

## **When is an artist carrying on business as a professional artist?**

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There are many ways in which arts businesses are different to other businesses. People who engage in arts businesses are often motivated by creative motives and the desire to influence public opinion. Art is not always produced with a pre-existing market in mind. Often an innovative artist will have to create a new market for their work. For these reasons, among others, the Tax Office has recently released a draft ruling dealing specifically with the issue of when an artist is carrying on business as a professional artist.

To some extent the Tax Office's new *Draft Ruling TR 2004/D12*, draws on the principles of what constitutes carrying on a business in the context of other industries. However, at the same time, it recognises the peculiar characteristics of the arts industry that make it unique. In making the differentiation the Tax Office is to be applauded, as the line between a hobby and a business venture is particularly difficult to draw in the arts context.

It is intended that once the ruling is issued in final, after consultation with industry, it will apply to both periods before and after its date of issue.

### **Arts businesses and other businesses – the differences**

As recognised by the Tax Office, there are significant differences between arts businesses and other businesses – warranting different tax treatment. The main differences being the following:

- People may engage in art activity for purposes other than the desire to make a profit, eg for creative purposes which may include the desire to influence and change public opinion. These purposes will usually continue to be present even when the activity amounts to the carrying on of a business.
- Art activity, even when carried on as a business, may be performed as a supplement to other income-earning activities, or may be supplemented by other income-earning activities.
- The relationship between the cost of creating art and its commercial value is more variable. In some cases there will be no relationship between the cost of creating art and its commercial value. Accordingly, even when the art activity amounts to the carrying on of a business, there may be no certainty that the art activity will lead to income being derived.
- Art activity may not be pursued with the same degree of repetition or systematic behaviour as other businesses.
- Artists are likely to seek to build a reputation by seeking recognition in their field, for example by developing an audience for their work and by making their work available to the public.

These reasons, in the Tax Office's view, called for a separate ruling dealing specifically with arts businesses – hence the development of *TR 2004/D12*.

### **Who is a professional artist?**

In its draft ruling, the Tax Office defines the term "professional artist" by reference to sec 35-10(5) of *ITAA 1997*. Broadly, a professional artist is a person who carries on activities of the type referred to in the definition of professional arts business, including:

- an author of a literary, dramatic, musical or artistic work;
- a performing artist, eg actors, musicians, entertainers, etc; or
- a production associate, eg choreographers, art directors, costume designers, etc.

Whether an artist is a professional artist has a number of significant tax implications. These include, most importantly, whether the income from the activity will be ordinary income, whether losses or outgoings will be necessarily incurred in carrying on the business activity and therefore deductible and whether any of the special provisions dealing with artists apply.

### **When is a business being carried on?**

While recognising the differences between arts businesses and other businesses, the Tax Office nonetheless still draws extensively on the ideas and concepts from case law in other contexts of when a business is carried on.

Relevantly, the courts and tribunals have developed a number of "factors" or "indicators" that provide guidance on whether a person's activities amount to the carrying on of a business. Importantly though no single factor is determinative and the relative importance of each factor varies depending on the circumstances. The factors can be summarised as follows:

- whether the activity has a significant commercial purpose or character;
- whether the person has more than just an intention to engage in business;
- whether the person has a purpose of profit as well as a prospect of profit from the activity;
- whether there is repetition and regularity of the activity;
- whether the activity is of the same kind and carried on in a similar manner to businesses in the industry;
- whether the activity is planned, organised and carried on in a businesslike manner;
- the size, scale and permanency of the activity; and
- whether the activity is better described as a hobby, a form of recreation or a sporting activity.

Ultimately, the determination of whether a business is carried on is based on an overall impression gained after looking at the activity as a whole and the intention of the person undertaking it.

### **Significant commercial purpose or character**

For an artistic activity to constitute the carrying on of a business it must have a significant commercial purpose, be carried on in a viable manner and with the intention of resulting in financial gain. Importantly, the fact that an artist is also pursuing other non-commercial goals does not necessarily deprive the activity of a commercial character. As has been recognised in the context of professional sportspeople, the pursuit of excellence in a chosen field by a person may amount to the carrying on of a business. What turns the pursuit of excellence into the carrying on of a business is the decision by the person to try and make a profit from the application of their skills, accompanied by activities designed to implement this commercial goal.

When the sole motivation of a person (objectively determined) is to achieve personal enjoyment and satisfaction from an artistic or sporting pastime, they will not be regarded as carrying on a business. What differentiates a professional artist or sportsperson is the direction of their artistic or sporting prowess towards commercial ends.

In addition, the fact that an artist works at their art outside of any hours of employment is not decisive of whether their artistic activities amount to a business.

The practice of art is particularly high risk and often the profit-motive indicator will be demonstrated more by a person's genuine attempts to make their arts activity profitable, than by consistent actual profits. By contrast to many other business persons:

- the capacity of an artist to derive income is not "linear". In other words, the derivation of income in a particular year is not an indicator that similar

income will be derived in the following year or years (hence the existence of the income averaging provisions for artists);

- the income derived by an artist is not always a result of the artist directing their art work to a particular commercial market, but rather may depend upon the acceptance of the artist's work by the market; and
- the popularity of an artist's work (and therefore their commercial success) may fluctuate over time, for reasons outside the control of the artist.

These factors should be borne in mind in assessing whether an artist is carrying on business as a professional artist.

### **Intention to engage in business**

A person intends to carry on a business if they make the decision to commercially exploit the skills they may have developed pursuing the same activity as a hobby or pastime and this is reflected in their overt and planned activities. However, to be carrying on a business the person needs to have done more than decided to commence a business by:

- purchasing any items required to start a business; and
- actually commencing business operations.

### **Profit motive**

This indicator refers to the artist's subjective intention to profit from the activity, as determined on an objective basis. The indicator determines whether a person has an intention to make a financial or commercial gain or a genuine belief that a financial or commercial gain will be made in the future.

Importantly, the fact that a person's business is making a loss is not conclusive that the person does not have a genuine belief that the business will be able to make a financial or commercial gain in the future.

As correctly pointed out by the Tax Office, an arts business involves a high risk commercial activity and it is often difficult to ascertain whether a profit motive exists by focusing on whether or not a profit is actually made from the activity. Therefore, in the arts context, the following activities will be relevant in determining whether a taxpayer has a genuine profit motive:

- endeavouring to bring the art work or service to relevant markets;
- creating or enhancing industry contacts (eg gallery owners, art dealers, literary or performing arts agents, critics);
- offering art work for sale as well as actual sales of art work to the public;
- offering expert services through commission or consultancy;
- related income seeking activities (other than direct sales) including applying for grants, awards, patronage, commissions, and so on;
- making their art work accessible to the public through activities designed to raise the profile of the taxpayer as an artist, eg publicly exhibiting art works, creating works for public performance and contributing written work for publication;
- entering art competitions, residencies and award events;
- undertaking research into the proposed arts business and consultation of experts (art experts or business advisers) prior to and during the activity; and
- reputation building as part of an overall intention to make a profit.

In the end, it will be a question of fact whether the available evidence points to an activity being pursued with profit making in mind, or whether the person is driven solely by the personal enjoyment and satisfaction they derive from their art, so as not to constitute the carrying on of a business.

### **Repetition and regularity of activity**

It has often been said in other contexts that conduct of a commercial nature in a regular, continuous and systematic fashion is required before a business is being carried on. However, as an artist is often engaged in creating original pieces of work,

the pattern of repetition characteristic of other businesses may not exist to the same degree in an arts business. However, for an arts activity to be carried on as a business, the activity should be conducted on a regular basis overall. In the case of artists, there will be repetition, usually not in the sense of producing identical output, but rather in the repeated application of the artist's skills to different pieces of work. In addition, for financial reasons, artists will often engage in other types of non-arts related work, which may be periodically or simultaneously interspersed with their arts activities.

Accordingly, in the case of artists, the necessary regularity and repetition will exist where:

- the artist practises their arts skills in the manner and for the time required to maintain a high professional standard;
- the arts activity is conducted with sufficient regularity to demonstrate a commitment to engage in a business, not just indulge a hobby or pastime;
- the artist regularly participates in activities designed to promote their art work and/or build their reputation as an artist. Depending on the type of art work involved, this can include such things as the setting up of a website to display their works; circulation of invitations to art openings or exhibitions; or entering art competitions; and
- the artist engages in a systematic application of their skills across a variety of artistic endeavours.

In borderline cases, it will be necessary for a taxpayer to demonstrate regular attempts to promote themselves and their art work to the public, for the purpose of finding or creating markets for their art work.

### **Industry comparison**

Apart from being different to other industries, the arts industry itself is far from homogenous. Accordingly, in undertaking an industry comparison, the particular type of art practiced by the person should be carefully examined. For example, an arts activity is more likely to be considered a business if it is carried on by the taxpayer

with organised business methods and procedures ordinarily found in the same kinds of arts activities that would be recognised as being professional arts businesses.

For artists, this indicator will involve an examination of each of the following factors:

- industry and peer recognition as an artist;
- qualifications (or equivalent experience) typical of those in the relevant industry sector;
- public and media recognition as an artist;
- meeting the eligibility and selection criteria for grants, awards and professional opportunities;
- appointment to a particular position being contingent on the person's status as an artist;
- memberships of professional associations including unions;
- reputation building in a manner consistent with others in the relevant industry sector;
- methods of application and time commitment to activity consistent with others in the relevant industry sector; and
- obtaining the advice or services of an agent, manager, legal or financial adviser, if such is common in the taxpayer's industry sector.

### **Organization and system use**

Although less likely than for other businesses, a professional arts activity can still be carried on in a systematic and organised way in accordance with ordinary commercial principles. If a professional artist conducts his/her activities on a spontaneous basis, with no method or plan, then the professional artist is less likely to be regarded as carrying on a business.

Organisation is demonstrated by the use of business records and books of account, business premises, licences or qualifications, written business plans, existence of contracts to record agreements and a registered business name.

## **Size, scale and permanency of activity**

One of the main peculiarities of the arts industry is that the scale of business activity is typically small. While a business often involves activities on a large scale, the courts have recognised that a business can be carried on in a small scale.

As a result of the small scale of business activity, it is common for artists to be engaged in other business activities or employment activities concurrently with their arts activities. This, however, does not prevent the arts activities from being carried on as a business.

The courts have also recognised that some arts businesses have commercially inactive periods. An artist may be engaging in creative activities including researching and building up a body of work. However, this does not mean that the taxpayer is not carrying on a business in the inactive periods.

Whether an arts activity is being carried on with sufficient size and scale so as to constitute a business may be demonstrated by the following:

- the activity and output must be beyond what is needed to meet the personal needs of the artist; and
- the volume of output must be sufficient to enable the taxpayer to be regularly bringing their work to suitable markets.

As acknowledged by the Tax Office, an artist may engage in a variety of arts-related activities, none of which, when viewed in isolation, would be of sufficient scale to amount to the carrying on of a business. However, the same activities viewed as a whole may present a cohesive picture of an artist diligently exploiting their skills in a variety of ways so as to amount to the carrying on of a business.

## Hobby or business – the critical question

If the manner in which a person undertakes their activity shows that it is merely a hobby, recreation or sporting activity, then it will not constitute a business. Likewise, if the person's activities predominantly involve purchasing goods for self-consumption or selling goods to family and friends, at cost, then the person will not be treated as carrying on a business. However, a hobby may turn into a business.

Before carrying on a professional arts business, a person will usually wish to be a professional artist. To this end, the person is likely to:

- seek to bring their art work to suitable markets, so as to gain a profit from the application of their artistic skills; and
- attempt to build their public reputation as an artist and awareness of their art work.

By contrast, some indicators of a person engaged only in the pursuit of a hobby or recreation include:

- where it is evident, as determined on an objective basis, that the taxpayer does not intend to make a profit from the activity;
- where losses are incurred because the dominant motive for engaging in the activity is personal pleasure, rather than the taxpayer also being driven by the desire to commercially exploit their artistic skills;
- where there is no plan in place to demonstrate how the taxpayer intends to make a profit from their art work;
- where any sales made by the taxpayer are to friends and relatives, not to the general public; and
- where the taxpayer does not intend to carry on a business, but rather intends to pursue a hobby or engage in a form of recreation.

## Conclusion

More than ever before, artists are using their talents for commercial ends. Undoubtedly, however, the extent to which such commercial ends are pursued will vary from individual to individual. Accordingly, the Tax Office's identification of the arts industry with all its uniqueness comes at an opportune time. In particular, guidance on what does and does not constitute a business in the arts context is critical as an increasing number of artists view profit as their motive in undertaking the activity. However, with the wide spectrum of activities involved in the pursuit of art it will prove difficult for the Tax Office to lay down definitive rules on when an activity constitutes the carrying on of a business.

In its *Draft Ruling*, the Tax Office has made a genuine attempt at demonstrating that it understands the peculiarities of artistic pursuits, while at the same time according certain business people in the arts industry the tax treatment they equitably deserve. It remains to be seen whether the draft ruling will need to be amended in light of the decision to be reached by the High Court in the sports industry context in the *Stone case* (2003 ATC 4584).