

Patrons Despite Themselves: Taxpayers and Arts Policy. By Alan L. Feld, Michael O'Hare, and J. Mark Davidson Schuster. New York: New York University Press, 1983. Pp. xx, 263, appendix, notes, index. \$22.50.

*Reviewed by Sam Foulk**

Patrons Despite Themselves: Taxpayers and Arts Policy examines an existing tax expenditure of consequence: indirect government support for the arts.¹ The stated purposes of the study are (1) to describe the types of indirect government support for the arts, and (2) to illustrate the effects of this indirect support (p. 5). To achieve these purposes, the study analyzes the tax treatment of artists, the various forms of indirect aid to the arts, who benefits from and who pays for the aid, who decides how the aid is used, how the aid affects the arts, and the stability

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¹ The genesis of this book lies in the seminal work of Professor Stanley S. Surrey. Professor Surrey has advocated tax expenditure analysis in several articles and in his book, *Pathways to Tax Reform: The Concept of Tax Expenditure*. S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (1973); Surrey & Helmuth, *The Tax Expenditure Budget — Response to Professor Bitker*, 22 NAT'L TAX J. 528 (1969); Surrey & McDaniel, *The Tax Expenditure Concept: Current Developments and Emerging Issues*, 20 B.C.L. REV. 225 (1979).

A tax expenditure is an amount representing what the Treasury would have collected but for a given deduction from income or an exclusion from income. The amount of tax foregone by the Treasury is an indirect expenditure and, in many cases, a subsidy for what is perceived as a desirable social or governmental policy. For example, the interest deduction allows home purchasers to deduct interest paid from their income. I.R.C. § 163(a). This loss of revenue can be viewed as a tax expenditure which indirectly subsidizes the purchase of homes and, therefore, the building industry. The allocation of this subsidy among the members of society is regressive in a supposedly progressive rate system. Given two individuals in different tax brackets but with the same deductions, the individual in the higher tax bracket would receive a larger subsidy than the individual in the lower tax bracket. Professor Feld, one of the authors of *Patrons Despite Themselves: Taxpayers and Arts Policy*, in his review of *Pathways to Tax Reform* states that tax expenditure analysis not only requires that there be a predisposition against future tax expenditures but also that the existing tax expenditures be scrutinized to determine if they efficiently achieve their social goal and if they fairly offer government incentives without regard to income levels. Feld, Book Review, 88 HARV. L. REV. 1047, 1055 (1975).

of the aid. In the final chapter of the book, the authors draw conclusions from their study and as a result make specific recommendations for changes in existing law.

The analysis Professors Feld, O'Hare and Schuster undertake gives short shrift to the complaint of visual artists that they are treated unfairly under the present tax laws (pp. 10-23). The alleged mistreatment of the visual artist is two-fold: (1) heirs cannot afford to inherit an artist's work because of confiscatory estate taxes; and (2) the artist may only deduct the value of materials when she donates an art object, whereas a collector may deduct the fair market value of the work when she donates the same object.²

The authors point out that estate taxes do not penalize the heirs of a visual artist, but treat them in the same way as any other heir. Charitable bequests of property are entirely tax deductible from the estate and not subject to estate tax.³ There is an unlimited marital deduction for the portion of the estate that passes to the surviving spouse.⁴ Starting in 1987, estate taxes are eliminated for estates smaller than \$600,000.⁵ Moreover, there is a provision allowing fifteen years for the payment of estate taxes for closely held businesses whereby the heirs may, if necessary, sell the art objects piecemeal and avoid flooding the market and depressing their value.⁶ Thus, no sound tax policy exists which should allow the estate of a wealthy artist to be treated differently from the estate of any other wealthy person.⁷

The authors deny that the federal income tax laws discriminate against the visual artist, but they then propose that artists be allowed to treat the appreciation of an art object after creation as capital gain

² Under present law, a collector contributing appreciated property to a public charity may deduct the fair market value of the property with the proviso that if the donor had sold rather than donated the property, the donor would have realized long-term capital gain. I.R.C. § 170(e). A public charity is an organization which meets the requirements of I.R.C. § 170(b)(1)(A). For tangible personal property, there is the additional requirement that it be used by the exempt organization to which it is donated. I.R.C. § 170(e)(1)(B)(i). If it is not used by the exempt organization, the donor may only deduct the basis of the property plus 60% of its appreciation. I.R.C. § 170(e)(1)(B)(ii).

³ I.R.C. § 2055.

⁴ I.R.C. § 2056.

⁵ I.R.C. § 2001.

⁶ I.R.C. § 6166.

⁷ The authors recount a bizarre incident of a visual artist who, irate with estate taxes, destroyed \$1.5 million of his art work. This is an unusual example of creative estate planning (p. 20). *In re Rothko*, 43 N.Y.2d 305, 372 N.E.2d 291, 401 N.Y.S. 2d 449 (1977).

rather than as ordinary income.⁸ The authors contend that the artist should be able to treat her work as a capital investment. Their proposal would allow the artist at the time of creation to choose whether to include in income the fair market value of the work, less cost of materials, and subsequently treat the work as a capital asset. For example, if the cost of materials is \$100 and the fair market value of the art work is \$1,000, the artist may elect to include \$900 (\$1,000-\$100) in income. If the artist so elects, she will have a tax basis of \$1,000 in the art work. If the work is sold several years later for \$5,000, the artist would realize a capital gain of \$4,000, rather than \$4,900 (\$5,000 - \$100) ordinary income.

This proposal suffers from serious defects. It would present the Internal Revenue Service with the administrative nightmare of determining when the artist has to make the election and how to value the art work accurately at the time of creation. Assuming that the thread served to lead one through this administrative maze, the artist would be treated differently from and more preferentially than similarly situated taxpayers. What distinguishes the artist from the cabinetmaker, the dressmaker, or even the manufacturer of an inventory asset? Each of their products, when sold, is the source of ordinary income (pp. 221-22). Even if each of these individuals is accorded the same treatment as the artist, the proposal would increase dramatically the tax expenditure inherent in the preferential treatment of long-term capital gains.

The proponents of indirect aid contend that an indirect subsidy is more stable than a direct subsidy since it is not scrutinized in the same way as direct aid and therefore not subject to the vagaries of changes in government. Even though a budget report of tax expenditures is published, it attracts scant attention primarily because it lacks the required legislative review required by a direct appropriation. The authors point out that this hidden system of aid is not a desirable public policy and clearly demonstrate that the stability of indirect aid is illusory (pp. 179-211).

Changes in tax law, though not directly affecting the provisions of the Internal Revenue Code that sanction the indirect subsidy to the arts, do affect the amount of the subsidy. The most obvious example is a change in the income and estate tax rates. The lowering of rates will reduce the subsidy since there is less incentive for charitable contribu-

⁸ There is a similar recommendation in Note, *Tax Treatment of Artists' Charitable Contributions*, 89 YALE L.J. 144 (1979), but this Note does not suggest an election at the time of creation. The Note also outlines a mechanical approach to allocating appreciation. *Id.* at 165 n.57.

tions. Conversely, the raising of rates will increase the subsidy since there is more incentive for creating tax deductions. Even the accelerated cost recovery system enacted by the Economic Recovery Tax Act of 1981 will reduce the incentive for businesses to give to the arts by lowering the income tax liability of businesses.⁹ With these and many other examples from the past fifteen years, the authors show the instability of the amount of indirect arts subsidy. Arts institutions are even more seriously affected than religious and educational institutions when there is a reduced incentive to make donations. A study by the Commission on Private Philanthropy has shown that donors give to religious or educational institutions before giving to art institutions.¹⁰ The authors conclude that this is so, not so much because donors consider arts institutions unimportant, but because donors perceive an obligation toward their churches and schools (p. 182). When the incentive to give is reduced, a donor will continue to support her church and alma mater and discontinue support for the arts.

The authors counsel arts institutions to be aware of pending tax legislation and its effect on them (p. 181). In trying to preserve or to increase the indirect subsidy through tax legislation, the arts institutions are on the razor's edge since the interests of the arts institutions are opposed to those of their wealthy donors. For example, arts institutions would welcome higher tax rates as an incentive for donations whereas wealthy donors are opposed to higher tax rates.

The authors' analysis of the types of indirect aid was hampered by the fact that 1973 is the last year for which complete data exists (p. 24). Given this limitation, the authors detail the sources of tax expenditures that are hidden in federal income, gift, and estate taxes and in state and local taxes. The study shows that the amount of indirect aid is far greater than the amount of direct aid. The analysis of state income tax expenditures provides an excellent illustration of an inefficient tax expenditure (p. 51). Because of the federal deduction for state income taxes paid,¹¹ the state tax expenditure partially benefits the federal government. The example in the book posits a taxpayer who itemizes deductions and is in the twenty-five percent federal and the eight percent state income tax bracket. If the taxpayer makes a donation to a charity of \$300, she will receive a deduction from state income taxes of \$300

⁹ I.R.C. § 168.

¹⁰ Morgan, Dye & Hybels, *Results from Two National Surveys of Philanthropic Activity* in COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, RESEARCH PAPERS I, 175-324.

¹¹ I.R.C. § 164(a)(3).

and the state will make a tax expenditure of \$24 (eight percent of \$300). Since the taxpayer's state income tax liability is reduced by \$24, her federal deduction for state income taxes paid is reduced by \$24 with the consequence that the federal tax liability is increased by \$6. Thus, the state's tax expenditure is inefficient since only a portion of it acts as an incentive for giving and part of it benefits the federal government. The authors note that this is the only instance in which the incentive is inversely related to the donor's income (p. 52).

The authors find the present system of indirect aid mildly redistributive (pp. 102-03). Their study shows a redistribution of benefits from the very wealthy to the moderately wealthy and well-educated. They find little demographic difference in audiences for different types of art forms.

The present system of deductions allows, according to its advocates, a diffusion of decisionmaking in the arts, whereas a direct aid system would center decisionmaking in Washington, the state capitol, or city hall (p. 104). Although this has an egalitarian ring to it, the authors' study amply proves that the decisionmakers, and not the government, tend to be the wealthy (pp. 170-78). It is easier for the wealthy to contribute to the arts because they have more money, and because a dollar contribution costs the wealthy less than a dollar contribution costs a lower bracket taxpayer. This concentration of power in the wealthy has had a profound effect on how arts institutions operate. The donor controls not only the use of her gift, but also the use of the tax expenditure portion of the gift, which in many cases is fifty percent of the gift. The authors give examples of professional and ethical compromises related to the indirect subsidy which are at once predictable, given the pressures and financial restraints under which the institutions operate, and shocking (pp. 169-77).

The unethical behavior of donors and the pressure placed on museum directors is illustrated when a donor gives the museum a check for \$100,000, stipulating that it must be expended on a certain painting. The donor owns the painting whose fair market value is \$50,000. The donor sells the painting to a friendly art dealer for \$95,000, after assuring the art dealer that the museum will purchase it for \$100,000. The museum purchases the painting from the art dealer. The museum has a new painting, the dealer has a profit of \$5,000, and the "donor" has a tax break plus a cancelled check to prove the amount of her contribution deduction (pp. 172-73).¹²

¹² In a second example, Alan Shestack, director of the Yale Art Gallery, relates the tale of a donor who offered him an art object provided that he backdate the time of the

For these and other reasons, the authors recommend that a thirty percent credit replace the charitable contributions deduction (pp. 216-22).¹³ The credit would be less regressive than the deduction in that the same contribution by individuals in different tax brackets would reduce each individual's tax liability by the same amount. A credit, while increasing the overall amount of contributions to charities, would reduce the amount of contributions to art institutions, since the main contributors to art institutions are wealthy and a tax credit would offer less incentive to contribute than does the charitable deduction (pp. 216-20). The credit would increase the amount of contributions to religious and welfare institutions, since contributors in lower tax brackets tend to donate to these institutions, and the credit would offer them more incentive to contribute than does the deduction.

In addition to replacing the deduction with a credit, the authors would limit the amount of a capital asset contribution to the taxpayer's basis in the asset plus sixty percent of its appreciation. The sixty percent represents the deduction the donor would have received had she sold the property.¹⁴ Even though the authors recognize that donors are apt to be less generous in contributions of property under their proposal, it is still sound tax policy to treat the donor of appreciated property in the same way as the donor of cash.

In their analysis of donor control over making gifts of property to arts institutions, the authors perceive the ability of the donor to restrict the use of the gift as unsound public policy (pp. 224-29). To ease these restrictions, the authors recommend either that a partial deduction be given for restricted gifts, or that there be legislation requiring that donor restrictions lapse after a certain number of years. The first proposal would discourage gifts of restricted property from potential donors, but it would be a hard provision to administer. The authors acknowledge that arts institutions might enter into "gentlemanly undertakings" to allow covert restrictions on the property to curry the favor of a wealthy donor. Although the authors claim that the partial deduction would have low administrative costs, it still would be a difficult administrative task to value art work taking into consideration the restrictions. It is

donation since a deduction in the prior year would be more advantageous to the donor. Mr. Shestack refused the art object, but saw a photograph of the same object on the cover of another museum's catalogue. It was described as one of the major acquisitions of the previous year (pp. 172-73).

¹³ See *supra* note 2, for a description of the tax treatment of contributions of appreciated property.

¹⁴ I.R.C. § 1202.

presently difficult to value even unrestricted art work.¹⁵ How does one value a restriction that a certain painting must be hung in a certain spot? The second proposal, lacking the administrative difficulties of the partial deduction, is very sound, although it involves the same problem of personal understandings since an arts institution might respect donor restrictions to encourage future donations of property.

Most of the authors' recommendations stay within the basic framework of the present system of indirect aid. Their study has clearly shown that there are multiple problems connected with the system. Their recommendations try to adjust the present system to make it work more efficiently and more equitably. This was probably the wisest and most pragmatic course. Only in one instance did the authors make a specific recommendation that an indirect subsidy be replaced by a direct subsidy. This recommendation related to the property tax exemption which the authors found the least effective indirect aid mechanism. They proposed this change because of (1) the resulting inequities between the large cities where the museums are located and the suburban towns with no museums but museum visitors, and (2) the incentive to overcapitalize. At the end of this specific recommendation, there is a general discussion about the replacement of indirect aid with direct aid. The authors seem to favor this change on policy grounds, arguing that if there is a public policy for subsidizing the arts, it should be public rather than covert (pp. 229-31).

This study has shown how indirect subsidies operate with regard to arts institutions. It also shows the seriousness of the effect that this form of aid has on the institutions. Theoreticians who might argue that there should be no indirect aid could find support in this admirable study of its effect. But this viewpoint would in all likelihood not receive legislative applause and therefore the immediate repeal of the existing indirect subsidy to charities is unlikely. This study, based as it is on a thorough and perceptive analysis of the existing structure, might persuade a legislative body to enact some of the recommended changes. It

¹⁵ See Anthoine, *Deductions for Charitable Contributions of Appreciated Property — The Art World*, 35 TAX L. REV. 239 (1980), for a discussion of valuation problems without considering a diminished value for donor restrictions. Congress, in the Economic Recovery Tax Act of 1981, enacted I.R.C. § 6659 which imposes a penalty for overvaluation in certain circumstances. This should have an *in terrorem* effect on contributors who would excessively overvalue their contributions. The Service's response to overvaluation was to establish the Commissioner's Art Advisory Panel, which has proven to be an effective watchdog over contributors who would overvalue contributions. Valuation of art objects is fraught with enough difficulties without adding the valuation of donor restrictions.

might have proved useful if the authors had posited the replacement of indirect aid with direct aid and had discussed the effect of this on arts institutions. To have done so might have been an empirical impossibility. There is no way to determine what the government would do to replace the indirect aid. There is also no way to estimate how much donors would contribute without the tax incentives of the indirect aid system except to conclude that the total would be dramatically reduced. It would be too much to hope that there would be a generation of Maecenases or Medicis who would contribute to the arts without substantial tax incentive.