



Form **W-4**
Department of the Treasury
Internal Revenue Service

Tax Guide for Small Business

April

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TAX TIME FOR THE ARTIST: POSSIBLE TAX DEDUCTIONS FOR THE VISUAL ARTIST

by Dr. John Daab, Certified Fraud Examiner

Introduction

Visual artists may not know that the steps involved in creating art, the areas used, and the materials and equipment purchased to produce the art are gold nuggets when it comes to tax time. Yes you love your work and are not really concerned about how much you make selling it. A Damien Hirst you are not. Some of your stuff has been sold but not a lot. You have business cards, letterhead and a marketing plan, work with various

galleries, make trips to museums, and even have parties focusing on your works. In your effort to sell your art as an artist you may be a business. Indeed, think about what you are going to place on your canvas. At the same time start thinking outside the canvas.

The Canvas, or Concrete and Beyond

I love to create reinforced concrete sculptures. My garage was supposed to be for cars; it is now a storage area for my materials and equipment, an area for

creating the forms for my sculptures, and mixing concrete to pour into my forms. I tried to deploy my living room but my wife would not allow it. She noted that concrete splatters would be hard to remove from some of the art hanging on the walls. I also have a room in the house which serves as an office. In this office I have furniture, copiers, computers, printers, phones, reading materials, and copy paper. As an artist, my working garage, office, and all the materials, equipment and associated expenses necessary to carry out my art business are potential deductions which could offset my art income. In point, genuine tax deductions used to offset art income put taxes back into the pocket of the artist.

Business or Hobby

If you think of your art as just a hobby and really do not want to reward yourself with tax deductions, well maybe move on and browse the FAR® gallery. If, on the other hand, you are producing, and pushing your art to make a profit, that is, to make more money than you spend producing it, chances are that you are a genuine business, and the IRS allows businesses to take many, many deductions or write-offs against the income the business receives. For example, against the income I receive for my concrete sculptures, I can deduct my garage which is used solely for producing my works, all my tools, and any equipment used in the production of the works. Please note, this is just for starters. The significant point here is that your artistic endeavors must satisfy the IRS code descriptions of a business. This does not mean that when you file your taxes and take your deductions all you have to do is tell the IRS that – Yay! I am a business.

IRS Criteria for Being a Business

The IRS provides several criteria for what constitutes a business. For an artist, these would include the following:

- The artist must carry on the endeavor in a businesslike manner.
- You are depending on the sales of your work as income.

- Your costs of doing business, your losses or deductions must be necessary to the point that your business may not move ahead or be complete without them, such as the new grinding machine to smooth out your sculpture, or printer to copy your works to send to galleries. You should not deduct a \$400 pair of Prada sneakers as part of your artist wardrobe!
- If necessary you must change your methods of operation to increase profits.
- You must have the knowledge needed to be successful in the business.
- You must make a profit in some of the years. The rule of thumb is that in 3 out of 5 years you must be profitable.
- You should have made a profit in similar activities in the past.
- You should expect to make a profit in the appreciation of the assets used in the endeavor.

Note that these criteria are somewhat generic, and if you are genuinely involved in creating a profit-making enterprise from your art, you have reached the first plateau in satisfying IRS rules. Do not think for a moment that the IRS is going to allow deductions and write-offs unless you have properly demonstrated that you have examined the criteria and rules and, comparing these to your own activities, you satisfy the criteria of a business.

Business Revenue or Income from Your Art

Revenue or income from your art consists of sales, prizes, and trades. If during a given year you sold ten works valued at \$10,000 each, your business made \$100,000 in sales. If you received prizes, awards, or anything of value, the dollar value of that income must be reported. If instead you received a Dodge Dakota worth \$15,000 instead of cash, you received income of \$15,000. If you traded one of your sculptures valued at \$1,000 for a painting worth \$5,000, your reported income was \$4,000 or \$5,000 minus \$1,000 equals \$4,000 gain. If during that year

you received \$100,000 in cash+ \$15,000 in a truck+ \$4,000 in a painting, your reported yearly income should total out to be \$119,000. In point, the IRS expects you to report any income or gain associated with your art business at tax time. You should also be paying estimated taxes quarterly if you are able to estimate the income for the quarter. Failing to provide estimated taxes creates penalties and interest costs.

The Costs of Doing Business: The Tax Write Offs

In the income section it was noted that the income for the given tax year was \$119,000. Without many deductions your income would be taxed at 39% of your \$119,000 or \$45,000+/- . You would be able to keep about \$74,000. I don't know about you, but I would not be happy giving away \$45,000 unnecessarily to the IRS.

Bring on the deductions! There are about nine generic categories of deductions applicable to income. They are continuing education, travel, promotions, supplies, expenses, equipment (See IRC179 covered below), telephone, home office, and other. Let's consider the biggies first and most issue related.

Home Office

The home office deduction consists of the parts of your house used to produce your business income and following the square footage involved one may deduct the percentage of square footage dedicated to the business use in terms of mortgage costs or rent, utilities, insurance, etc. For example, if your house is 2,000 square feet and your business use is 1,000 square feet, your business use is about 50%. Let us say that adding up all the costs of carrying the house equals \$20,000 a year, your business deduction would be \$10,000. It gets better. You may also depreciate the percentage of the house used for the business. This should be thought out carefully since the depreciation must be recaptured when you sell. Assuming that you do not want the depreciation you have at least reduced your taxable income by \$10,000. Your income to be taxed is no longer \$119,000 but \$109,000. Put \$3-4,000 in your pocket. You no longer owe \$45,000 but \$41,000+/- . This deduction in the

past was problematic and a red flag for an audit. Tax researchers note that this year it may not be as problematic.

The Internal Revenue Code 179 (Equipment)

It has been said that IRC179 is one of the biggest benefits or deductions allowed for a small business. Basically it allows a substantial amount to be deducted from your tax income for the purchase of a piece of business-related equipment put into use during a given tax year. Let us say that you need a truck to move your art to various galleries during the year. IRC 179 lists the criteria of trucks to be used in the deduction. It will also identify the maximum deduction for the year, maximum cost of the equipment and the allowable period of depreciation. For example let's say you buy the Dodge Ram with quad seating selling for \$40,000. The IRC179 will allow a deduction amount for the first year of operation (in the past around \$25,000). Additionally, the auto may be depreciated to put more money back into your pocket. In the past you could purchase equipment for up to \$125,000 and each year deduct the yearly allowed amount up to the \$125,000. Although you may be getting large deductions for the equipment, keep in mind that the cost of the equipment is a very real expenditure. You might realize that the big IRC179 write off is not worth the deduction since the cost of operation – gas, maintenance, monthly payments, down payment, insurance, value after sale and so on – might not be in the best interest of your business. For example, you might realize after one month that the equipment is not working out. You will be lucky if your car salesperson will give you more than 50 % of the value of the one month old \$40,000 truck. The point here is that the IRC179 is a benefit which must be thought of in terms of costs/benefits to your business, and not based on likes, status, or coolness of product.

Meals

If during the course of doing business it is necessary to go to a restaurant for a meal, you may deduct the cost of the meal. However, meals fall under entertainment and as such the real deduction amounts

to only half of the cost. Your staff may be included, as long as it has a business purpose.

Education

Education necessary to continue your profession may be used as an allowable deduction. Private lessons, classes, visits to galleries, museum memberships, lectures, and special exhibits fall under this category. Education necessary to change your profession is not usually allowed.

Travel

If your art business requires that you travel you may deduct auto, train, and plane costs associated with your trip. Additionally, you may deduct taxis, tips, parking, tolls, miles and meals. Traveling does not mean only to deliver or pick up your art. If you must travel for schooling, lectures, professional meetings, client interviews, you may be able to deduct the costs.

Ads and Promotion

Every business at one time or another needs to get the word out about what it does. As an artist, business cards, websites, ads, slides, announcements, resumes, photos, and portfolios need to be developed so as to bring in a sale. You can't sell unless people or organizations know about your work. Those costs, which promote the artist, are deductible.

Supplies

Brushes, canvases, stretchers, paint, mediums used (steel, clay) cleaning compounds, clothes, safety items, paper, ink, pens, tables, and whatever supplies are used to conduct your art business may be deducted as a cost.

Expenses

Phone, internet, garbage removal, environmental clean-ups, heating, air conditioning, water, sewer, property taxes, insurance, models, memberships, food and wine for openings, repairs, postage, subscriptions, books, security and fire alarm service, attorneys, accountants, and other service personnel needed to conduct your art business may be written off.

Others

Some costs develop which are not found in the IRS tax deduction categories. These "others" develop as technology moves ahead of IRS postings or may simply have been overlooked in the IRS lists. If you use your iPod in your business and it is not listed, it may be filed as a deduction, and listed in the "other" category. If it is a genuine cost of doing business then it should be deductible.

Significant Points to Consider for the Artist

- The areas discussed are not meant to provide any advice to artists, but to let them know that at tax time there are many IRS deductions allowed to artists as businesses.
- The tax code is complicated and artists may want to secure the advice of tax professionals, or use software programs before sending their filings to the IRS. However, the IRS makes it possible for you to complete your own tax returns using the forms they provide and reading the instructions accompanying each.
- Not all deductions are equal. Some are simple, and others are double edged. The IRC179 would seem to provide great benefits, but a closer look says that great costs could arise from engaging the benefit. A sensible approach is to purchase the equipment you need and can afford and then be sure to include the cost in your deductions.
- CPAs and tax attorneys are warning that the IRS has been directed to pull out the stops for 2008 filings. They will be checking out the big deductions as audit red flags, i.e. 179 and the home office deduction. They will also be focusing on failure to report all income, inaccuracy in numbers and contradictions between third party number reporting and the numbers the taxpayer is using. Your numbers should match your bank's report to the IRS. It is noted here that some tax software programs provide auditing services with your filings. Experts advise that if audited do not do it alone.

- In energizing deductions, the artist must keep strong documentation to establish that the deduction exists on paper and not in memory. Keep all your credit card statements, bank records and receipts for everything you intend to deduct. Keep a mileage log for all vehicles used for business purposes. Maintain your bank records, keep your planning book up to date, and be careful how you use cash as a cost payment. The receipt for the \$300 paint set you just bought with cash is easily lost.

- A bank debit card or a credit card with their accompanying detailed statements are a good way to provide a rolling record of your costs, and also serve as an identifier that you are not a hobbyist but an artist running a business.

Summary

Visual artists working as business entities are required to report their income to the IRS. As a business reporting income you are also allowed to deduct the costs associated with producing the income. To the extent that deductions reduce income for taxation, the artist pays less in taxes and puts more money in his or her pocket. Artists must stay on top of what they can deduct and at the same time keep accurate and good business records to support deductions. Failing to do so might allow Uncle Sam to reach back into your pocket and take more as the result of interest and penalties arising from careless tax filings.



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