

## Damage in the art market

History and current situation  
of the taxation of commercial art sales  
by Birgit Maria Sturm

**Summary: After almost a year's delay, on 18 December 2014 the finance ministers of the German federal states published a restrictive application decree<sup>1</sup> on the new VAT arrangements for art sales. According to this decree, the application of the statutory 30% flat-rate marginal taxation, which is supposed to help the German art trade to compensate for the loss of reduced VAT, is being arbitrarily overturned.**

This dramatic development concerning the abolition of reduced VAT for commercial art sales came about via the threat of formal infringement proceedings by the European Commission to the German Federal Government at the beginning of 2012. Thus far the reduced rate of seven percent applied to sales of collectors' items and artworks – as was the case for most other cultural assets. The tax reduction, once introduced as a reasonable guidance tool for indirectly promoting art and culture, thus exempts the trade from the accumulation of VAT. This is because artworks are counted among the few mobile goods which are not “consumed”, but are kept as they are by their owners and are sold time and again for different reasons, so that they circulate throughout the trade (also to the benefit of the creators, who profit from resale rights tax when their works are resold).

In this respect the Federal Government did the art market a good turn by phasing out the EU VAT Directive of 2006, which surreptitiously and incomprehensibly struck visual art from the list of beneficiary goods. Even in Germany for decades there was a cross-party consensus on the inviolability of VAT reduction for art sales – a cultural-political principle which every Minister of Culture so far had committed to.

Bernd Neumann and Hans-Joachim Otto, who served in the Ministry of Economic Affairs as Minister of Culture and the Minister of State respectively until the end of 2013, crumbled very quickly under the pressure from the Commission and, despite extensive initiatives made by the BVDG, were not in the position to keep up the reduced VAT rate for a highly ambitious sector of the cultural economy. At the same time the EU itself had an – albeit intricate – loophole at the ready, which even the Ministry of Finance was willing to choose.

Amongst the multitude of appendices to the VAT Directive there is a so-called statement for the minutes, tailored and with exclusive reference to the art trade. Just a few sentences introduce the possibility of applying 30 percent flat-rate marginal taxation, if *“the purchase price, which is paid by the taxable dealer to the supplier, cannot be precisely determined”*<sup>2</sup>

In fact, this kind of tax - 30% of the purchase price is taxed at the standard rate, 70% remains exempt of tax – has already been applied since 1996 in France, namely *both* in the primary market (sale of artworks by cooperation between creator and gallery owner) *as well as* in the secondary market (art trade, buying and selling of artworks from all periods).

The following point of civil law, which is discussed in detail in the French application decree<sup>3</sup>, is crucial here: It is the commission business that is primarily practised in the art market. For instance, according to Commission law, a gallery would actually be able to make a claim against the artist for compensation of the expenses incurred when distributing and selling: Participation in art trade fairs, costs of documentation, production, handling and exhibiting, publications and much more besides. However, over time a custom has developed, whereby professional galleries and art dealers forgo this right to compensation from the clients – not only in Germany, not only in France, but worldwide. In contrast, the selling price is divided up according to an agreed rate, often fifty-fifty. The purchase price for a single artwork thus consists of the corresponding artist's share (client) *in addition to* the share of the total costs of sales promotion related to the individual artwork. Because this share of the expenses concerning a single artwork is, however, not quantifiable because of market conditions, the purchase price also cannot actually be determined. For this reason the EU Commission *and* the EU Council have created, in a joint statement for the minutes which applies explicitly to the art trade, the possibility of assessing 30% of the purchase price as taxable at the applicable standard rate of that Member State within a margin scheme.

Since only a model supported in European law can be considered by the political representatives in this country, an arrangement based on the aforementioned minutes seems to be “inevitable”. Thus an almost identical wording to theirs has also been used in the revised version of § 25a UStG (German Turnover Tax Law): *“If the purchase price of an artwork cannot be determined or if the purchase price is inconsequential, then the amount on which the turnover is calculated is fixed at 30 percent of the selling price.”*

Although the German legislative authority conformed to the EU invective by introducing the standard rate, it allows *compensation* for abolishing the current tax reduction to be awarded to the art trade at the same time as the 30% flat-rate margin. This legislative will was unmistakably expressed in the explanatory statement of § 25a UStG:

*“The change shall ... offset disadvantages which arise for the commercial art trade because of the abolition of the reduced VAT rate. Thus a weakening of the position of art in Germany shall be avoided. The provision corresponds to an arrangement valid in France.”*<sup>4</sup>

Under these assumptions, the flat-rate margin in the tax package with the subtle title “Amtshilferichtlinienumsetzungsgesetz” (Administrative Assistance Directive Implementation Law) was adopted by the German Bundestag at the end of 2012 and by the Bundesrat in mid-2013, and finally came into force at the beginning of 2014. Despite consent from the Länderkammer (Chamber of States), the Finance Ministers of the states were then bent on pulling the rug from under the new arrangement that was essentially favourable to the art market. This is because, in federal Germany, the federal states are allowed to have a say on the *practical implementation* of various taxation laws. The *application decree* presented itself as a means to an end.

How does this procedure work? This sort of decree must be voted on by the states: The draft of this is formulated by experts, put on the agenda of the Federal Conference of Finance Ministers (FMK) and then discussed. Or perhaps not; it is resubmitted and then at some point endorsed by the ministers. The Conference of Finance Ministers is not held accountable to anyone for delaying decisions, let alone for their “quality”; it is a closed shop in which even the Federal Finance Minister does not have the right to vote. Information on the state of affairs can only be obtained indirectly, if at all. Even the authority of the representatives for culture and media was kept at a distance. A loud storm kicked up by Monika Grütters – who was rightly infuriated about an entire cultural sector being forced into a thoroughly insecure position for months on end – fell on deaf ears. This was also the case with her demand that the Federal Conference of Ministers of Culture should come to a quick and pro-market solution with their counterparts in the highest ranks of financial management<sup>5</sup>. Yet the lethargy of the Ministers of Culture on this cultural-politically existential and complex matter is not our main concern.

The driving force behind the art tax boycott was the chairman of the FMK, the North Rhine-Westphalian Finance Minister, Norbert Walter-Borjans, whose understanding of cultural topics has become legend at least since the Aachen casino affair at the end of 2014. One of the main warnings of the BVDG – that the German art market is being eroded away because of worsened general conditions in international competition – was accepted by the sale, for which Walter-Borjans was politically responsible and which was taxed favourably to boot, of two major Warhol pictures in New York, where the art market is booming.<sup>6</sup>

In short, the present decree limits the application of the flat-rate margin to the sale of artworks which were acquired as part of a sort of household clearance amongst a mass of various objects or within a “*collection of artworks as an entity*” – or if the purchase price of an artwork was under 500 euros (application decree p. 7-9). Yet these three explicitly mentioned examples only occur as an exception in the art trade. The structural inability to determine the purchase price, in light of costly and long-term sales promotion measures, is negated. The application decree therefore provides for the paradox that the flat-rate margin cannot be used by precisely the sector for which it was conceived.

The executive body was incapable of realising the legislative will for a compensation payment for the loss of the reduced VAT by finding an adequate regulation. Why? Initially the expenses typical of the Commission and the art market were dismissed as mere operating expenses. Furthermore the 30% flat-rate margin was repulsed as a sort of dirtying of the German tax system – as if there were not numerous sector-specific special schemes here already. In addition there was an ingrained misunderstanding, saturated with clichés, of financial bureaucracy regarding the art market, which could barely be eradicated despite constant efforts by the BVDG and its fellow campaigners to explain. Finally the states requested clarification from the Federal Ministry of Finance of the French application decree regarding legal conformity with EU requirements – a procedure which, according to the latest reports, was recently introduced, but the outcome of which remains undecided. Ultimately it should be assumed that the cause of this delay strategy is a rather profane interest: the prospect of higher income from VAT revenue, from which the federal states will receive their respective share.

The history of the issue of the art market and VAT shows how severely the legislative power can

be domesticated and the legislature's will can be undermined by subordinate administrative bodies. This unprecedented undermining of the division of powers corresponds to the core principles of the legal system and should drive not just entrepreneurs of the art market up the wall. Yet even the Vice Chancellor and Minister of Economic Affairs, Sigmar Gabriel, was banging his head against a brick wall with his appeal to the Conference of Finance Ministers that an application decree should be brought about in terms of a statutory regulation and in the interests of the German art market.

By taxing marketers and artists differently – the reduced rate still applies for creators - an additional massive inequality of treatment has occurred, which could have been balanced out by the flat-rate margin. This is similar to import turnover tax which is also staying at a status quo – 7 percent. This is made possible by the EU VAT Directive and has the fatal consequence of galleries and art dealers losing considerable sums to the tax authorities when the standard tax rate is applied: the sense of the input tax deduction in the art market is driven ad absurdum. This is an utterly unacceptable situation which pre-programmes significant conflicts into the working relationship between galleries and artists and on top of that encourages studio sales.

It remains to be seen whether the high commission (on average 50 percent) to visual artists can continue to be maintained in light of the enormous financial distribution costs of the galleries. Even galleries, in comparison with other cultural institutes, have to pay incredible sums to the social insurance for artists because of these high fees: in other words, a bottomless pit.

The German art market, which is carrying out professional, highly engaged cultural projects with an affinity for artists at its own financial risk, is nearing the limits of its capacity. This is acutely visible in the competition in relation to the booming art market in Switzerland, where there is only a minimal VAT of 8.5 percent and where there is – just like in countries outside of Europe – *no* resale rights tax. Or, as an example, the Künstlersozialkasse (artists' social insurance) with its constantly rising contributions which no European or international counterpart understands. Thus the professional ethics of the gallery owner as a discoverer and supporter of the visual arts are not merely fiscally undermined in Germany. It should not come as a surprise if investments in young talent will have to be restricted – whereby the tax disaster backfires and finally also affects the artists.

In the future, galleries will apply a strengthened approach to the margin scheme thus far mostly practised in the traditional art trade, that is the taxation of the difference between purchase and selling price (with the standard rate), in their commission business. This kind of tax represents a certain easing in economic pressure, but also has its pitfalls, because it cannot be used in every case and an input tax deduction is out of the question.<sup>7</sup>

The BVDG requires what even the most undiscerning Finance Ministers have contemplated: to revise the decision against the flat-rate margin, *if* the French arrangements stand up to a test in keeping with European law. In a statement in November 2014, the Commissioner for Finance and Economic Affairs, Pierre Moscovici, emphasised the reliability of fiscal compensation for artworks in the Member States and in so doing demonstrated pro-market intentions.<sup>8</sup> This is the point where German cultural politicians have to engage.

Monika Grütters has succeeded in securing the reduced VAT for the mass media of audio books within the shortest amount of time. Now her commitment is required on an EU level for attaining equal fiscal treatment of artists and art dealers: Artworks must be put back on the list of tax-privileged cultural assets alongside books and theatre tickets, with the aim of re-introducing reduced VAT for commercial art sales. Only through such an initiative will we be able to see whether the Minister for Culture is keen to tackle the art market – in which the commercial promotion of culture is taking place par excellence.

Notes and sources:

1) Anwendungserlass Kunstgegenstände und Sammlungsstücke (Application Decree for Artworks and Collectors' Items).

Oberste Finanzbehörden der Länder (highest state tax authorities), 18 December 2014

[http://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF\\_Schreiben/Steuerarten/Umsatzsteuer/Umsatzsteuer-Anwendungserlass/2014-12-18-aenderungen-besteuerung-kunstgegenstaende-sammlungsstuecke.pdf?\\_\\_blob=publicationFile&v=1](http://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Steuerarten/Umsatzsteuer/Umsatzsteuer-Anwendungserlass/2014-12-18-aenderungen-besteuerung-kunstgegenstaende-sammlungsstuecke.pdf?__blob=publicationFile&v=1)

2) Statement for the minutes for the conference on 14 February 1994 on Recast Directive 94/5/EC, printed in Rau/Dürrwächter, UStG, 156th supplement, on art. 26a VAT Directive

3) Official Gazette of the Finance and Tax Authorities of France - General Directorate BOI-TVA-SECT-90-40-20120912 of 12/09/2012

4) Deutscher Bundestag, 17th parliamentary term/draft of a Finance Law in 2013, Journal 17/13033 of 10/04/2013, p. 97

5) "Grütters kritisiert Länder scharf" ("Grütters harshly criticises state government"). Announcement of the Bundestag's Committee for Culture and Media on 12/02/2014

[http://www.bundestag.de/presse/hib/2014\\_02/01/261756](http://www.bundestag.de/presse/hib/2014_02/01/261756) also: Press release dated 14 March 2014: Cultural-political summit of states and municipalities in the Federal Chancellery.

<http://www.bundesregierung.de/Content/DE/Pressemitteilungen/BPA/2014/03/2014-03-14-bkm-kulturpolitisches-spitzengespraech.html>

6) Press release by BVDG on 22/10/2014 on the Warhol affair in North Rhine-Westphalia

<http://www.bvdg.de/pressemitteilungen/warhol-affaire>

7) On this matter see primarily Friedhelm Unverdorben: Der Deutsche Kunsthandel entdeckt die Differenzbesteuerung – Über die Folgen des Wegfalls des ermäßigten Umsatzsteuersatzes. ("The German art trade discovers the margin scheme - On the consequences of the abolition of the reduced VAT rate.") In: MwStR - VAT Act 6/2014, p. 191 et seqq.

8) European Parliament, reply from Pierre Moscovici on behalf of the Commission to the parliamentary question P-007939-14 of 14 October 2014, 27/11/2014 <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=P-2014-007939&language=EN>