

NO.: **IT-504R2 (Consolidated)**

DATE: See *Bulletin Revisions* section

SUBJECT: INCOME TAX ACT
Visual Artists and Writers

REFERENCE: Section 9 (also sections 67.1, 110.4, and 110.6, subsections 10(1), (6), (7), and (8), 18(12), 70(5), and 118.1(1), (6), (7), (7.1), and (10); paragraphs 8(1)(j), 8(1)(q), and 69(1)(b) of the *Income Tax Act* and Parts XVIII and XXXV of the *Income Tax Regulations*)

Latest Revisions – ¶s 12, 14 and 15

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Bulletin Revisions

Application

This bulletin is a consolidation of the following:

- IT-504R2 dated August 9 1995; and
- subsequent amendments thereto.

For further particulars, see the “Bulletin Revisions” section near the end of this bulletin.

Summary

This bulletin deals with the determination of income, for income tax purposes, of a visual artist or writer. The main topics discussed are:

- criteria used to determine whether a visual artist or writer is an employee or self-employed,
- factors to be considered in determining the existence of a reasonable expectation of profit,
- valuation of inventories,
- implications of charitable donations of capital property and of inventory (including cultural gifts), and
- artists' employment expenses deduction allowed under paragraph 8(1)(q).

The special concerns of performing artists are discussed in the current version of IT-525, *Performing Artists*. The word “artist” as used hereinafter refers to a visual artist.

Discussion and Interpretation

Income Sources

¶ 1. For purposes of the Act, a taxpayer's income for a taxation year includes income from all sources inside or outside of Canada, including income from each office, employment, business or property. Losses from those sources are deductible in computing income for the year. Self-employment is not specifically referred to in the Act as a source of income because a self-employed taxpayer is generally considered to be carrying on a business which, as indicated above, is referred to as a source of income.

Employee or Self-Employed

¶ 2. Many factors must be taken into consideration in establishing whether an individual is an employee or is self-employed. The question to be decided is whether the contract between the parties is a contract of service that exists between an employer and an employee, or is a contract for services, that is, the engagement of a self-employed individual. A contract of service generally exists if the person for whom the services are performed has the right to control the amount, the nature, and the management of the work to be done and the manner of doing it. A contract for services exists when a person is engaged to achieve a defined objective and is given all the freedom required to attain the desired result. For example, there is an indication that a contract for services may exist where the artist or writer has a chance of profit or risk of loss, deals (directly or through an agent) with different persons (clients) during the course of a year, provides the tools and equipment required in carrying out the services or can hire helpers, fix their salary, direct them or dismiss them.

¶ 3. When dealing with persons of particular skills and expertise, such as artists and writers, supervision and control of the manner in which the work is done may not be a critical and decisive factor. However, no single factor is conclusive in all circumstances. The determination of whether or not an artist or writer is under a contract of service or a contract for services is a question of fact, and will depend on the nature and the terms of the contract or arrangement (written or oral), its duration, and all the elements that constitute the relationship between the parties. In any case of doubt as to the status of an artist or writer, advice should be obtained from a Revenue Canada tax services office.

Reasonable Expectation of Profit

¶ 4. Section 9 of the Act provides that a taxpayer's income for a taxation year from a business (self-employment) is the profit therefrom for the year. The concept of profit is critical in determining whether a taxpayer's artistic activity or literary undertaking constitutes the carrying on of a business or is merely the furtherance of a hobby or interest of the taxpayer that is of a personal nature. Generally, any undertaking or activity of a taxpayer that results in profits or has a reasonable prospect of profits would be viewed as the

carrying on of a business. On the other hand, where the activity or undertaking has no reasonable expectation of producing profits, a business would not be considered to have been carried on and any losses that resulted would not be deductible for income tax purposes.

Whether or not a taxpayer has a reasonable expectation of profit is an objective determination to be made from all the facts. The relevant factors to be considered in making such a determination will differ with the nature and extent of the activity or undertaking.

The nature of art and literature is such that a considerable period of time may pass before an artist or writer becomes established and profitable. Although the existence of a reasonable expectation of profit is relevant in determining the deductibility of losses, in the case of artists and writers it is recognized that a longer period of time may be required in establishing that such reasonable expectation does exist.

¶ 5. Factors which will be considered by the Department in determining whether or not an artist or writer has a reasonable expectation of profit include:

- (a) the amount of time devoted to artistic or literary endeavours,
- (b) the extent to which an artist or writer has presented his or her own works in public and private settings including, but not limited to, exhibiting, publishing and reading as is appropriate to the nature of the work,
- (c) the extent to which an artist is represented by an art dealer or agent and the extent to which a writer is represented by a publisher or agent,
- (d) the amount of time devoted to, and type of activity normally pursued in, promoting and marketing the artist's or writer's own works,
- (e) the amount of revenue received that is relevant to the artist's or writer's own works including, but not limited to, revenue from sales, commissions, royalties, fees, grants and awards which may reasonably be included in business income,
- (f) the historical record, spanning a significant number of years, of annual profits or losses relevant to the artist's or writer's exploitation of his or her own works,
- (g) a variation, over a period of time, in the value or popularity of the individual's artistic or literary works,
- (h) the type of expenditures claimed and their relevance to the endeavours (e.g., in the case of a writer there would be a positive indication of business activity if a substantial portion of the expenditures were incurred for research),
- (i) the artist's or writer's qualifications as an artist or writer, respectively, as evidenced by education and also by public and peer recognition received in the form of honours, awards, prizes and/or critical appraisal,
- (j) membership in any professional association of artists or writers whose membership or categories of membership are limited under standards established by that association,

- (k) the significance of the amount of gross revenue derived by an artist or writer from the exploitation of that individual's own works and the growth of such gross revenue over time. In applying this factor, external influences such as economic conditions, changes in the public mood, etc., which may affect the sale of artistic or literary works will be taken into consideration, and
- (l) the nature of the literary works undertaken by a writer. It is considered that a literary work such as a novel, poem, short story or any non-fictional prose composition that is written for general sale or syndicated distribution would normally have a greater profit potential than a work undertaken for restricted distribution.

¶ 6. No particular factor described in ¶ 5 above is more important than another and no one factor determines whether or not an activity is a business carried on for profit or with a reasonable expectation of profit. All relevant criteria are considered together in making a determination and the taxpayer's failure to meet any one particular factor will not in itself preclude the taxpayer's artistic or literary activities from qualifying as a business.

¶ 7. In the case of an artist or writer, it is possible that a taxpayer may not realize a profit during his or her lifetime but still have a reasonable expectation of profit. However, in order to have this "reasonable expectation of profit" the artistic or literary endeavours, as the case may be, of the artist or writer must be carried on in a manner such that, based on the criteria in ¶ 5 above, they may be considered for income tax purposes to be the carrying on of a business rather than, for example, a hobby.

Artists' Inventories

¶ 8. Subject to 9 below, subsection 10(1) requires that in computing income from a business inventory be valued at its cost to the taxpayer or its fair market value, whichever is lower, or in such other manner as may be permitted in Part XVIII of the Regulations. Inventory of an artist will include unfinished and finished works of art and materials and supplies that are on hand and unsold at the fiscal year-end of the artist's business. The cost of a work of art includes the cost of materials (e.g., paint, canvas, sculpturing medium) and labour (other than the artist's own labour) used in its execution and an appropriate portion of variable overhead expenses (e.g., fees of models, kiln energy cost). For additional information concerning the valuation of inventory, reference should be made to the current version of IT-473, *Inventory Valuation*. Because of the special circumstances applicable to artists, the Department will permit them to exclude from inventory any travel expenses related to works of art produced or to be produced by them and to deduct such expenses in the taxation year during which they are incurred. The restrictions in section 67.1 on the amount that may be deducted for food or beverages consumption expenses (i.e., generally, 50% of such expenses—see the current version of IT-518, *Food, Beverages and Entertainment Expenses*) and

the restrictions on motor vehicle expenses (see the current version of IT-521, *Motor Vehicle Expenses Claimed by Self-Employed Individuals*) must be taken into consideration in determining such travel expenses.

¶ 9. As a general rule, the cost of property unsold and material unused (i.e., inventory) at the fiscal year-end of a business is only deductible in computing the profit or loss of the business for a subsequent fiscal year when any such property is sold. However, in computing income for a taxation year from a business of creating paintings, murals, original prints, etchings, drawings, sculptures or similar works of art, an individual other than a trust may, under subsection 10(6), elect in the individual's return of income for the year to value the inventory of that business at nil. It should be noted that the election under subsection 10(6) cannot, by virtue of subsection 10(8), be made by an individual in respect of:

- (a) any work of art which has not been created by that individual, or
- (b) a business of reproducing works of art.

Where an individual has made an election under subsection 10(6) for a taxation year, the value of the individual's qualifying inventory for each subsequent taxation year shall, by virtue of subsection 10(7), be deemed to be nil unless the individual, with the concurrence of the Minister and on such terms and conditions as are specified by the Minister, revokes the election.

Work Space in Home Expenses

¶ 10. Subsection 18(12) restricts the deduction, in computing income from a business, of expenses in respect of an office, studio or other work space in the home of an individual. Such expenses will be deductible only if the work space is either:

- (a) the individual's principal place of business, or
- (b) used exclusively by the artist or writer to earn business income and also used on a regular and continuous basis to meet clients or customers.

Expenses otherwise deductible relating to the work space cannot create or increase a loss from the business for which the space is used, but the expenses not allowed because of this restriction in a year are treated as expenses related to the work space incurred in the immediately following year. This permits the carry-forward of such expenses to the next year providing either condition (a) or (b) above is met in that next year. Where either condition (a) or (b) above is met on a continuous basis such expenses not deductible in a year may be carried forward indefinitely. For further details refer to the current version of IT-514, *Work Space in Home Expenses*.

Gifts and Charitable Donations in Kind

¶ 11. When an artist creates a work of art with the intention of selling it but instead donates it to another person, the donation is considered to be a disposition of a property from

the artist's inventory. The donation by an artist of other property (e.g., diaries or correspondence) would be considered to be a disposition of capital property. Similarly, the donation by a writer of original manuscripts, letters, memoranda or similar papers would generally be considered to be a disposition of capital property since it is not usually the business of a writer to produce and sell such original documents.

¶ 12. Subsection 118.1(6) may be beneficial to an artist or writer who makes a gift (including a gift by will) of a capital property to a registered charity or other organization described in the definition of "total charitable gifts" in subsection 118.1(1) or to Her Majesty in right of Canada or a province (hereinafter referred to as a "qualified donee"). When such a gift is made and, at that time, the fair market value of the capital property exceeds its adjusted cost base, subsection 118.1(6) provides for a reduction of the capital gain which would otherwise result from the application of the deemed disposition rules in paragraph 69(1)(b) or subsection 70(5) by allowing the donor (or executor) of the property to designate an amount not greater than that fair market value and not less than that adjusted cost base. The designated amount is deemed to be both the proceeds of disposition for the purpose of determining the donor's capital gain (three-quarters of capital gains is included in income) and the fair market value of the gift for the purpose of the tax credit allowed for charitable contributions, if the making of the gift is proven by filing a receipt containing prescribed information pursuant to Part XXXV of the Regulations.

¶ 13. Where an individual makes a gift described in the definition of "total cultural gifts" in subsection 118.1(1) of property (other than inventory) of the individual, such a gift will not result in a capital gain from the disposition of the property by virtue of subparagraph 39(1)(a)(i.1). However, by virtue of subsections 118.1(3) and (10), the individual may claim a tax credit based on the fair market value of the gift, as established by the Canadian Cultural Property Export Review Board (the Review Board), provided the making of the gift is proven by filing a receipt as indicated in ¶ 12 above. In addition, the individual must file a certificate, provided by the Review Board, which establishes that the property meets all of the criteria set out in paragraphs 29(3)(b) and (c) of the *Cultural Property Export and Import Act*. For a discussion on Canadian cultural property see the current version of IT-407, *Disposition after 1987 of Canadian Cultural Property*.

¶ 14. Subject to ¶s 15 and 16, when an individual who is carrying on an artistic business makes a gift of a property that is in his or her inventory (as explained in ¶ 11), the individual is, by virtue of subparagraph 69(1)(b)(ii), deemed to have received proceeds of disposition for the property equal to its fair market value at the time of the gift and an amount equal to that fair market value must be included in the individual's income. However, where the recipient of the gift is a qualified donee (see ¶ 12), part or all of the fair market value of that gift may be used in determining the tax

credit available to an individual who has made such a gift. In the case of gifts to qualified donees, other than gifts the fair market value of which are included in "total Crown gifts", "total cultural gifts" or "total ecological gifts", all of which are described in subsection 118.1(1), the portion of such gifts available for the tax credit is limited to 75% of the individual's income for the year, assuming the individual has not made any gifts of capital property in the year in which case the limit may be increased. The increase which can result from gifts of capital property is discussed in the current version of Interpretation Bulletin IT-110. However, any portion not used in determining the tax credit may be carried forward for possible tax credit in the following 5 years.

¶ 15. Where an individual makes a gift to a qualified donee (see ¶ 12) of a work of art of the individual's own creation that is property in his or her inventory and, at the time of the gift, the fair market value of the property is greater than its cost amount (i.e., its inventory value—see ¶ 8), the individual may designate an amount under subsection 118.1(7) and such designated amount will be deemed to be the individual's proceeds of disposition and the fair market value of the gift. However, the designated amount cannot be greater than the fair market value of the property, nor less than its cost amount. In addition, the designation must be made in the individual's return for the year in which the gift is made and the gift must be proven by filing a receipt as indicated in ¶ 12. To illustrate the practical effect of subsection 118.1(7), consider an artist with a net income of \$20,000 who wishes to donate a painting to a registered charity. The painting is the artist's own creation. It has a fair market value of \$70,000 and a cost amount of nil (the artist has elected under subsection 10(6)). If the \$70,000 value were used, the artist's net income would increase to \$90,000 but the charitable donation to be used in determining the artist's tax credit would be limited to \$67,500 (75% of \$90,000) for the year in which the painting was donated. The artist's taxable income would also be increased by \$70,000 as a consequence of the donation. Under subsection 118.1(7), the artist could value the painting at \$60,000 for income tax purposes. Such a designation would increase the artist's net income to \$80,000 and the charitable donation of \$60,000 would be fully available for the tax credit since it is equal to 75% of \$80,000.

¶ 16. After 1990, where an individual makes a gift described in the definition of "total cultural gifts" in subsection 118.1(1) of property that is a work of art created by the individual and that is included in his or her inventory, the individual will be deemed, under subsection 118.1(7.1), to have received proceeds of disposition equal to the cost amount of the work of art. Consequently, no profit or loss will result from the disposition (gift) of the property by the individual. By virtue of subsections 118.1(3) and (10), however, the individual will be entitled to a tax credit based on the fair market value of the gift, as established by the Review Board, providing the requirements set out in ¶ 13 above are met.

Example

An individual has made an election under subsection 10(6) to treat the value of inventory as nil for the purpose of calculating income from a business that is the individual's artistic endeavour. The individual makes a gift of a work of art from inventory which falls within the definition of "total cultural gifts" in subsection 118.1(1), and which is determined to have a fair market value of \$10,000 by the Review Board. Under subsection 118.1(7.1), the amount required to be included in the income of the individual will be nil (the cost amount of the property). However, the fair market value of the gift, \$10,000, will be included in the individual's total cultural gifts for the purpose of determining the amount of the tax credit to which the individual is entitled under subsection 118.1(3).

¶ 17. For the 1982 to 1987 taxation years, section 110.4 provided for a procedure of forward averaging whereby an individual, who was resident in Canada throughout a taxation year and the two immediately preceding taxation years, could elect to deduct from the year's taxable income an amount of eligible income. The individual would pay a refundable tax on the amount of income so deducted and add that deducted amount to the taxable income of a future year, in a lump sum or spread it over a number of future years. The provision to make the election to deduct an amount of eligible income from taxable income was repealed effective for 1988. The election to add a previously deducted amount to the taxable income of a subsequent year is available up to and including 1997. For more information concerning forward averaging reference should be made to form T581, *Forward Averaging Tax Credit*.

¶ 18. If certain prescribed forms, receipts or other supporting documents are not required to be filed with a return of income, such as when the return is filed electronically ("E-filed"), they should nevertheless be retained and readily available as the Department has the authority under subsection 220(2.1) of the Act to subsequently request them as proof of the claims being made or in support of the information being reported. It should, however, be noted that where a return is E-filed, elections and designations (along with the necessary documentation) are still required to be filed by the due dates established in the Act. For more information contact a Revenue Canada tax services office.

Expenses of Employed Artists and Writers

¶ 19. An artist or writer who is an employee is not allowed any deductions in computing income from an office or employment, other than those provided in section 8. In particular, paragraph 8(1)(q) allows a deduction for a taxpayer's expenses paid to earn employment income from an artistic activity that falls into any of the following categories (hereinafter referred to as a "qualifying artistic activity"):

- (a) creating (but not reproducing) paintings, prints, etchings, drawings, sculptures or similar works of art;
- (b) composing a dramatic, musical or literary work;
- (c) performing a dramatic or musical work as an actor, dancer, singer or musician; or
- (d) an artistic activity in respect of which the taxpayer is a member of a professional artists' association that is certified by the Minister of Communications, now the Minister of Canadian Heritage.

¶ 20. The expenses which can be deducted under paragraph 8(1)(q) cannot exceed a limit for each taxation year. The limit is calculated by taking the lesser of:

- (a) \$1,000; and
- (b) 20% of **all** the taxpayer's employment income for the year, before claiming any deductions under section 8, from **all** qualifying artistic activities;

and then subtracting the amounts deducted for the year, in calculating employment income from those qualifying artistic activities, under paragraphs 8(1)(j) (interest or capital cost allowance for motor vehicles or aircrafts) and 8(1)(p) (musical instrument costs).

¶ 21. Any expenses paid in the year to earn employment income from qualifying artistic activities that are not deductible for the year under paragraph 8(1)(q) because they exceed the limit described in ¶ 20 above, and that are also not deductible under any other provision of the Act, are carried forward to the immediately subsequent year by virtue of paragraph 8(1)(q). In the subsequent year, the expenses carried forward plus any new expenses paid in the year (to earn employment income from qualifying artistic activities) are subject to the paragraph 8(1)(q) limit, as calculated for that year. Again, any undeductible amount would be carried forward.

¶ 22. The following example illustrates the rules discussed in ¶ 19 to 21 above:

An artist earned employment income from qualifying artistic activities from both Employer A and Employer B during the same taxation year. The following information relates to the artist for that taxation year:

| | Employer A | Employer B | Total |
|------------------------------------|---------------|---------------|-----------|
| Income received in the year | \$ 15,000 | \$ 7,500 | \$ 22,500 |
| | 0 | ===== | ===== |
| | ===== | = | |
| | = | | |
| Related expenses paid in the year: | | | |
| Advertising & promotion | \$ 400 | \$ 300 | \$ 700 |
| Travel* | \$ 800 | \$ 500 | \$ 1,300 |
| | ----- | ----- | ----- |
| Total | \$ 1,200 | \$ 800 | \$ 2,000 |

==== === =====
= =

Capital cost allowance
on motor vehicle
deducted under
paragraph 8(1)(j) 350
\$ =====

* The taxpayer meets the requirements of paragraph 8(1)(h); consequently, the travel expenses are **deductible** under that provision.

The amount deductible under paragraph 8(1)(q) for the current year is calculated as follows:

- Eligible artists' employment expenses (amount paid for advertising & promotion—see note below) \$ 700
=====

- Limit under paragraph 8(1)(q):
The lesser of:

(i) \$1,000, and

(ii) \$4,500 (20% of \$22,500);

that is, \$ 1,000
Less: capital cost allowance \$ 350 \$ 650
----- =====

Amount deductible under paragraph 8(1)(q) for the year (the eligible expenses of \$700, but not exceeding the limit of \$650) \$ 650
=====

Eligible artists' employment expenses to be carried onward to the subsequent year (\$700 eligible – \$650 deductible) \$ 50
=====

Deductions allowed in computing the current year's employment income:

Capital cost allowance
(paragraph 8(1)(j)) \$ 350
Artists' employment expenses
(paragraph 8(1)(q)) \$ 650
Travel expenses
(paragraph 8(1)(h)) \$ 1,300

Total \$ 2,300
=====

Note: Since the travel expenses of \$1,300 were paid to earn employment income from a qualifying artistic activity, the taxpayer could choose to include them in the eligible artists' employment expenses instead of deducting them under paragraph 8(1)(h) (the eligible artists' employment expenses would therefore be \$2,000 instead of \$700). However, the amount deductible under paragraph 8(1)(q) for the year would remain \$650 due to the above limit. In addition, the \$1,300 of travel expenses could not be included in the amount to be carried forward by virtue of paragraph 8(1)(q), since they are deductible in the current year under paragraph 8(1)(h) (even though not actually deducted). Consequently, the artists' employment expenses to be carried forward would remain \$50 (\$2,000 eligible – \$650 deductible under paragraph 8(1)(q) – \$1,300 deductible under paragraph 8(1)(h)). In these circumstances, it would therefore be to the taxpayer's advantage to deduct the \$1,300 under paragraph 8(1)(h).

¶ 23. For a discussion on certain other expenses which may be deducted under section 8 by employees, in computing income from an office or employment, refer to the current version of the following interpretation bulletins:

- IT-103 *Dues Paid to a Union or to a Parity or Advisory Committee*
- IT-158 *Employees' Professional Membership Dues*
- IT-352 *Employee's Expenses, Including Work Space in Home Expenses*
- IT-518 *Food, Beverages and Entertainment Expenses*
- TI-522 *Vehicle and Other Traveling Expenses – Employees*

Bulletin Revisions

¶s 1 to 11, 13 and 16 to 23 have not been changed since the issuance of IT-504R2 dated August 5, 1995.

¶ 12 has been modified to change the expression “qualifying donee” to read “qualified donee” as per the definition of that expression in subsection 149.1(1) of the Act. [December 8, 2000]

¶s 14 and 15 are revised because of a legislative amendment to subparagraph (a)(iii) of the definition of “total gifts” in subsection 118.1(1) resulting from the adoption of S.C. 1998, c. 19 (formerly Bill C-28). Applicable to taxation years that begin after 1996, this amendment has the effect of increasing the limit of total gifts generally to 75% of the individual’s income. [December 8, 2000]

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