COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 28.04.1999
COM(1999) 185 final

REPORT FROM THE COMMISSION TO THE COUNCIL ON THE EXAMINATION OF THE IMPACT OF THE RELEVANT PROVISIONS OF COUNCIL DIRECTIVE 94/5/EC ON THE COMPETITIVENESS OF THE COMMUNITY ART MARKET COMPARED TO THIRD COUNTRIES' ART MARKETS

CONTENTS

1. BACKGROUND

Council Directive 94/5/EC[1], which introduced special VAT arrangements applicable to second-hand goods, works of art, collectors' items and antiques, was adopted on 14 February 1994, operative from 1 January 1995. This Directive was the culmination of a process that commenced with a proposal for a Seventh VAT Directive in 1978[2].

During the negotiations that eventually led to agreement on the Directive, many Member States expressed their desire to retain certain pre-existing reliefs and special schemes. The motives were both to maintain revenue receipts and to protect traditional markets, in particular the fine art market, which had hitherto enjoyed favourable tax treatment in certain Member States, from sudden large increases in VAT rates. As a result, certain measures were introduced on either a temporary or permanent basis. The permanent provisions include a special scheme for dealers in second-hand goods (including works of art); a special scheme for sales by public auction and the possibility of applying either a reduced rate or an effective reduced rate of VAT on works of art in certain circumstances. The temporary provisions apply to Germany, which was allowed an option for calculating the taxable amount for the sales of works of art, and the UK, which was permitted to apply a 2.5% rate to importations of works of art. The temporary provisions expire on 30 June 1999. The purpose of these transitional measures was to provide an intermediate step in the application of the common rules applicable to works of art with the intention of preventing sales moving to third countries, especially the United States and Switzerland.

In accordance with the minutes statement adopted at the time that agreement was reached in the Council on the Directive, the Commission undertook to "re-examine the impact of the relevant provisions of this Directive on the competitiveness of the Community art market compared to third countries' art markets and to report the conclusions of that examination to the Council by 31 December 1998".

This report is the fulfilment of that undertaking and it is based on an independent study commissioned for the purpose of collecting all the available facts on the art market from which conclusions could be drawn; the views expressed by the European art market, including associations representing the interests of the trade; the views of Member States on the operation of the Directive and its impact on the art market, and the Commission's own view and analysis.

As regards the request that was sent to Member States, replies were received from the German, Greek, Swedish and United Kingdom administrations. Other than the United Kingdom, the respondents confirmed that Directive 94/5/EC worked well and that no major difficulties had been experienced. The UK submission requested that the Commission should either propose the continuation of its derogation or else propose that all Member States could, if they wished, apply a 2.5% rate to the importation of works of art. This would have the effect of perpetuating the existing derogation granted to the United Kingdom, which would otherwise expire on 30 June 1999.

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[1] OJ No L 60, 3.3.1994, p. 16.

[2] COM(77) 735 final of 6 January 1978.

2. THE ART MARKET

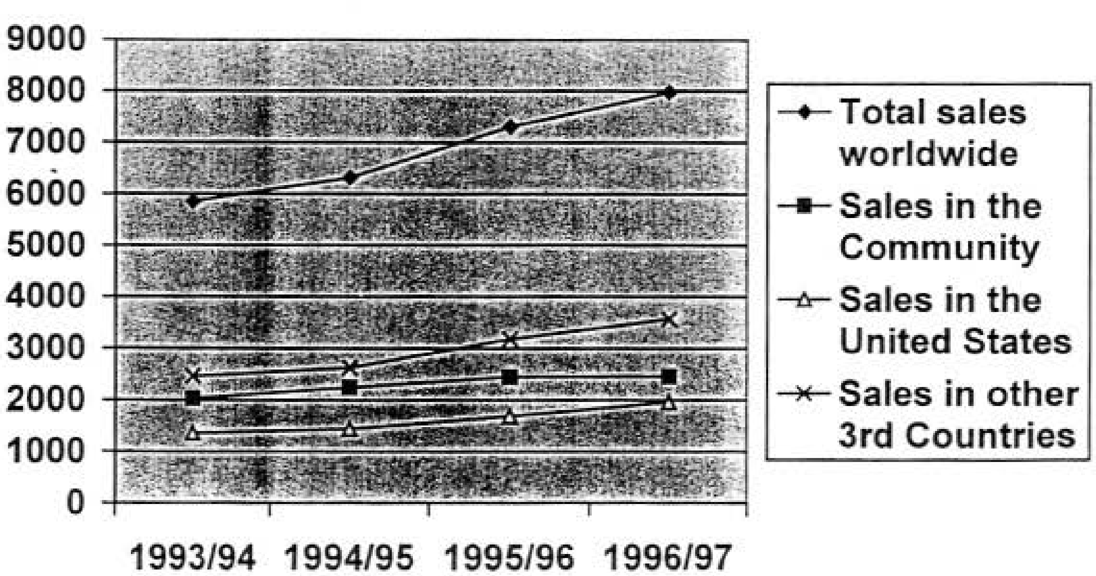
The art market is characterised by the fact that the existing stock of works of art is very large relative to the market, notwithstanding that nine out of ten works of art created are only ever sold once. Access to the market is generally by means of dealers and auction houses. More than three quarters of the sales in the art market are by dealers, of whom there are estimated to be in excess of 100.000 worldwide. As regards sales by auction, this market is dominated by two international firms who, between them, control 60% of the world art auction market. The fees charged by auction houses are broadly similar across all markets, while it is difficult to assess accurately the profits made by dealers.

The definition of works of art for VAT purposes is contained in Annex I to the 6th VAT Directive[3], and includes certain pictures, certain original engravings, original sculptures, tapestries, certain ceramics, certain enamels on copper and certain photographs. In practical terms, most of the sales of works of art are in fact paintings.

2.1. Total Size of the art market

It is estimated that the total worldwide level of sales of works of art are of the order of €8,000 million. These sales are divided between dealers, who account for annual sales in the order of €6,200 million and auction houses, which account for sales in the order of €1,800 million. One of the difficulties encountered in the examination of the market was the fact that figures can be skewed by a small number of large-value sales. For example, two sales in the United States in 1997 amounted to more than €263 million. One of these sales raised over €180 million, and set a record for the largest total ever achieved for a single-owner collection at auction.

Chart 1: Sales of works of art between 1993/94 and 1996/97 in EUR million



Source: Table 1.

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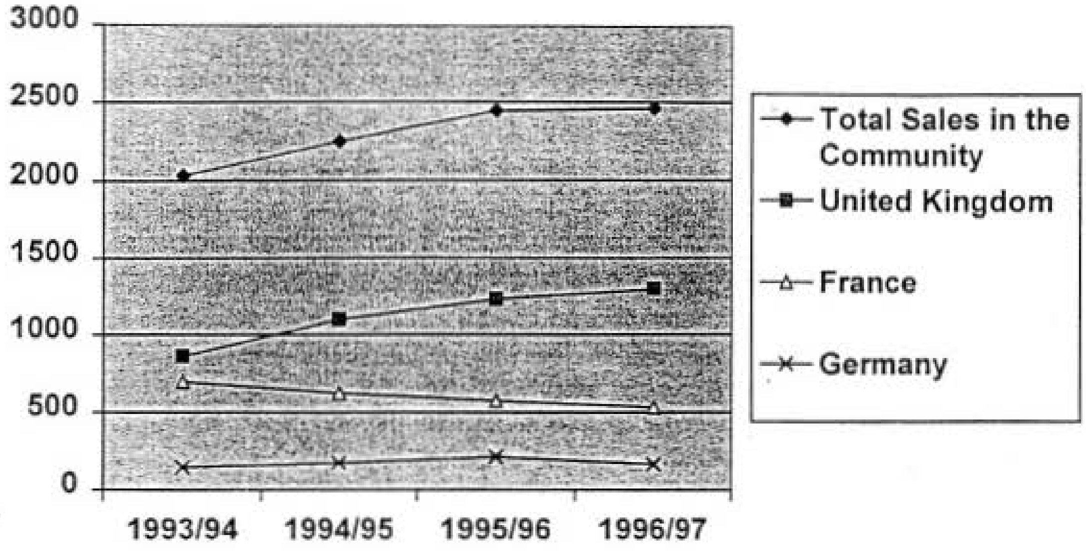
[3] Directive 77/388/EEC.

Chart 2: Sales of works of art in the Community between 1993/94 and 1996/97



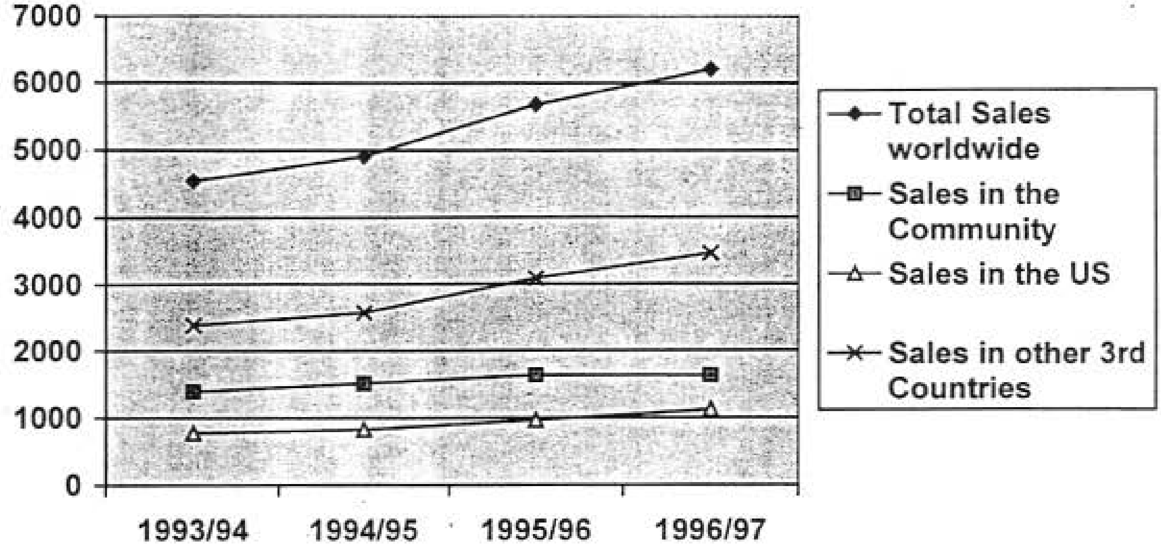
Source: Table 1

2.2. Sales by dealers

Little accurate data is available on sales of works of art by dealers. This is due to the fragmented nature of the dealers' sector of the international art market, and the fact that art dealers are generally privately owned, often family-run, businesses. It is estimated that the largest dealers in any market would control no more than 5% of total sales.

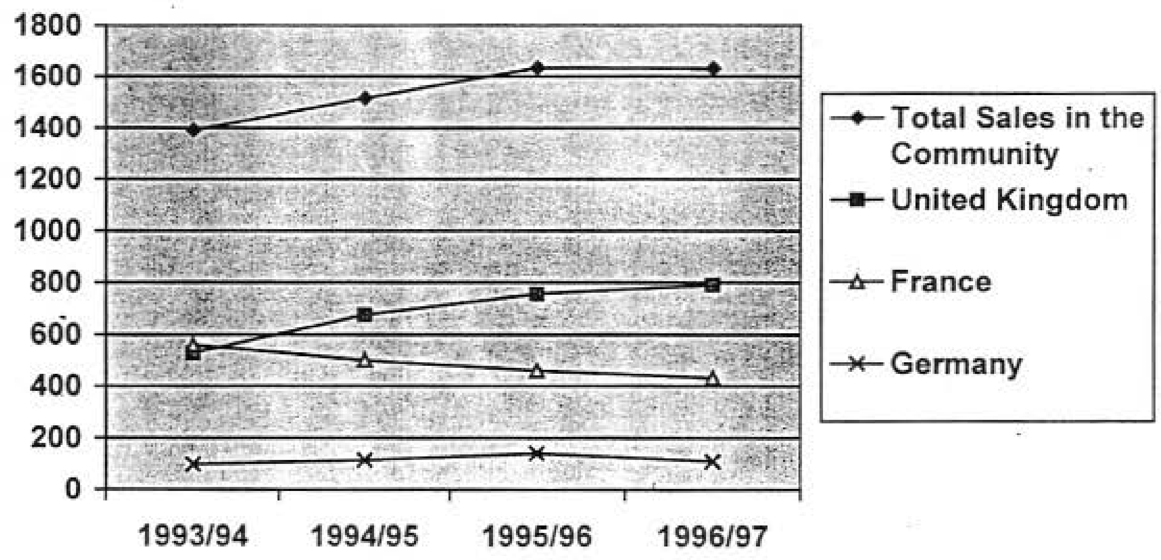
Geographic distribution of total dealer sales is significantly different to that of auction sales. Best estimates indicate that the Community accounts for 26% of global dealer sales, while the United States accounts for 18%. Within the Community, the United Kingdom is the largest market, accounting for 48% of total sales within the Community, followed by France with 26% and Germany with 7%. The value of works of art sold by dealers between 1993/94 and 1997/98 in the Community is estimated to have increased by 17%, whereas the increase in value worldwide was 37%. There are, however, stark differences between Member States over this period; the value of sales in the UK increasing by 50%, while the value of sales in France decreased by 23% and Germany shows an increase of 11%.

Chart 3: Evolution of sales of works of art by dealers between 1993/94 and 1996/97



Source: Table 2

Chart 4: Evolution of sales of works of art by dealers between 1993/94 and 1996/97 in the Community



Source: Table 2.

2.3. Auction sales

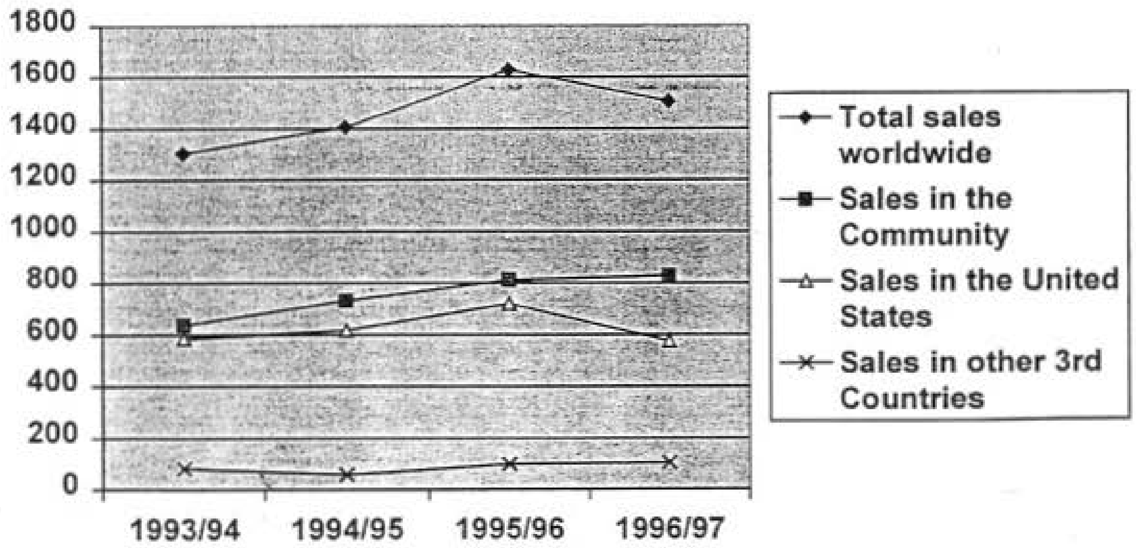
The global art market is dominated by two international auction houses. Both are publicly quoted companies with combined auction sales of some €3,500 million in 1997, of which just over one third are accounted for by sales of paintings, with the remainder split between antiques, furniture, jewellery and other items.

Whilst exact data for the market as a whole is extremely hard to obtain, the two major auction houses appear to account for around 60% of all world-wide sales of works of art by auction in value terms. In addition to these two international firms, there are a number of domestic auction houses in each major art market that tend to operate mainly in their home markets, although some are beginning to form alliances in order to expand their international coverage. However, the two firms dominate the international scene, running 7 out of the top 8 auction rooms around the world. Both of these firms have sales rooms in all the major markets, offering substantial choice to a potential vendor by placing items for sale in that market which appears to be the most promising.

The world market is split almost equally between the European Community and the United States, each accounting for some 47% of all picture sales at auction during the 1996/97 season. Within the Community, the largest market is the UK, accounting for 61% of sales in the Member States, followed by France at 12% and Germany at 7%. The value of picture sales at auction between 1993/94 and 1997/98 in the Community increased by 30%, whereas the value on third country markets increased by 41%. Of the major European markets, the UK sales increased by 51% over the period, France experienced a drop of 28%, while Germany recorded an increase of 13%.

If however, one excludes the two US sales mentioned earlier, the relative share for the European Community increases to 55% and that of the US drops to 38%. Similarly, excluding these two large sales, the value of picture sales at auction in the US actually decreased by over 1% between 1993/94 and 1996/97[4].

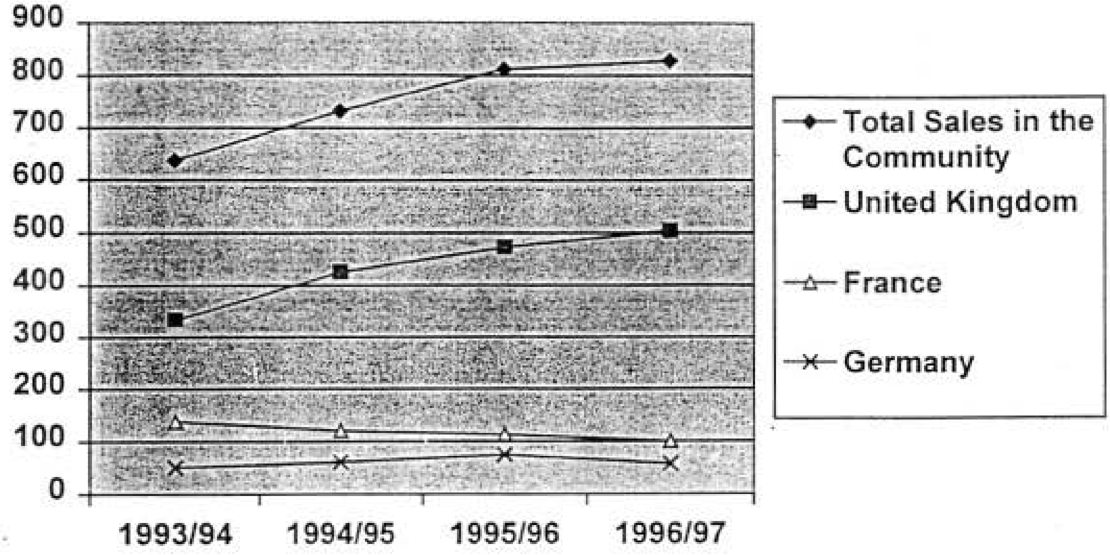
Chart 5: Evolution of sales of works of art by auction between 1993/94 and 1996/97 (Excluding the two large US sales)



Source: Table 3.

[4] If only the single largest sale is excluded, the value of sales in the United States shows an increase over the period of 12.5%.

Chart 6: Evolution of sales of works of art by auction between 1993/94 and 1996/97 in the Community



Source: Table 3

2.4. Factors which influence the evolution of the art market

In the course of compiling this report, it became evident to the Commission that many factors interact in the context of the art market, including:

- The fact that the art market is a global market;
- The fact that there is an effective duopoly in relation to auction sales;
- The rules regarding the conduct of and organisation of auctions;
- Exchange rate fluctuations;
- The desire of vendors to get the best possible price when selling works of art and the expectation that placing the goods for sale on one market as opposed to another would help achieve this aim;
- The level of artists' resale rights;
- The difference in purchasing power between markets and the relative strength of domestic economies;
- The likely effect of the stock market boom in the United States on consumption expenditure, particularly on luxury goods;
- The concept of whether or not works of art are a good investment;
- The cost of moving works of art between markets;

- The level and scope of sales taxes and VAT.

Although each of these factors play an important role, and as many of the factors are related, the Commission's mandate in respect of this report only concerns VAT, and has restricted its analysis to the likely influence of VAT on the competitiveness of the art market.

3. VAT AND THE ART MARKET

Generally speaking, VAT applies to all sales of goods and services in the Community. Transactions in works of art are like any other transactions and are subject to the same rules. Accordingly, if works of art are sold by artists resident in the Community to Community residents, VAT at the appropriate rate is chargeable. If works of art are sold to non-Community residents, and the works are exported from the Community, no VAT arises. If works of art are imported into the Community and purchased by Community residents, or if works of art are purchased outside of the Community and imported, then VAT is payable in the Community. If, on the other hand, works of art imported for re-sale are simply purchased for export, no VAT arises.

As regards the rate of VAT, again the general principle applying to other goods applies to works of art. This means that the standard rate of VAT should be applied, as works of art do not feature in Annex H of the 6th VAT Directive, which is the list of supplies of goods and services to which a reduced rate can be applied.

When the 6th VAT Directive was adopted in 1977, it left open, among other things, the question of how to deal with second hand goods. The basic principle of the 6th VAT Directive is that VAT is charged on goods each time that they are sold by a taxable person. Therefore VAT is due each time that there is a sale. No difficulties are created when the vendor, who is a taxable person, purchases from another taxable person for resale. Generally speaking, the VAT charged by one taxable person to another is deductible, and the vendor's liability to the national treasury is the difference between the VAT he has already paid to his supplier, and the VAT he has collected from his customer. The difficulty arises when the vendor is a taxable person and the goods have been purchased from a non-taxable person. The vendor must charge VAT on his sale, but he cannot deduct input VAT because he has not been charged any. In these circumstances, the vendor's net VAT liability would be far more than the tax on the value he has added to the goods, were it not for Directive 94/5/EC which amended the 6th Directive.

3.1. What are the relevant provisions of Directive 94/5/EC and how do they affect the operation of the art market?

Directive 94/5/EC introduced harmonised procedures whereby taxable persons were permitted to account for tax on the margin, or value added to goods. This allowed taxable persons to be sure of their tax liability on each transaction and regularised many schemes in operation in Member States, particularly in the used car market.

In addition to the special arrangement for taxable dealers (the margin scheme), the Directive introduced optional special arrangements for sales by public auction, which establish the taxable amount in respect of goods sold at auction. Both of these schemes concern the art market, the subject of this report.

What these special schemes do is that they redefine the taxable amount, without reference to tax rates. There are also a number of provisions regarding VAT rates, or effective VAT rates by which Member States are permitted to apply a reduced rate to importation of antiques and works of art and 1st sales by their creator. At the time of the discussion of the draft Directive in the Council, it was considered that an immediate move to the standard rate from zero-rating or exemption applying to importations of works of art into the Community would be too much of a shock for the markets of certain Member States to take and, accordingly, those Member States who had not applied a positive VAT rate to the importation of such goods as at 1 January 1993 were permitted to apply either a reduced rate, or a rate which would not be less than 5%. The United Kingdom, which had hitherto exempted from VAT the importation of certain works of art, was given additional time to adapt, and was permitted to apply an effective rate of 2.5% to such importations until 30 June 1999.

In addition to VAT payable on the margin, VAT is also due at the standard rate on the fees charged to both the purchaser and vendor. The Commission is currently taking infraction procedures against one Member State for permitting the application of the rate applicable to importations of works of art to these fees where the works of art have been sold while under the temporary importation arrangements.

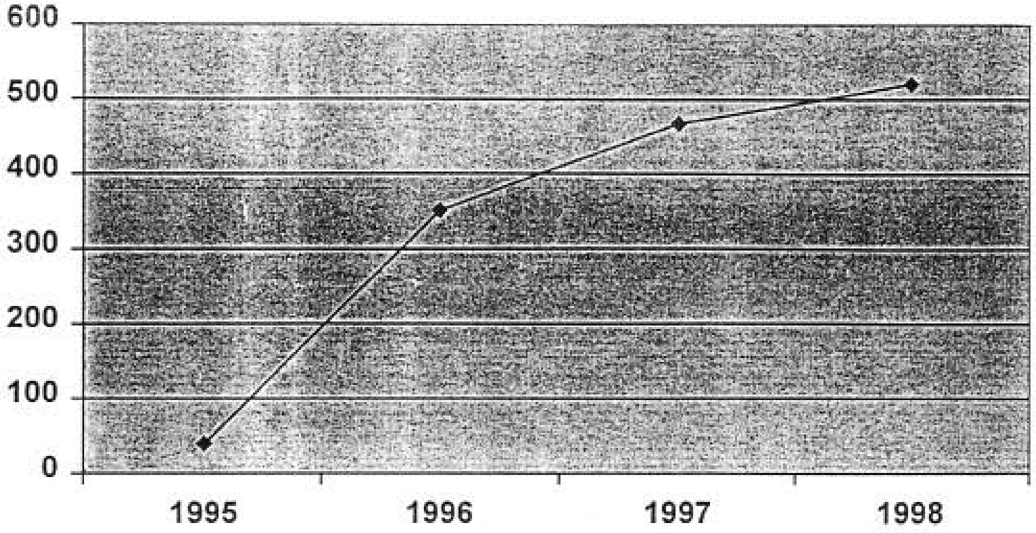
In fact the amount of VAT collected from the sale of imported works of art is relatively low and, for example, the increase in the UK of the rate of VAT on imports from 2.5% to 5% is estimated to result in additional receipts to the UK Treasury of the order of €3 million per annum.

3.2. Use of temporary export/import

Works of art sometimes move between Community and third country markets. The situation may appear complicated for individual artists, particularly where, for example, works of art are sent outside of the Community for the purpose of display with the intention of sale. Notwithstanding that the works of art remain the property of the artist until sold, the temporary exportation facilities provided under Customs legislation may either not be flexible enough or may be considered too burdensome to be applied. Individual artists also complained about the amount of paperwork involved to avail of this facility.

Temporary importation is a facility that appears to be used often by auction houses. The scheme permits the temporary importation of works of art with a view to their eventual sale within a two-year period without payment of VAT that would normally arise at importation. The advantage from the purchaser's point of view is that if the goods are to be subsequently exported from the Community, no VAT will be payable, with the exception of the standard rate on the auctioneers' fees. In fact, the use of the temporary importation arrangements in the UK has increased by a factor of 13 between 1995 and 1998, and it appears that almost all imported works of art sold by auction are covered by these arrangements. It is estimated that more than 50% of works of art entered into the temporary importation arrangements in the UK subsequently remain in the Community.

Chart 7: The value of works of art and antiques entered into temporary importation in the United Kingdom



Source: Report by Market Tracking International, for the European Commission.

Imports of works of art into the United Kingdom, excluding temporary importations, dropped from €992 million in 1994 (when works of art were exempt from VAT) to €776 million in 1995, when VAT was introduced, to €624 million in 1997. This switch from permanent to temporary importation came about because of the cash-flow advantage provided by the latter which arises from the deferral of the VAT which would otherwise be payable on the physical entry of the goods into the Community.

The practical difficulties encountered in respect of transfers of works of art between Member States reflect some of the complications of the current transitional VAT system which have already been examined in the Commission's report on the operation of the transitional arrangements for charging VAT in intra-Community trade[5]. Where the works of art are moved between markets in the Community, and are subsequently sold in a Member State other than that in which he is identified for VAT, the vendor must identify himself there for VAT and charge VAT in accordance with the rules applying in that Member State.

3.3. Perceptions

It is clear that vendors of works of art will generally sell where they perceive that they will get the best price. While there is little variance between the fees charged by auctioneers, the cost of carriage, insurance and freight arising when works of art move between locations can be significant. A vendor will generally take these additional costs into consideration when deciding where he will sell. However, more often than not, the

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[5] COM(94) 515 final of 23 November 1994.

choice is determined by the strength of the market itself. If it is perceived that a better price would be obtained in one location than another, for whatever reason, then a vendor will take the appropriate business decision.

One of the perceptions identified by the study is that the marking of works of art on a sales catalogue as being potentially liable to VAT in the Community, because they have been imported, has a tendency to reduce the bid price, because the purchaser is aware that he will also have to pay VAT, in addition to fees, on the hammer price, unless the works of art are to be exported.

Of course, as explained above, if the goods were purchased outside the Community and subsequently imported, VAT would be payable on the value for Customs purposes (including the cost of carriage, insurance and freight from the foreign auction room). The study did not reveal any widespread smuggling of works of art back into the Community, but did reveal that the general tendency in the art market was to prefer "cash deals", especially as concerns dealers.

The introduction of VAT at 2.5% on works of art imported into the United Kingdom following the adoption of Directive 94/5/EC resulted in intense lobbying by the associations representing the British art industry. This intensive campaign resulted in an increased awareness of the imposition of VAT. Sometimes such campaigns can result in being self-fulfilling prophecies, but it is clear that this was not to be the case in the UK, where the market appears to have powered ahead since the introduction of VAT on importations.

3.4. The effect of VAT on an artist's choice as to how and where s/he will introduce new works of art into the market

The study mentioned earlier found that VAT had no bearing on an artist's decision regarding how or where to introduce a work of art into the market. It is apparent that the neutrality of the VAT rules does not create distortion in this regard.

4. THE EFFECT OF VAT ON THE COMPETITIVENESS OF THE ART MARKET

While the purpose of this report is not to do a detailed analysis of Value Added and sales taxes as applied to works of art in different markets, it is nevertheless important to establish whether or not the application of VAT in the Community puts the art market at a disadvantage when compared with sales taxes applied to sales in other markets. As can be seen from table 1, the single largest competition faced by the Community market is that of the US market. Both of these markets together accounted for 94% of total auction sales in 1996/97. While these two markets only accounted for 45% of total dealer sales in 1996/97, the next biggest market, that of Switzerland, only accounts for less than 0.7% of total world dealer sales.

The standard rate of VAT in the Community is between 15% and 25%, the average rate being 18%. This compares with a sales tax in New York State, the major art market in the United States, of 8.5% charged on the full price. Taking into account that in the Community VAT is charged on the margin, rather than the full sale price, a private individual who is not a taxable person for VAT would have to purchase a work of art on which the vendor made a profit approaching 50% before the purchaser begins to pay more tax than a resident of New York state.

If VAT were to have an impact on the competitivity of the Community art market, one would expect this to be evident in a Member State where VAT on importation was first introduced, such as happened in 1995 in the UK. Yet, as can be seen from table 1, the value of sales on the UK market increased by more than 50% between 1993/94 (at which time imports of works of art were exempt from VAT) and 1996/97 (at which time imports of works of art were subject to VAT at a rate of 2.5%). Worldwide sales of works of art increased by 36% in the same period, as can be seen from the same table.

5. FINDINGS

Total worldwide sales of works of art increased by 36% between 1993/94 and 1996/97. Over 50% of this increase relates to sales by dealers in markets other than the traditional 3rd country markets of the United States and Switzerland (see Tables 1 and 2). The ratio of sales by dealers in the Community and the United States is quite constant by comparison (see chart 3). As regards sale by auction, excluding the two large sales in the United States in 1997, which in statistical terms could be considered as a "blip", sales in the Community show consistent growth (see chart 5).

While the Community art market shows continued growth, it is clear that it is not growing at the same pace as third country's art markets because of increased dealer sales in 3rd countries such as those in South East Asia, Eastern Europe and Latin America. However, it is also evident that the growth within the Community is uneven, with the United Kingdom powering ahead of other Member States. The state of the French art market could be contributed to by the fact that up to now, French law determined that only "commissaires-priseurs" can conduct auctions, thus limiting the possibilities for involvement by the two main global auction houses. This is now changing with proposals or de-regulation going through the French Parliament. It is also worthy of note that the largest shareholder in one of the two major auction houses is now a French company, while the major shareholder in the other is an American.

In practical terms the VAT effect is rather neutral, as Community purchasers are obliged to pay VAT wherever they purchase works of art, and non-Community purchasers, who purchase within the Community and take the goods outside of the Community, do not suffer VAT on the goods. It is therefore irrelevant where Community purchasers buy works of art, unless on buying in a 3rd country, the work of art is subsequently smuggled into the Community.

6. CONCLUSIONS

The role of the Commission is first and foremost the guardian of the treaties and it is obliged to make sure that no distortions of competition exist in the single market.

For VAT purposes, works of art are treated like any other goods. A Community resident pays VAT on works of art wherever he buys them in the Community, and on bringing works of art which he has purchased in a third country into the Community, he will pay VAT not only on the full value of the item, but also on the costs incurred in respect of the carriage and insurance from the 3rd country to the Community. A Community resident intending to purchase a work of art will not therefore gain a tax advantage by purchasing it in a third country.

The existing Community VAT legislation permits Member States to apply the reduced rate of VAT (which cannot be lower than 5%), to imports of works of art, collectors' items and antiques as defined in Annex I of that Directive. If this option is applied by Member States, they are also permitted to apply the reduced rate of not less than 5% to supplies works of art which are

- Effected by their creator or his successors in title,

- Effected on an occasional basis by a taxable person other than a taxable dealer where these works of art have been imported by the taxable person himself or where they have been supplied to him by their creator or his successors in title or where they have entitled him to full deduction of the value added tax.

In fact, the United Kingdom, which is the largest Community art market, applies the standard rate of 17.5% to all 1st supplies of works of art by their creator and to imports of works of art created after 1 April 1973, and has chosen to apply the low rate (2.5% until 30 June 1999, thereafter 5%) only to imports of works of art which were created prior to 1 April 1973[6].

With the expiration on 30 June 1999 of the derogation granted to the United Kingdom, all Member States have the option of applying "their" low rate of VAT, or the minimum reduced rate of 5% specifically to the importation of works of art if they so wish. It is of course up to Member States to make this decision based on budgetary or other factors.

The derogation granted to Germany regarding the option to calculate the taxable amount was never applied in practice.

Many factors play a role in the evolution of the world art markets, the examination of which is outside the scope of this report. The Commission has nevertheless found no evidence to suggest that VAT has a significant impact on the competitiveness of the Community art market vis-à-vis the markets of third countries. It therefore concludes that the adoption of Directive 94/5/EC has had no significant impact on the Community art market and accordingly does not see the necessity of making any legislative proposals on this matter.

The Commission is of the opinion that the current legislative framework is sufficient to ensure that the Community art market continues to flourish and that existing distortions between Member States will be significantly reduced after 30 June next. Accordingly, the Commission does not intend to make any proposal for legislative changes in relation to the VAT treatment of works of art.

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[6] The Commission's services are currently considering whether this differentiation in rates of VAT on imports of works of art is compatible with the principle of a single rate for the same category of transactions which is inherent in Article 12(3)(a) of the Sixth Directive.

Table 1: Sales of works of art between 1993/94 and 1996/97 in EUR million.

	1993/94	1994/95	1995/96	1996/97
Total sales worldwide	**5849**	**6316**	**7308**	**7980**
Sales in the Community	**2029**	**2247**	**2447**	**2461**
United Kingdom	863	1101	1229	1297
France	696	621	572	532
Germany	148	174	215	166
Sales in the United States	**1358**	**1441**	**1680**	**1954**
Sales in Switzerland	**71**	**82**	**85**	**76**
Sales in other 3rd Countries	**2391**	**2546**	**3097**	**3490**

Source: Report by Market Tracking International, for the European Commission.

Table 2: Sales of works of art by dealers between 1993/94 and 1996/97 in EUR million.

	1993/94	1994/95	1995/96	1996/97
Total Sales worldwide	**4545**	**4907**	**5679**	**6210**
Sales in the Community	**1391**	**1515**	**1635**	**1633**
United Kingdom	529	675	756	792
France	558	500	459	432
Germany	97	113	140	108
Sales in the US	**774**	**824**	**961**	**1116**
Sales in Switzerland	**41**	**47**	**49**	**43**
Sales in other 3rd Countries	**2339**	**2521**	**3034**	**3418**

Source: Report by Market Tracking International, for the European Commission.

Table 3: Sales of works of art by auction between 1993/94 and 1996/97 in EUR million (Excluding the two large US sales)

	1993/94	1994/95	1995/96	1996/97
Total sales worldwide	**1304**	**1408**	**1629**	**1507**
Sales in the Community	**638**	**732**	**812**	**828**
United Kingdom	334	426	473	505
France	138	121	113	100
Germany	51	61	75	58
Sales in the United States	**584**	**617**	**719**	**575**
Sales in Switzerland	**30**	**35**	**36**	**33**
Sales in other 3rd Countries	**52**	**25**	**63**	**72**

Source: Report from Market Tracking International for the European Commission and Commission services calculations.

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