

DONATIONS OF CULTURAL PROPERTY AND ART

This Reference Guide deals with the special federal income tax rules relating to the donation of Canadian Cultural Property and artistic works.

INTRODUCTION

Artistic Works

The *Income Tax Act* includes special provisions dealing with the donation of works of art. These special rules apply equally to *works of art, literary manuscripts, and musical compositions* created by an *artist, author, or composer*.¹ Accordingly, the comments below apply to all such artistic works. For the purposes of this guide, the term “artist” should be read as referring also to a writer or composer and the terms “art” or “artistic works” should be read as referring also to written works and musical compositions.

General Consequences of Disposition by Way of Gift or at Death

Generally, works of art that the individual holds as part of his or her private collection would be treated as capital property of the individual.

In general, when an individual gives away capital property during lifetime, he or she is considered to have received proceeds equal to the fair market value of the property for income tax purposes. Where the fair market value is greater than the individual’s cost of the property, this would result in a capital gain, of which fifty percent would be subject to income tax.

Similarly, on death, income taxes would be triggered as a result of the deemed disposition of capital property which occurs immediately prior to death, unless the property passes to a spouse or to a spouse trust. This tax cost would be the responsibility of the estate, so it would reduce the amount of the residue available for distribution, to the disadvantage of the residue beneficiaries.

Works of art that are inventory (such as works that an individual created for sale) may also trigger tax on their disposition by way of gift or at death. This would produce income, one hundred percent of which would be subject to tax.

¹ This is based on a 1999 letter of opinion from the Canada Revenue Agency.

January 2005

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The distinction between inventory and capital property is important in determining certain income tax consequences arising when an artistic work is donated, as discussed below.

Gifts of Art which are Not Gifts of Canadian Cultural Property

For tax purposes, gifts of Canadian Cultural Property are distinct from other kinds of gifts that may entitle the donor to tax credits, such as "*Charitable Gifts*" and "*Crown Gifts*". If any individual makes a gift of an artistic work that is not Canadian Cultural Property, the gift may still be a *Charitable Gift* or a *Crown Gift*. Basically, *Charitable Gifts* are gifts of various kinds of property (such as money or other assets) to registered charities. *Crown Gifts* are gifts of various kinds of property to Her Majesty in right of Canada or a province.

For more information about the rules regarding *Charitable Gifts*, including the charitable donation tax credit and the income tax implications of various planned giving options, please refer to our Reference Guide on Charitable Giving.

GIFTS OF CANADIAN CULTURAL PROPERTY BY AN INDIVIDUAL

Tax Treatment on Disposition

Generally, where an individual makes a gift of capital property such as a work of art that is not inventory, the individual is considered to have sold the property for fair market value proceeds, possibly resulting in the realization of capital gains. However, in the case of certain gifts of Canadian Cultural Property, the deemed proceeds are not included in the calculation of the donor's capital gains. In other words, there is an exemption from tax on certain dispositions of Canadian Cultural Property. However, the donor may still take advantage of any capital losses that result. Note that losses from the disposition of Canadian Cultural Property would generally be considered losses from the disposition of "listed personal property", which includes things such as art. Losses from the disposition of "listed personal property" can only be used to offset gains from the disposition of "listed personal property", not capital gains generally.

Gifts which will qualify for this exemption from capital gains tax include a gift

- ❖ of an object that the Canadian Cultural Property Export Review Board has determined meets certain criteria ("Cultural Property Criteria") set out in the *Cultural Property Export and Import Act (CPEIA)*;

which gift was made

- ❖ to an institution designated ("Designated Institution") under the CPEIA. (In the case of a gift made by Will, the gift must have been made within the

period ending 36 months after the death of the taxpayer or within such longer period as is reasonable in the circumstances.)

The federal government's Canadian Heritage department provides information on which institutions are considered Designated Institutions.

Qualifying for the Tax Credit for Gifts of Canadian Cultural Property

A tax credit is available in respect of certain gifts of Canadian Cultural Property, whether made during life or by Will. To obtain the tax credit, a gift that falls within the definition of "total cultural gifts" must have been made. An individual's "total cultural gifts" include the fair market value of a gift:

- ❖ of an object that the Canadian Cultural Property Export Review Board has determined meets the Cultural Property Criteria,

which gift was made

- ❖ to a Designated Institution.

We will refer to such gifts as "*Gift(s) of Cultural Property*".

Calculating the Tax Credit for Gifts of Cultural Property

When an individual calculates his or her tax credits for the year, including the year of death, there is a credit for "*Total Gifts*" made. *Total Gifts* include gifts such as *Gifts of Cultural Property*, and also *Charitable Gifts*, *Crown Gifts*, and "*Gifts of Ecological Property*". However, there are different rules regarding what amounts of these various gifts may be added to the *Total Gifts* in calculating the tax credit for the *Total Gifts*.

To understand the tax credit available in respect of *Gifts of Cultural Property*, a comparison to the credit for *Charitable Gifts* is useful.

Where a *Charitable Gift* is made during lifetime, a donor is limited to claiming the credit in respect of a gift to a value not greater than 75% of the donor's net income for tax purposes for the year (referred to as "net income" in this discussion). If the gift exceeds this limit, there is no credit for the excess in the year of the gift, although the credit can be carried forward for five years. However, for gifts made in the final year of life, including gifts made by Will, the limit is increased from 75% of the donor's net income to 100% of the donor's net income. Furthermore, if the *Charitable Gifts* made in the year of death or by Will exceed 100% of the donor's net income for that year, the excess amount of the gifts is deemed to have been made in the *preceding* year, and the limit for that prior year is also increased to 100% of the donor's net income. This is discussed further in our Reference Guide on Charitable Giving.

In contrast, the above limitations on the amount of gift that qualifies for the tax credit do not apply to *Gifts of Cultural Property*. The entire amount of a gift of cultural property is added to the individual's *Total Gifts* for the purpose of calculating the tax credit for the *Total Gifts*, even if the value of the gift exceeds the individual's net income for the year of the gift. Any amount unclaimed in the year of the gift may be claimed in any of the next five years.

The federal² tax credit in respect of the "total gifts" is calculated as follows:

- ❖ For the first \$200 gifted, the credit is calculated based on the *lowest* marginal tax rate (currently 16%); and
- ❖ For amounts over \$200, the credit is calculated based on the *highest* marginal tax rate (currently 29%).

Since there is no limit on the amount of "gift of cultural property" that qualifies for the credit, the tax credit in respect of *Gifts of Cultural Property* would be, similarly, 16% of the amount of the *Gift of Cultural Property* up to \$200, plus 29% of the amount of the *Gift of Cultural Property* over \$200.

Gift of Cultural Property Made in the Final Year of Life or by Will

A larger credit may be available where a *Gift of Cultural Property* is made in the final year of life or by Will. A gift made by Will is deemed to have been made in the final year of life. To the extent that the tax credit is not claimed for the gift against tax payable in that year, the gift is deemed to have been made in the preceding year. For example, if the gift made in the final year of life is large enough that the tax credit would exceed the income tax payable in that year, the excess amount may be used to offset tax in the preceding year. This is often referred to as a "carryback" of the tax credit.

Will Planning Considerations with Gifts of Cultural Property

In some cases certain gifts may be made by way of a "remainder interest" or a "charitable remainder trust", but this kind of gift can, in some circumstances, interfere with the tax credit for *Gifts of Cultural Property*.

A gift of a remainder interest means, for example, directing in your Will that certain property is to be held in trust for the use of someone such as a family member (for example, a spouse) during his or her lifetime, and that on the spouse's death, the item is to be given to the ultimate recipient. While the spouse is alive, the ultimate recipient's interest is a "residual interest" in the property. With *Charitable Gifts* the Canada Revenue Agency ("CRA") has taken

² Note that each province also provides its own provincial tax credits for charitable donations, which will provide additional tax savings. This discussion addresses only the federal donation tax credit.

the view that a residual interest can be valued, and therefore such a gift may qualify for the charitable donation tax credit immediately on the death of the person who made the Will, even though the ultimate recipient has not yet received the property. This is useful because the tax credit can then be used in the deceased's final year of life, with the "carryback" available.

However, regarding *Gifts of Cultural Property*, the CRA has indicated that a gift of a residual interest in cultural property is not a gift of the cultural object itself, so in the case of such a gift the special rules regarding *Gifts of Cultural Property* would not apply immediately on death. When the trust eventually gives the cultural property to the Designated Institution (for example, on the spouse's death), the trust itself will qualify for the rules regarding *Gifts of Canadian Cultural Property*, but the "carryback" of the tax credit, discussed above, would not be available since it is the trust, not the deceased, making the gift.

Therefore, if you plan to make a *Gift of Cultural Property* by Will, it is advisable to provide a simple bequest of the property directly to the Designated Institution. If you would like to leave the cultural property for your spouse for the rest of his or her life, following which it is to be given to the Designated Institution, it may be best to provide an outright bequest of the property to your spouse. Both your Will and your spouse's Will should then provide that, if your spouse has predeceased you, the cultural property is to be given to the Designated Institution. This way the cultural property will be given to the Designated Institution on the death of the second of you, no matter who dies first. If leaving the cultural property outright to your spouse is not appropriate, there are other planning options to consider.

GIFTS OF AN ARTIST'S OWN ART INVENTORY WHICH IS CANADIAN CULTURAL PROPERTY

Tax Treatment on Disposition

Special rules apply where an artist makes a gift of a work of art that he or she created and that forms part of his or her inventory, and where the gift also meets the requirements to qualify as a *Gift of Cultural Property*.

Where the fair market value of the work of art (inventory) exceeds its cost to the artist, instead of realizing income on making the gift as would normally occur, the artist is deemed to have sold the work of art for proceeds equal to its cost. Thus, no income is realized for income tax purposes. However, for the purposes of the tax credit, the artist may use the full fair market value of the work of art to calculate the credit.

The same special rules may apply to any individual who acquired, by inheritance, art inventory of a deceased artist.³ Generally, when the inheriting individual gifts or disposes of the inherited inventory, the individual would realize income for income tax purposes. However, if the individual gifts the inherited art and the gift meets the requirements to qualify as a *Gift of Cultural Property*, the individual will not realize income for tax purposes, although he or she may use the full fair market value of the art to calculate the tax credit.

It should also be noted that, where such a gift is made by Will by the artist or the individual described in the above paragraph, the individual or artist is deemed to have made the gift immediately before death, so the "carryback" of the tax credit would be available.

Regarding the availability of the *Gift of Cultural Property* tax credit, the calculation of the credit, gifts made at death, and Will planning considerations, please see the discussion above under the headings:

- ❖ Qualifying for the Tax Credit for Gifts of Canadian Cultural Property;
- ❖ Calculating the Tax Credit for Gifts of Cultural Property;
- ❖ Gift of Cultural Property Made in the Final Year of Life or by Will; and
- ❖ Will Planning Considerations with Gifts of Cultural Property.

GIFTS OF AN ARTIST'S OWN ART INVENTORY WHICH IS NOT CANADIAN CULTURAL PROPERTY

Different rules apply where an artist makes a gift of a work of art that he or she created and that forms part of his or her inventory, and the gift does *not* meet the requirements to qualify as a *Gift of Cultural Property*, but does qualify as a *Charitable Gift* or a *Crown Gift*.

In this case, where the fair market value of the work of art (inventory) exceeds its cost to the artist, instead of realizing all of the inherent income in the work of art on making the gift as would normally occur, the artist or his or her executor may elect an amount between the cost and the fair market value of the art. The elected amount is deemed to be the individual's proceeds of disposition of the work of art, possibly resulting in taxable income. However, the elected amount is

³ The special rules apply provided that, when the art was inherited by the individual, the transfer from the deceased's estate to the individual qualified under certain tax rules dealing with the disposition of "rights or things" at death. One example of "right or things" would be the inventory of an artist. The art inventory would generally have to be transferred to the inheriting individual within one year of the date of the death of the artist, in order for the "rights or things" rules to apply.

also deemed to be the fair market value of the gift for the purpose of calculating the tax credit.

The same rules may apply to any individual who acquired, by inheritance, art inventory of a deceased artist.⁴ Generally, when the inheriting individual gifts or disposes of the inherited inventory, the individual would realize income for income tax purposes. However, if the individual gifts the inherited art and the gift qualifies as a *Charitable Gift* or *Crown Gift*, the individual or his or her executor may elect an amount, between cost and fair market value, which is deemed to be the individual's proceeds of disposition for income tax purposes, as well as the fair market value of the gift for calculating the tax credit.

It should also be noted that, where such a gift is made by Will by the artist or the individual described in the above paragraph, the individual or artist is deemed to have made the gift immediately before death, so the "carryback" of the *Charitable Gift* or *Crown Gift* tax credit would be available.

TAX RULES OF OTHER JURISDICTIONS SHOULD BE CONSIDERED

It should be noted that the above discussion deals only with the *Canadian* tax rules pertaining to the gifting of artwork. If the artist is a citizen of the US, he or she will be subject to the tax laws of the US as well, and should therefore investigate the US tax rules and implications regarding the gifting of art. Specific provincial tax rules may also apply depending on the province of residence of the artist.

⁴ As noted above, these special rules apply provided that, when the art was inherited, the rules regarding "rights or things" applied.