



## **SALES TAXES — A TRAP FOR UNWARY ARTISTS AND DEALERS**

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In the past couple of years, high-profile cases involving the avoidance of sales and use taxes have underscored how important it is that artists, galleries and collectors clearly understand their responsibilities for collecting and paying sales and use taxes. In New York, art collectors, including Sam Waksal, CEO of ImClone, Robert J. Hurst, president of the board of the Whitney Museum of American Art, and L. Dennis Kozlowski, the former CEO of Tyco International, have been investigated by the Manhattan district attorney in connection with the avoidance of millions of dollars in sales taxes due on the purchase of expensive paintings, jewelry and other high-priced art. In 2006, Kozlowski agreed to pay over \$3 million in sales taxes, penalties and interest — and is serving at least 8 years in prison.

Respected art dealers have been caught up in these investigations and their reputations have been harmed as a result. The pressures placed on artists and gallery owners to find ways around collecting sales taxes, particularly on high-value transactions, can be enormous and it can be easy for the unwary to get swept up by buyers' demands. To avoid these problems, it is important for artists, galleries and collectors to know when sales and use taxes are due, whose responsibility it is to collect them, and to carefully maintain sales and shipping records to accurately document the transaction.

Sales and use taxes are imposed under state and local law. While each state's sales tax requirements vary, in most jurisdictions the collection, reporting and payment of sales taxes is required for sales transactions occurring within the state. An artist conducting business within a state is required to collect, report and pay state and local sales tax on any artwork sold by the artist in that state. This typically includes sales through an artists' studio, at art fairs, craft shows, flea markets, private homes and even nonprofit events such as church bazaars. If the artwork is sold through a gallery, the gallery is usually responsible for collecting, reporting and paying the appropriate sales taxes. Barter sales — in which an artist trades a work of art for goods or services — are also normally subject to sales (and possibly income) tax. The artist or gallery is also usually responsible for collecting sales taxes for online sales to residents of the state in which the artist or gallery is located. Since sales taxes must be paid to the state even if the artist or gallery fails to collect the tax from its customers, the failure to collect sales taxes when due can result in an unforeseen and unexpected tax liability for the unwary artist or gallery.

Under certain circumstances, such as where artwork is sold for immediate resale, or is sold to a non-profit, there may be exceptions to the sales tax requirement. Exempt transactions need to be carefully documented with an appropriate certificate of exemption from the state's revenue department. However, the biggest exemption by far, and the one that is subject to the most abuse, is that in most states the responsibility to collect sales tax does not apply where the art is purchased for shipment out of the state in which it is bought. In such cases, the buyer is responsible for paying any sales tax, or alternatively any use tax, which may be imposed by the state to which the art is shipped. Well-heeled buyers can be tempted to avoid paying sales tax in states with higher sales tax rates by shipping high-priced artwork to their out-of-state residences.

While the practice can be done legitimately, naive or unscrupulous artists and dealers can find themselves complicit in committing tax fraud. In the Kozlowski case, the purchases made from several New York art dealers were documented with paperwork indicating that the artwork was shipped to New Hampshire, where Tyco had offices, when in fact the artwork was actually sent to Mr. Kozlowski's New York City residence. According to the New York Times, one art dealer tried to explain this discrepancy by saying that the artwork was hung in the New York apartment so that Mr. Kozlowski could decide if he really liked it. In the Hurst case, the artwork was apparently shipped commercially to Hurst's home in Colorado, and then immediately returned to New York on a private jet.

Most art purchases do not involve the sizable sales taxes owed in the Hurst or Kozlowski cases. Nevertheless, liability for payment of sales tax on each transaction is on the artist or gallery, and, in some states, there are criminal penalties for failing to collect sales tax when due. So it is extremely important for artists and galleries to record all transactions in which sales taxes are collected and, in the case of out-of-state sales where no sales tax is collected, to carefully



document details of the transaction and the rationale for not collecting the tax. On each sales record issued to a customer, the dollar amount of taxable sales and the amount of sales tax should be stated. If the item is shipped out of state, the invoice should indicate that the item was shipped out of state and indicate the place of delivery. Copies of all documents evidencing the shipment, including shipping receipts, bills of lading, and the like, should be kept together with the invoice. These records should be kept for a minimum of three years, and ideally at least five years, after the sale.

For more information on sales taxes, contact the state department of revenue in the state where you are doing business. In Minnesota, circulars on state sales tax, including Sales Tax Fact Sheet 154 (Arts and Crafts) and 169 (Photography and Video Production) are available online at [www.taxes.state.mn.us](http://www.taxes.state.mn.us).