long as the French gallery applies the special VAT regime (to be determined based on the invoice issued by the French gallery, contract etc.). However it will be included in the price to be paid.

Otherwise, if the French gallery does not apply the special regime, it will issue an invoice for French VAT.

At the time of purchase, no personal income tax or social security is payable. Similarly, at the time of sale, if this is considered a one-off sale, this would not constitute taxable income. However, if sale of art is a regular activity for you, the sale constitutes taxable income, subject to income tax and social security contributions.



2.4. The company I work for (a Romanian company) intends to buy a work of art from a Romanian gallery. What tax implications should we consider?

In this type of case, it should be determined whether the Romanian gallery applies the VAT special regime or the general one, as described under point 1.2. Assuming that the art gallery applies the VAT special regime, no VAT would be mentioned on the invoice received and the buyer would not deduct any VAT.

Just as for private investors, there are no customs implications when acquiring artwork locally, as long as it holds European Union goods status.

From a corporate tax perspective, the buyer would not be allowed to recover the value of

the acquisition through depreciation charges. If the artwork is sold in the future, the gains derived from the transaction would be taxable at the standard corporate tax rate of 16%.

Let's assume the Romanian company decides to buy a sculpture valued at EUR 100,000 and, for simplification purposes, we'll disregard any potential accounting revaluation requirements. After 5 years, the sculpture's market value surges to EUR 300,000. The proceeds of the transaction (i.e. EUR 200,000) would be included in the ordinary taxable profit of the company and taxed at the standard 16% corporate tax rate.

The gallery has also proposed a sponsorship or leasing arrangement (as opposed to an actual purchase) in exchange for my company being able to display the artwork. Would the tax implications change in this case?

Generally, expenses can be claimed as deductible for corporate tax purposes if incurred for business purposes. The buyer would have to discuss with its tax advisor and decide if there are enough grounds to claim the deductibility of the instalments. If deductible, the advantage of this structure is that the company would recover the costs by claiming lease charges, as opposed to the

first option where no depreciation expenses would be recognized.

While companies are encouraged to support art, they are not allowed to receive any artwork in exchange for their financial support. If that is the case, the Romanian company would not be allowed to claim a tax credit for the sponsorship granted.





2.5. The company I work for (a Romanian company) intends to purchase online a work of art from a US gallery. What tax implications should we bear in mind?

From a customs perspective, the implications and obligations detailed under point 2.2 apply to the same extent to both private investors and companies.

The import of these goods into Romania would generate VAT payment liabilities. Thus, VAT would need to be paid at the customs office and on the date when the goods are imported into Romania.

The Romanian company would face similar corporate tax implications as described in the scenario above (2.4). While the place from which the artwork is acquired makes no difference from a corporate tax perspective, the company could face different revaluation requirements for artwork held as investments, due to the different accounting standards applied.



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Sponsorships

Companies are encouraged to sponsor art, science and community projects. Consequently, sponsorship credits are available if the beneficiary is a not for profit organization working in one of the following fields: culture, education, support for study, science, humanitarian work, religious activity, sport, medical provision, social services, environmental protection, and restoring historical monuments. Specifically, Romanian tax law provides a tax benefit, as sponsorships granted in one financial year can be used as a tax credit (i.e. deducted from the corporate income tax due) up to the following minimum thresholds:

- 0.5% of turnover
- 20% of the corporate income tax due (before applying the tax credit for sponsorships).

A further benefit is that sponsorship expenses which exceed the limitations mentioned above in one financial year are not lost, as they can be carried forward and used as a tax credit for up to 7 years (each year within the two limitations mentioned above).

Let's take an example. A company concludes a sponsorship agreement in November 2018 and, under the agreement, it pays 15.000 lei to the beneficiary. The company has the following financial results:

Total turnover: 1.002.000 lei.

Taxable profit = 157.000 lei.

The corporate tax before deducting sponsorship expenses is calculated as follows:

$157,000 \times 16\% = 25,120$ lei.

Considering the deduction conditions provided for in art. 25 par. (4) lit. i) of the Fiscal Code, by applying the limits, the values are:

- 0.5% of the turnover = 5.010 lei;
- 20% of the corporate tax before deducting the sponsorship expenses = 5.024 lei.

The lower amount of the two is 5.010 lei.

For the year 2018, the corporate tax payable is:

$$25.120 - 5.010 = 20.110 \text{ lei.}$$

The amount that was not deducted from the corporate tax, i.e. 9,990 lei, is carried over for the next 7 consecutive years. Recovery of this amount will be made based on calculations similar to the one above, for each tax year.



Starting from April 2018, legal entities applying the microenterprises regime are also encouraged to grant sponsorships. Thus, they have the right to deduct from microenterprise income tax the related amounts up to 20% of the due tax. One of the criteria for benefiting from this right is that the sponsorship's beneficiary must be a nonprofit organization or religious organization that is an accredited supplier of social services, with at least one accredited social service. If the sponsorship expenses exceed the limit, the excess amount can be carried forward for the next 28 consecutive quarters.

Individuals also have the opportunity to encourage art foundations. In this respect they can direct part of their income tax towards not for profit entities, as follows:

- 2% of the amount of income tax payable, to support not for profit entities, as well as for the granting of private scholarships, in accordance with the law; or
- 3.5% of the amount of income tax payable, to support not for profit entities, which are accredited social service providers with at least one licensed social service, in accordance with the

law.

The tax authorities calculate and direct these amounts towards the not for profit entities based on the information provided by the taxpayer in his/her income tax and social contributions return, which needs to be submitted no later than 15 March. Alternatively, individuals may opt for the income payer (e.g. employer) to calculate, withhold and pay these amounts to the not for profit entities directly.



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Tips and tricks

As an individual investor buying art from Romania or from elsewhere in the European Union, you may not be significantly affected from a tax point of view. However, if you decide to sell that work of art, certain tax implications may arise and you may want to talk to your tax advisor before taking this step. If the work of art is bought from outside the

European Union, please make sure you take customs and VAT into consideration at the time of the purchase.

For corporate investors, different VAT implications will arise even at the time of the purchase and increases in the value of the work of art will bring corporate income tax implications. Leasing and sponsorships are complicated tax issues for art so make sure you analyse these options carefully before entering into these types of transaction.

Whether you are an individual or a corporate investor, think ahead and make sure you properly analyse the impact of your transactions before they actually occur. Document each transaction and keep copies of all supporting documents (e.g. invoices, contracts, etc.).



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Credits

KPMG in Romania has been established for 20 years. During this time we have developed a significant knowledge base, and experience of the Romanian market. We have assisted clients from a wide range of sectors. We aim to provide value to our clients by drawing on our understanding of the Romanian market, as well as our global knowledge base, through colleagues in the KPMG network.

KPMG in Romania provides assistance with domestic and international tax, so we work both with Romanian companies and with multinationals. We help companies and organizations comply with their legal requirements, and we give tax assistance in relation to day to day activities. We also assist with tax planning, helping our clients to structure their businesses in an efficient way from a tax point of view, and take

advantage of potential tax savings where possible. We have helped many companies, both Romanian and foreign, to do business successfully in Romania. We look forward to doing the same for you.

KPMG in Romania also helps individuals to manage their portfolio, and advises on the numerous tax and regulatory issues related to complex investments, as well as assisting with compliance. We have a specialised team with extensive knowledge of the issues faced by individual investors, high standards of confidentiality and a commitment to delivering quality service to our clients. In addition, we can draw on the resources and expertise of the KPMG international network, so are in a particularly strong position to support with complex cross-border issues.

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