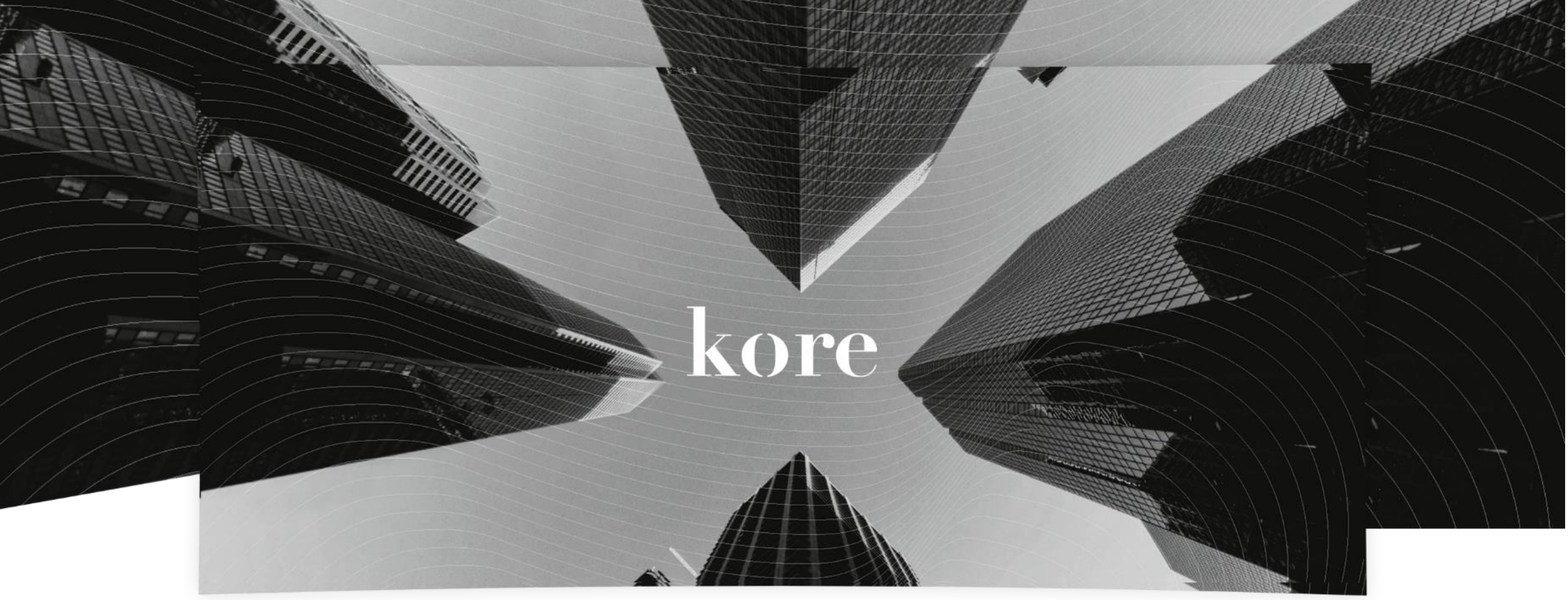

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> ***"Capital gains derived from private sales of artworks are not subject to personal income tax"***

Tax Considerations for Private Investments in Art and Digital Art

By Kore Partners

In the private wealth ecosystem, art represents an asset class of growing importance and is often linked with the identity of the family making the investment. For private investors, art is considered an investment opportunity due to its potential for long-term appreciation, portfolio diversification, and its ability to provide for the so-called passion investing element.

The art trade is now a multi-billion-dollar global industry, with an estimated value of sales of art and antiquities reaching $65 billion in 2021. This industry spans from large auction houses, small antique dealers, to private sales between institutional investors or amateur enthusiasts. As with any asset class, holding artworks brings several important tax considerations that range from capital gains tax considerations, estate tax or charitable donations issues, and value-added tax and customs duties issues when acquiring or holding art. Recently, the emergence of NFTs as digital art has become an important sub-topic with its own tax nuances.

Understanding these implications for Portuguese tax residents can make a difference, and our private client insight outlines the key considerations.

Income Tax on Private Art Investments

In Portugal, capital gains derived from private sales of artworks are not subject to personal income tax. This means that the non-recurrent activity of transferring movable property such as art outside a business activity is consequently non-taxable in Portugal. Private investors do not need to report income from the disposal of artworks and have no further reporting as there is also no wealth tax in Portugal.

Only when an individual is considered to be engaged in a professional activity related to the sale of artworks will any gains qualify as income from self-employment and become taxable, subject to the progressive tax rates that may reach 48% plus surtaxes.

Gains arising from the sale of artworks held through Portuguese taxable legal entities are subject to Corporate Income Tax of 21% plus applicable surtaxes on the difference between the sales price and the purchase price less any qualifying depreciation/amortization. Therefore, there are generally no advantages in Portugal to owning artworks through legal entities. This includes holding art through private foundations (Portuguese or foreign-based).

Art and Indirect Taxes and Customs

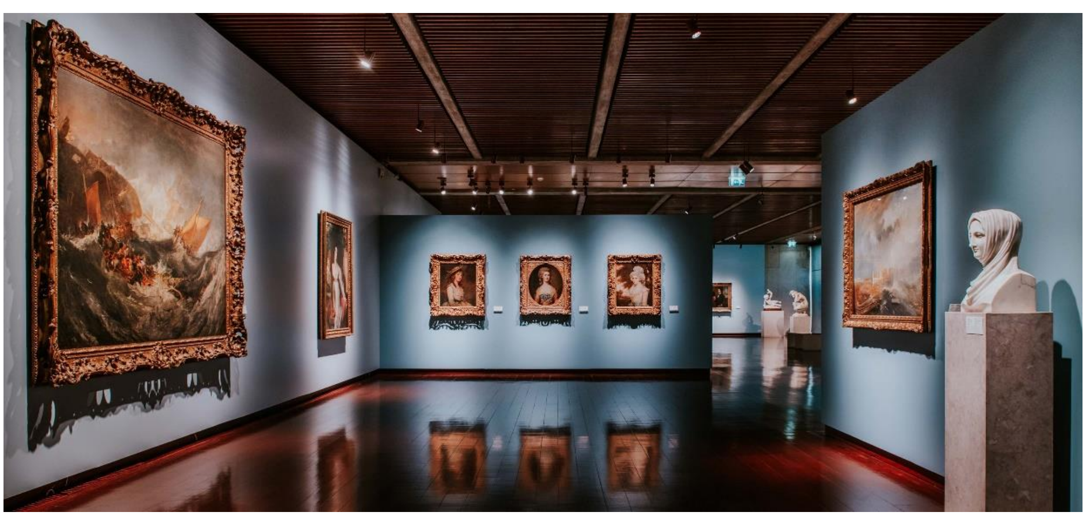
Indirect taxes are also critical when a private investor acquires an artwork either in Portugal, in the EU, or even outside the EU to then dispatch the artwork to Portugal.

"A 6% VAT reduced rate (instead of the 23% standard rate) may be applicable to certain supplies of works of art"

For domestic or EU transactions, only VAT is relevant. In Portugal, VAT is levied on the supply of goods and services located within the Portuguese territory, generally at the standard 23% tax rate. However, in the artwork field, a 6% VAT reduced rate may apply to the supply of works of art that may be framed as: (i) pictures, paintings, and drawings; or (ii) original engravings, prints, and lithographs entirely handcrafted by the artist. For this purpose, the certificate of authenticity may be required.

For artwork acquired within the EU, local VAT will generally be levied (at rates of each country), and such an invoice will allow the artwork to be transported across EU borders without any customs restrictions. Acquisitions for resale or in the framework of a business activity may require further analysis.

When acquiring artworks outside the EU, it is important to highlight that non-EU goods are subject to a customs declaration upon their entry into the EU, which is generally made via a customs broker who represents the importer in the relation with customs authorities. Most artworks may qualify for a 0% customs duty on entry in Portugal. From a VAT perspective, the private investor will need to pay VAT at the customs office (either at 6% or 23%) after completing a customs declaration for the non-EU artwork.



Estate Tax Considerations and Charitable Donations of Art

Portugal does not technically have an inheritance tax. Stamp Tax only applies to gratuitous transfer of assets located in Portugal via gift or inheritance outside a wide direct family exemption. Artwork is an example of excluded property (non-registrable movable asset), and hence no tax implications arise on transfer gifts or inheritance.

For valuable art kept in properties outside Portugal, other considerations may arise as some countries levy inheritance tax merely based on the location of the assets or tax residence of the beneficiary. In certain cases, it may be necessary to consider trust or foundation structures to hold artworks.

Donating art and other collectibles to charity will not give rise to any negative tax implications for private investors but will also not provide any tax advantage in terms of tax credits. Portugal provides tax incentives in the form of tax credits available to individual donors, but those only cover cash donations up to 25% of the donation, which in most cases is limited to 15% of total tax liability. Due to a set of limits on the overall tax credits, taxpayers in the highest tax bracket have limited or no tax credit available on those cash donations. Cross-border donations are not eligible for tax purposes.

"Donating art and other collectibles to charity will not give rise to any negative tax implications nor any significant tax credits."

For donations made by companies, except for donations to State Authorities that are considered fully deductible, corporate donations are considered deductible costs only up to a certain limit of the company turnover and depending on the nature of the beneficiary. For example, donations to private institutions in the cultural sphere are considered costs up to a limit of 5/1000 of the volume of sales/services provided, in an amount corresponding to 120% of the value of the donation (made in cash or in kind).

Digital Art and NFTs

The $69 million sale by contemporary artist Beeple may have propelled non-fungible tokens (NFTs) into mainstream art, but recently we have seen numerous pieces of artwork selling on Christie's and Sotheby's, as well as well-known artists directly selling albums or other artworks as NFTs.

True NFTs offer intrinsic and extrinsic value that is unique (the so-called non-fungibility or interchangeability) and will have a degree of interoperability across the blockchain, providing owners with a certificate of authenticity associated with the digital artwork. NFTs are generally bought and sold by creator-seller or a buyer-reseller through an online marketplace such as OpenSea, Blur, and Y2Y2. The consideration is usually paid in the form of crypto assets such as Ethereum.

In the digital sphere, Portugal recently adopted a position as of January 1, 2023, that excludes typical non-fungible tokens (NFTs) from the definition of taxable crypto-assets for income tax purposes, just like physical artwork. This means the gains arising from selling NFTs are also considered not taxable to the extent they are made outside a business activity. For a private buyer who holds NFTs primarily for sale to customers in the ordinary course of business, an NFT will qualify as business income.

In terms of indirect tax, most EU states, including Portugal, have not issued any guidance on NFTs and VAT, namely if the transfer of NFTs may be considered an electronically supplied service. Some EU countries, like Belgium or Spain, have already concluded that NFTs are, in fact, digital services. A recent EU working paper provides initial thoughts on the VAT treatment of transactions relating to NFTs and indicates that they will most likely be taxable in most cases. This is an area that should evolve in the near future.

Finally, as regards inheritance/gift of digital assets, the options are different than for physical artwork that is excluded property. For crypto-assets (including NFTs) deposited with Portuguese-based entities (such as an exchange), they are deemed to be Portuguese assets to which a 10% stamp tax may apply if gifts/inheritance occur outside the direct family (i.e., spouses, partners, descendants, and grandchildren). As for non-domestically held crypto-assets (including NFTs), the 10% stamp tax may also apply when the deceased (in the case of inheritance) or beneficiary (in donations) is a tax resident in Portugal, and the direct family exemption does not apply. This means, for example, that a donation of NFTs to a brother is subject to a 10% stamp tax on the value of the crypto-asset transferred.

Final take

The five cornerstones of taxation of artwork in Portugal are:

1. Gains derived from private sales of artworks are not subject to personal income tax to the extent this is not carried out as a professional activity. Portugal grants the same tax treatment for artworks for income tax purposes to NFTs.

2. There are generally no advantages in Portugal to holding artworks (or digital art) through legal entities, including local or foreign trusts or foundations.

Final take (continued)

3. The transfer of artwork by inheritance or gift is excluded from stamp tax in Portugal. Donations and inheritance covering specifically NFTs may be subject to a 10% stamp tax when benefiting outside direct family members (i.e., spouses, descendants, and ascendants).

4. A 6% VAT reduced rate (instead of the 23% standard rate) may be applicable to certain supplies of works of art. Even if no VAT is generally charged on NFTs, this is an area where future developments are expected.

5. For art purchased outside the EU, most artworks may qualify for 0% customs duty on entry in Portugal, but private investors need to pay VAT at the customs office.

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