

**DESCRIPTION OF TAX BILLS**  
**(S. 649, S. 851, and S. 852)**  
**RELATING TO**  
**THE TAX TREATMENT OF ARTISTS**

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ESTATE AND GIFT TAXATION

OF THE

COMMITTEE ON FINANCE

ON NOVEMBER 10, 1981

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PREPARED FOR THE USE OF THE  
COMMITTEE ON FINANCE  
BY THE STAFF OF THE  
JOINT COMMITTEE ON TAXATION



NOVEMBER 6, 1981



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## INTRODUCTION

The Senate Finance Committee's Subcommittee on Estate and Gift Taxation has scheduled a hearing on November 10, 1981, regarding the tax treatment of artists.

There are three bills scheduled for the hearing: S. 649 (Senator Baucus, et al.), S. 851 (Senator Moynihan), and S. 852 (Senator Moynihan).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, explanation of the provisions of the bills, effective dates, and estimated revenue effects.

## I. SUMMARY

### 1. S. 649—Senators Baucus, Lugar, Kasten, Leahy, Williams, and Heinz

#### Special Valuation for Estate Tax Purposes, and Removal of Certain Income Tax Limitations on Charitable Contributions, of Artistic and Creative Property

Under present law, donors of appreciated property, the sale of which would give rise to long-term capital gain, generally are allowed an income tax deduction equal to the fair market value of the donated item. However, a taxpayer who makes a charitable contribution of appreciated property, the sale of which would give rise to ordinary income (or short-term capital gain), generally is required by present law to reduce the amount of the deduction (from fair market value) by the amount of any ordinary income (or short-term capital gain) which the taxpayer would have realized had the property been sold at that time (sec. 170(e)). The effect of this rule is to limit the charitable income tax deduction to the donor's basis in the property.

Under present law, the sale of a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property by its creator results in ordinary income (sec. 1221(3)). As a result, an author, artist, etc., who donates works of art, books, letters, or memorandums which he or she created or prepared generally is allowed a deduction limited to the cost of the materials used in the creation of the work.

Under present law, a decedent's gross estate generally includes the value of all property in which the decedent had an interest at the time of his death (sec. 2033). The amount included in the gross estate is generally the fair market value of the property interest on the date of the decedent's death, unless the executor elects to value all property in the gross estate on the alternate valuation date (which is six months after the date of death). Under these rules, works of art and literary and musical compositions are included in the gross estate of their creator at the fair market value of the property on the date of death or alternate valuation date, rather than at an amount equal to the decedent's income tax basis in the property.

The bill generally would provide an income tax charitable deduction equal to the full fair market value of any literary, musical or artistic composition, any letter or memorandum, or similar property contributed to a qualifying charity. However, no deduction would be permitted for a contribution of any such property prepared by any governmental officer or employee if such property arose out of, or was related to the performance of, that individual's official duties. The bill also would permit an executor to include qualified creative property in the decedent's gross estate based upon the decedent's adjusted basis rather than the property's fair market value.

**Effective date.**—The bill would be effective for contributions made, and estates of decedents dying, after December 31, 1980.

## 2. S. 851—Senator Moynihan

**Increased Income Tax Deduction for Charitable Contributions of Donor-Created Literary, Musical, or Artistic Compositions**

and

## S. 852—Senator Moynihan

**Allowance of an Income Tax Credit for Charitable Contributions of Donor-Created Literary, Musical, or Artistic Compositions**

Under present law, donors of appreciated property, the sale of which would give rise to long-term capital gain, generally are allowed an income tax deduction equal to the fair market value of the donated item. However, a taxpayer who makes a charitable contribution of appreciated property, the sale of which would give rise to ordinary income (or short-term capital gain), generally is required by present law to reduce the amount of the deduction (from fair market value) by the amount of any ordinary income (or short-term capital gain) which the taxpayer would have realized had the property been sold at that time (sec. 170(e)).

Under present law, the sale of a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property by its creator results in ordinary income (sec. 1221(3)). As a result, an author, artist, etc., who donates works of art, books, letters, or memorandums which he or she had created or prepared is allowed a deduction limited to the cost of the materials used in the creation of the work.

**S. 851**

S. 851 would permit a deduction equal to a statutorily prescribed percentage of fair market value for individuals who contribute self-created literary, musical, or artistic compositions to charitable organizations (under sec. 501(c)(3)) or governmental units (under sec. 170(c)(1)). The increased charitable deduction would not apply to certain charitable contributions of government officials.

**Effective date.**—The bill would be effective for taxable years beginning after December 31, 1981.

**S. 852**

S. 852 would permit a credit against income tax equal to a statutorily prescribed percentage of fair market value for individuals who contribute self-created literary, musical, or artistic compositions to charitable organizations (under sec. 501(c)(3)) or governmental units (under sec. 170(c)(1)).

The credit could not exceed the tax on the taxpayer's income from sales of literary, musical, or artistic compositions or the greater of \$2,500 or one-half of the taxpayer's total income tax for the year. The income tax credit would not apply to certain charitable contributions of government officials.

**Effective date.**—The bill would be effective for taxable years beginning after December 31, 1981.

## II. DESCRIPTION OF THE BILLS

### 1. S. 649—Senators Baucus, Lugar, Kasten, Leahy, Williams, and Heinz

#### Special Valuation for Estate Tax Purposes, and Removal of Certain Income Tax Limitations on Charitable Contributions, of Artistic and Creative Property

##### *Present Law*

##### *Income tax valuation*

Under the law since 1969, donors of appreciated property, the sale of which would give rise to long-term capital gain, generally are allowed an income tax deduction equal to the fair market value of the donated item. Thus, a collector who contributes a painting to a museum (more than a year after purchasing it, e.g., from the artist) may deduct the fair market value of the painting at the time of the contribution.

Except in two cases, however, a taxpayer who makes a charitable contribution of appreciated property, the sale of which would give rise to ordinary income or short-term capital gain, is required by present law to reduce the amount of the deduction (from fair market value) by the amount of any ordinary income or short-term capital gain which the taxpayer would have realized had the property been sold at that time (sec. 170(e)). Thus, a donor of appreciated ordinary income property (property the sale of which would not give rise to long-term capital gain) may deduct only the donor's basis in the property, rather than its full fair market value.

Under present law, the sale of a copyright, a literary, musical, or artistic composition, a letter, or memorandum, or similar property by its creator results in ordinary income (sec. 1221(3)). As a result, an author, artist, etc., who donates works of art, books, letters, or memorandums which he or she created or prepared generally is allowed a deduction limited to the cost of the materials used in the creation of the works. This is because the sale of the art works by the artist would give rise to ordinary income, in much the same manner as would the sale of inventory by a manufacturer.

These general rules of present law governing gifts of appreciated property to charity were enacted as part of the Tax Reform Act of 1969. Before the 1969 Act, except in a few limited circumstances,<sup>1</sup> a deduction was allowed for the full fair market value of the contributed property, and no income tax was imposed on the appreciation at the

<sup>1</sup> Before the 1969 Act, the amount of the charitable deduction was reduced only by the amount of gain which would have been treated as ordinary income under the recapture rules for certain mining property (sec. 617), depreciable tangible personal property (sec. 1245), and certain depreciable real property (sec. 1250), if the property contributed had been sold at its fair market value.

time of the gift. However, in 1969 Congress concluded that the combined effect of not taxing the appreciation and at the same time allowing a charitable contribution deduction for the appreciation as to produce unwarranted tax benefits that were significantly greater than the tax benefits from cash contributions.<sup>2</sup>

The Tax Reform Act of 1976 provided an exception to the general rule requiring a reduction in the charitable deduction for gain that would be treated as ordinary income had the appreciated property been sold for contributions by corporations of certain types of ordinary income property (e.g., medical equipment) donated for the care of the needy, the ill, or infants (sec. 170(e)(3)). In the case of such a qualifying charitable contribution of inventory, the exception generally allows a deduction equal to the sum of the taxpayer's basis in the property plus one-half of the unrealized appreciation (but not to exceed twice the basis of the property).

The Economic Recovery Tax Act of 1981 (ERTA) created a second exception to this general reduction rule for corporate contributions of newly manufactured ordinary income property to a college or university for research or experimentation, including research training (sec. 170(e)(4)). This exception permits a charitable deduction equal to the taxpayer's basis in the property plus 50 percent of appreciation (but not to exceed twice the basis of the property).

### *Estate tax valuation*

Under present law, a decedent's gross estate generally includes the value of all property in which the decedent had an interest at the time of his death (sec. 2033). The amount included in the gross estate is generally the fair market value of the property interest on the date of the decedent's death, unless the executor elects to value all property in the gross estate on the alternate valuation date (which is six months after the date of death).

<sup>2</sup> This result and the reason for the change were illustrated as follows in the Report of the Committee on Finance on the 1969 Act (S. Rep. No. 91-552, 91st Cong., 1st Sess. 80 (1969)) [Note that the Economic Recovery Tax Act of 1981 reduced the maximum individual income tax rate from 70 percent to 50 percent, effective January 1, 1982]:

. . . [I]n some cases it actually is possible for a taxpayer to realize a greater after-tax profit by making a gift of appreciated property than by selling the property, paying the tax on the gain, and keeping the proceeds. This is true in the case of gifts of appreciated property which would result in ordinary income if sold, when the taxpayer is at the high marginal tax brackets and the cost basis for the ordinary income property is not a substantial percentage of the fair market value. For example, a taxpayer in the 70-percent tax bracket could make a gift of \$100 of inventory (\$50 cost basis) and save \$105 in taxes (70 percent of the \$50 gain if sold, or \$35, plus 70 percent of the \$100 fair market value of the inventory, or \$70).

The committee does not believe that the charitable contributions deduction was intended to provide greater—or even nearly as great—tax benefits in the case of gifts of property than would be realized if the property were sold and the proceeds were retained by the taxpayer. In cases where the tax saving is so large, it is not clear how much charitable motivation actually remains. It appears that the Government, in fact, is almost the sole contributor to the charity. Moreover, an unwarranted tax benefit is allowed these taxpayers, who usually are in the very high income brackets. The committee, therefore, considers it appropriate to narrow the application of the tax advantages in the case of gifts of certain appreciated property.

Under these rules, works of art and literary and musical compositions, like other types of property, are included in the gross estate of their creator based upon the fair market value of the property at the date of death or alternate valuation date, rather than based upon the decedent's income tax basis in the property. Property (both appreciated and depreciated) which is included in the gross estate receives an income tax basis equal to its fair market value on the date of death (or the alternate valuation date) (sec. 1014). This, if the heir sells inherited property, all pre-death appreciation in the property's value is not subject to income tax.

Present law also permits a deduction from the gross estate for property passing to charitable organizations, the United States, and State and local governments (sec. 2055). The amount of this deduction is equal to the value of the interest in property received by the charity (in the case of an outright gift of property, the full value at which it is included in the gross estate). Thus, property can be contributed to a charitable organization free of Federal estate tax.

### *Issues*

The first issue is whether a change should be made in the present law rule which permits a creator of appreciated literary, musical, or artistic compositions to claim an income tax charitable deduction equal to the fair market value of the property minus any amount of appreciation that would have been taxed as ordinary income or short-term capital gain had the property been sold.

The second issue is whether a change should be made in the present law rule which provides for inclusion of appreciated literary, musical, or artistic compositions in a decedent-creator's gross estate based upon the property's fair market value.

### *Explanation of the Bill*

The bill would provide an income tax charitable deduction equal to the full fair market value of any literary, musical or artistic composition, any letter or memorandum, or similar property contributed to a qualifying charity if the taxpayer's personal efforts created such property. No charitable contribution deduction would be permitted for a contribution of any qualifying property prepared by any governmental officer or employee if such property arose out of, or was related to the performance of, that individual's official duties.

The bill would permit an executor to include qualified decedent-created property in the decedent's gross estate based upon the decedent's adjusted basis rather than the property's fair market value.<sup>3</sup> For these purposes, qualified decedent-created property includes any copyright, any literary, musical, or artistic composition, any letter or memorandum, or any similar property which was held by the decedent at the time of his death and which was created by the decedent.

<sup>3</sup> The bill does not modify the rule of present law under which the basis of property passing from a decedent is stepped up to its fair market value at the date of the decedent's death or alternate valuation date.

### ***Effective Dates***

The provisions of the bill relating to income tax valuation would apply to charitable contributions made after December 31, 1980.

The provisions of the bill relating to estate tax valuation would apply to estates of decedents dying after December 31, 1980.

### ***Revenue Effect***

It is estimated that this provision would reduce federal budget receipts by \$15 million a year.

## 2. S. 851—Senator Moynihan

### Increased Charitable Income Tax Deduction for Charitable Contributions of Donor-Created Literary, Musical, or Artistic Compositions

and

## S. 852—Senator Moynihan

### Allowance of an Income Tax Credit for Charitable Contributions of Donor-Created Literary, Musical, or Artistic Compositions

#### *Present Law*

Under the law since 1969, donors of appreciated property, the sale of which would give rise to long-term capital gain, generally are allowed an income tax deduction equal to the fair market value of the donated item. Thus, a collector who contributes a painting to a museum (more than a year after purchasing it, e.g., from the artist) may deduct the fair market value of the painting at the time of the contribution.

Except in two cases, however, a taxpayer who makes a charitable contribution of appreciated property, the sale of which would give rise to ordinary income or short-term capital gain, is required by present law to reduce the amount of the deduction (from fair market value) by the amount of any ordinary income or short-term capital gain which the taxpayer would have realized had the property been sold at that time (sec. 170(e)). Thus, a donor of appreciated ordinary income property (property the sale of which would not give rise to long-term capital gain) may deduct only the donor's basis in the property, rather than its full fair market value.

Under present law, the sale of a copyright, a literary, musical, or artistic composition, a letter, or memorandum, or similar property by its creator results in ordinary income (sec. 1221(3)). As a result, an author, artist, etc., who donates works of art, books, letters, or memorandums which he or she created or prepared generally is allowed a deduction limited to the cost of the materials used in the creation of the work. This is because the sale of the art works by the artist, would give rise to ordinary income, in much the same manner as would the sale of inventory by a manufacturer.

These general rules of present law governing gifts of appreciated property to charity were enacted as part of the Tax Reform Act of 1969. Before the 1969 Act changes were effective, except in a few limited circumstances<sup>1</sup> a deduction was allowed for the full fair market

<sup>1</sup> Before the 1969 Act, the amount of the charitable deduction was reduced only by the amount of gain which would have been treated as ordinary income under the recapture rules for certain mining property (sec. 617), depreciable tangible personal property (sec. 1245), and certain depreciable real property (sec. 1250), if the property contributed had been sold at its fair market value.

value of the gifted property and no income tax was imposed on the appreciation at the time of the gift. However, in 1969 Congress concluded that the combined effect of not taxing the appreciation and at the same time allowing a charitable contribution deduction for the appreciation was to produce unwarranted tax benefits that were significantly greater than the tax benefits from cash contributions.<sup>2</sup>

The Tax Reform Act of 1976 provided an exception to the general rule requiring a reduction in the charitable deduction for gain that would be treated as ordinary income had the appreciated property been sold for contributions by corporations of certain types of ordinary income property (e.g., medical equipment) donated for the care of the needy, the ill, or infants (sec. 170(e)(3)). In the case of such a qualifying charitable contribution of inventory, the exception generally allows a deduction equal to the sum of the taxpayer's basis in the property plus one-half of the unrealized appreciation (but not to exceed twice the basis of the property).

The Economic Recovery Tax Act of 1981 (ERTA) created a second exception to this general reduction rule for corporate contributions of newly manufactured ordinary-income property to a college or university for research or experimentation, including research training (sec. 170(e)(4)). This exception permits a charitable deduction equal to the taxpayer's basis in the property plus 50 percent of appreciation (but not to exceed twice the basis of the property).

### *Issue*

The issue is whether a change should be made in the present law rule which permits a creator of appreciated literary, musical, or artistic compositions to claim an income tax charitable deduction equal to the fair market value of the property minus any amount of appreciation that would have been taxed as ordinary income or short-term capital gain had the property been sold.

<sup>2</sup>This result and the reason for the change were illustrated as follows in the Report of the Committee on Finance on the 1969 Act (S. Rept. 91-552, 91st Cong., 1st Sess. 80 (1969)). [Note that the Economic Recovery Tax Act of 1981 reduced the maximum individual income tax rate from 70 percent to 50 percent, effective January 1, 1982]:

. . . [I]n some cases it actually is possible for a taxpayer to realize a greater after-tax profit by making a gift of appreciated property than by selling the property paying the tax on the gain, and keeping the proceeds. This is true in the case of gifts of appreciated property which would result in ordinary income if sold, when the taxpayer is at the high marginal tax brackets and the cost basis for the ordinary income property is not a substantial percentage of the fair market value. For example, a taxpayer in the 70-percent tax bracket could make a gift of \$100 of inventory (\$50 cost basis) and save \$105 in taxes (70 percent of the \$50 gain if sold, or \$35, plus 70 percent of the \$100 fair market value of the inventory, or \$70).

The committee does not believe that the charitable contributions deduction was intended to provide greater—or even nearly as great—tax benefits in the case of gifts of property than would be realized if the property were sold and the proceeds were retained by the taxpayer. In cases where the tax saving is so large, it is not clear how much charitable motivation actually remains. It appears that the Government, in fact, is almost the sole contributor to the charity. Moreover, an unwarranted tax benefit is allowed these taxpayers, who usually are in the very high income brackets. The committee, therefore, considers it appropriate to narrow the application of the tax advantages in the case of gifts of certain appreciated property.

## *Explanation of the Bills*

### **S. 851**

S. 851 would permit a deduction equal to a statutorily prescribed percentage of fair market value for individuals who contribute self-created literary, musical, or artistic compositions to charitable organizations (under sec. 501(c)(3)) or governmental units (under sec. 170(c)(1)).

The deductible percentage of fair market value would decrease as the donor's adjusted gross income increased. The maximum deductible percentage would be 86 percent and the minimum would be 30 percent. The amounts of adjusted gross income at which each decrease from the 86 percent maximum would be effective would vary depending on the donor's income tax filing status (i.e., married filing joint returns, married filing separate returns, heads of households, and unmarried individuals).

The bill would require the charitable recipient of the property to certify to the donor that the contributed property represents material of artistic, musical, or literary significance and that the property would be used in a manner related to the donee's exempt function. Although the deduction generally would be permitted to the individual whose personal efforts created such property, no deduction would be permitted for a charitable contribution of any qualifying property prepared by any governmental officer or employee if such property arose out of, or was related to the performance of, that individual's official duties.

### **S. 852**

S. 852 would permit a credit against tax equal to a statutorily prescribed percentage of fair market value for individuals who contribute self-created literary, musical, or artistic compositions to charitable organizations (under sec. 501(c)(3)) or governmental units (under sec. 170(c)(1)).

The creditable percentage of fair market value would decrease as the donor's adjusted gross income increased. The maximum creditable percentage would be 86 percent and the minimum would be 30 percent. The amounts of adjusted gross income at which each decrease from the 86 percent maximum would be effective would vary depending on the donor's income tax filing status (i.e., married filing joint returns, married filing separate returns, heads of households, and unmarried individuals).

Under the bill, the credit could not exceed the amount of tax on the donor's income from sales of literary, musical, or artistic compositions. Additionally, the credit could not exceed the greater of \$2,500 or one-half of the taxpayer's Federal income tax liability for the taxable year. Unused credits would be eligible for a five-year carryover.

The bill would require the charitable recipient of the property to certify to the donor that the contributed property represents material of artistic, musical, or literary significance and that the property would be used in a manner related to the donee's exempt function. Although the credit generally would be permitted to the individual whose personal efforts created such property, no credit would be permitted for a charitable contribution of any qualifying property pre-

pared by any governmental officer or employee if such property arose out of, or was related to the performance of, that individual's official duties.

***Effective Dates***

The provisions of the bills would apply to contributions made in taxable years beginning after December 31, 1981.

***Revenue Effect***

***S. 851***

It is estimated that S. 851 would reduce budget receipts by \$10 million a year.

***S. 852***

It is estimated that S. 852 would reduce budget receipts by \$20 million a year.



