

Benefit-Cost Analysis

Exemption of Sales by Writers, Composers and Artists (280-RICR-20-70-11)

Modification of Certain Income of Writers, Composers and Artists (280-RICR-20-55-13)

Rhode Island Division of Taxation, July 2024

Introduction

The Division of Taxation (“Division”) proposes to amend two regulations dealing with how artistic works are exempted from taxation: Exemption of Sales by Writers, Composers and Artists (280-RICR-20-70-11) and Modification of Certain Income of Writers, Composers and Artists (280-RICR-20-55-13).

Background

The Exemption from Sales Tax for Sales by Writers, Composers, Artists (R.I. Gen. Laws § 44-18-30B) and the Exemption from Tax for Writers, Composers, and Artists (per R.I. Gen. Laws § 44-30-1.1) were established by R.I. Pub. Laws 1996, ch. 432, § 1. While historically linked, the two tax benefit programs have diverged over time. Originally, eligibility criteria of both programs were narrowly defined to include only residents of selected zones within the City of Providence and justified as a way to revitalize downtown Providence. Over time, various zones in cities and towns throughout the state were added. Between 1996 and 2013, geographic eligibility for both the sales tax and personal income tax exemption programs expanded in unison. In 2013, the programs diverged when R.I. Pub. Laws 2013, ch. 144, art. 9, § 15 expanded the sales tax exemption to the entire state, but no such change was made to the income tax modification. These programs are administered in cooperation with the Rhode Island State Council on the Arts (“RISCA”).

The General Assembly justified the statewide expansion of the sales tax exemption upon the unique place of arts in Rhode Island’s culture and economy. The Office of Revenue Analysis (“ORA”) did find in a tax incentive evaluation of the artist income tax modification that Rhode Island has a higher concentration of arts employment than the nation (averaged across 2016-2018).

Both programs generally contain the same requirements. Eligible art must be “original and creative” and for “one-of-a-kind, limited production.” Eligible categories of art are defined in the statute as books, plays, musical compositions, paintings/photographs, sculptures, traditional crafts, film, and dance. Artists seeking the sales tax exemption must apply to the Division, itemize the artworks they are seeking to exempt, and attest that these artworks are one of a kind or limited production. These applications are also reviewed by RISCA. Artists utilizing the personal income tax modification can deduct the income they received from eligible art on their final income tax return filed in April and must attach a schedule itemizing the art that generated that income.

According to ORA’s *2024 Tax Expenditures Report*, 90 taxpayers claimed income tax modifications in tax year 2021 resulting in a revenue reduction of \$14,981 to the state. According to the Division’s *Impact of Sales Tax Exemption for Artists, Annual Report – 2024*, there was \$16,692,838 in tax-exempt sales in

2023, with 781 artists filling the annual forms required under the exemption. This \$16,692,838 in exempt sales resulted in a revenue reduction of \$1,168,498 in sales tax.

Proposed Amendments

The amendments to each regulation clarify which kinds of artistic works qualify for the income tax modification or the sales tax exemption. The goal of the amendments is to provide further structure to the statutory requirement that a work of art under these programs must be “one of a kind” and for “limited production.” To qualify as an eligible work, the regulations specify the work:

- must not be consumable;
- must not be intended for mass production or commercial production;
- must have a limited production of no more than 300 copies; and
- must not be sold through an online marketplace.

These requirements are new regulatory language, although they codify standards already utilized by the Division and RISCA. In addition, the 300-copy limit is in line with the definition of “work of fine art” found in R.I. Gen. Laws Ch. 5-62, titled “Works of Art – Artists’ Rights.”

Regulatory Options

Pursuant to the APA, R.I. Gen. Laws § 42-35-2.9(b)(1), the regulatory analysis must include “the benefits and costs of a reasonable range of regulatory alternatives.” In addition to the proposed amendment, other alternatives were considered, including:

1. A higher threshold of 500 copies that can be produced to still qualify as an eligible work,
2. A lower threshold of 100 copies that can be produced to still qualify as an eligible work, and
3. Allow eligible works to be sold through online marketplaces.

Cost-Benefit Analysis

Below, the Division analyzes the quantitative and qualitative societal costs and benefits resulting from the proposed regulatory amendments.

Pursuant to the Administrative Procedures Act (“APA”), R.I. Gen. Laws § 42-35-2.9(b), the Division has determined that there is no alternative approach among the alternatives considered during the rulemaking process which would be as effective and less burdensome to affected private persons as another regulation. Furthermore, the Division has determined that the benefits of the proposed rule justify the costs of the proposed rule, and the proposed rule will achieve the objectives of the authorizing statute in a more cost-effective manner, or with greater net benefits, than other regulatory alternatives.

Costs

The main cost to the proposal is to the artists whose works will not qualify for a tax exemption under this definition. This cost will manifest in two different ways, depending on the regulation in question:

- For artists unable to claim the personal income tax modification, their income tax liability will increase. These artists may see this reflected as lower profits (after taxes) from the sale of their art, or they may choose to pass this tax burden to the consumer in the form of higher prices. These higher prices may lead to lower demand for their art, which may lower their sales and lead to less income.
- For artists unable to claim the sales tax exemption, the final price of their art as paid by the consumer would be 7% higher (7% being the state's sales and use tax rate). For most goods, a higher price equates to lower demand.

As discussed in the background section, the personal income tax modification has limited usage when compared with the sales tax exemption. There is also a paucity of data about this modification due to the nature of year-end income tax filings. The Division chose to quantify the theoretical impact of the proposed changes to the sales tax regulation (280-RICR-20-70-11) given its higher usage and better available data. Generally, this analysis overstates the impact of the proposal and thus captures the potential impacts of the income tax regulation as well.

There is little consensus about the price elasticity of art. A chapter by Bruce A. Seaman from volume 1 of the *Handbook of the Economics of Art and Culture* looks at empirical studies of demand for the performing arts.¹ That chapter includes a table listing 48 price elasticities for the performing arts. These elasticities span studies from 1966 through 2002 and vary widely in what they are measuring. For example, some are for a specific type of performance art (like operas), some are short-run versus long-run elasticities, and some are not statistically significant. The performing arts are just one category of art eligible for tax exemption under these two regulations.

In the absence of better data, the Division has calculated a median price elasticity of -0.64 from that table. The negative elasticity indicates that as the price of art goes up, demand will go down. This is the typical price-demand relationship, although there are some luxury goods (known as Veblen goods) where demand actually increases with price. An elasticity of less than 1 indicates inelastic demand; demand will change less than the change in price. Art is likely an inelastic good because factors other than price (aesthetic quality and cultural relevance, for example) effect demand.

Data from the Division's Audit and Investigation Unit indicates that 60 applications for an artist sales tax exemption certificate were withdrawn or denied in 2023. It is important to note because the proposed amendments are codifying current practice, there is no actual change in marginal benefits and costs. However, to quantify the theoretical cost of adopting the artist sales tax exemption regulatory changes, the Division will assume that all 60 applications were denied because of the limits on eligible art established in the proposed regulation. This is an overestimation; some of these denials were likely due to statutory requirements that do not fall under the Division's regulatory discretion or other unique circumstances.

Given that 781 artists filed a sales tax reconciliation form in 2023 and total exempt sales were \$16,692,838, the average artist realized \$21,374 in exempt sales that year. (This average likely obscures significant variation in the types and prices of art sold under the program.) Assuming those 60 denied

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<https://faculty.econ.ucsb.edu/~lowell/191ac/readings/Supplemental%20readings/Seaman%20Empirical%20Studies%20Demand%20Arts%202006.pdf>

applications would have seen a similar level of sales, the proposed regulatory amendments impacted \$1,282,420 in sales that would have potentially been exempt from the sales tax. This is an overestimation given that certificates represent pieces of art while the previous calculation looks at the average total sales per artist. One artist could apply for multiple certificates while still selling an average of \$21,374 in artwork for the year.

The price elasticity of -0.64 implies that the imposition of the sales tax (which increases prices by 7%) would result in a 4.4% decrease in demand. Applying this 4.4% decrease in demand results in \$57,004 in lost sales for those artists in a typical year. The true cost to those artists is not the lost sales, but the profit forgone from those lost sales. The Division was not able to calculate a typical profit margin for artists.

Benefits

There are three benefits from these proposed amendments:

- Increased compliance with the intent of the statute, which aims to exempt limited and one-of-a-kind art from taxation and maintain taxation of commercial art,
- Increased revenue to the state due to increased compliance with the statute, and
- A reduced burden on the Division to administer the program.

Using the same assumptions as the cost section, the state would realize \$85,779 in additional sales tax from the 60 denied applications from the program (this takes the \$1,282,420 in affected sales, reduces it by 4.4% to account for the change in demand, and applies the 7% sales tax). Generally, changes in tax revenue quantified in a benefit-cost analysis are considered a transfer with no net societal benefits.

There is data available on the administration costs for the personal income tax artist modification. ORA's tax incentive evaluation report for the artist modification noted average administration costs in tax years 2016 through 2018 of \$32,638. When combined with forgone revenue from that program, the cost of administration accounted for 63.6% of the total cost to the state. Given the higher use of the sales tax exemption, the cost of administration of that program is likely a smaller share of the total cost. However, this illustrates that this is a relatively burdensome program to administer (and that is without considering the resources spent by RISCA). These proposed changes will aid in compliance and help limit those administrative costs.

Determination

The Division has determined that because these amendments codify current practice, there is no marginal change to the status quo. However, there is a theoretical decrease in the number of artworks eligible for these programs due to these rules being in place. Art that is not eligible for the exemption may see lower demand from consumers because the final price to consumers will be higher. This societal cost is outweighed by the interest of the Division in ensuring compliance with the statutory intent of the programs, aligning the definitions in the regulation with other statutory definitions of art, preventing the loss of revenue from ineligible art being granted tax exempt status, and minimizing the cost to the taxpayers to administer the programs.

Alternative 1: 500-Copy Threshold

Given that the 300-copy threshold is sourced from a different title of the general laws, and that chapter was adopted in 1987, the Division considered if a higher threshold would be more appropriate. While not directly relevant to setting an appropriate threshold, it is undoubtedly true that the number of jobs in the Rhode Island arts sector has increased over time. This higher number of jobs presumably implies higher demand for the arts. According to data from S&P Global Market Intelligence, employment in the Arts, Entertainment, and Recreation industry category increased 63% from 1990 (the first year data is available) to 2024. Applying 63% growth to the 300-copy limit would imply a threshold of 489 copies. The Division chose to consider a 500-copy limit.

Benefits

The main benefit of this alternative would be to the artists whose work would now be eligible for the exemption. These artists might be: (a) artists currently utilizing these programs, but who would now be able to sell a higher volume of art, or (b) artists not currently in the programs because their art would not be suitable given the current program requirements. In either case, the Division assumes these artists are already selling their art in Rhode Island. There is a third category of artists who formerly did not work or sell in the state but now choose to do so given the more generous program requirements. The relatively small change in price from these programs is unlikely to generate such strong incentives. These artists would be able to lower the price of their newly eligible art due to either the lack of sales tax, or the reduction in their income tax liability (savings which they might choose to pass to their customers in the form of lower prices).

There is a paucity of data about how a different copies threshold would change utilization of the program. The Division attempted to quantify this by assuming a change in the number of sales tax exemption certificates issued commensurate with the change in the threshold. Changing the threshold from 300 to 500 is a 67% change; in 2023 there were 163 certificates issued, meaning a 67% change would result in 109 additional certificates. Such a large increase is unlikely given that much of the marginal change will be captured as current artists in the program choose to sell more copies. In addition, there are some types of art (such as a play) for which the copies threshold is not applicable.

Assuming the same average sales per artist as above and applying that to the 109 new certificates results in \$2,322,606 in newly exempt sales. As mentioned previously, this is an overestimation because certificates are tied to specific artworks rather than artists; one artist could apply for multiple sales tax exemption certificates.

In the reverse of the prior calculation, the newly exempted art would see a price decline of 7%, which indicates a 4.4% increase in demand due to the assumed elasticity of -0.64. This new demand would generate \$103,240 of additional sales for these artists.

Cost

The main costs to this option would be to make the definition of art in these regulations out of step with the definition in R.I. Gen. Laws Ch. 5-62 and thereby decrease compliance with the intent of the statutes that create the income tax modification and sales tax exemption for artists.

In addition, assuming the higher copies threshold generates more artist sales tax exemption certificates that result in \$2,322,606 in newly exempt sales, the state would lose \$162,582 in sales tax revenue.

Determination

Because the statutes governing these programs specifically exclude commercial art, the threshold number of copies that can be produced under the definition of “limited” or “one-of-a-kind” art should reflect that legislative intent. The General Assembly, in a different section of the general laws governing artists rights, established a 300-copy threshold. It is true that the number of artists and the price of art has increased since that statute was adopted, as has the ability of artists to create multiple copies of their art using technology. However, the 300-copy threshold, which is the status quo, is an attempt to balance the interest of artists with adherence to the statute. While a higher threshold may allow for more art to be tax exempt, and thus spur more sales of that art, the Division has determined that increasing that threshold is not justified as this time.

Alternative 2: 100-Copy Threshold

The Division also considered if a lower copy threshold would better meet the intent of the exemption statutes.

Cost Estimation

The Division applied the same methodology to analyze this alternative as it did for alternative 1. This assumes a change in the threshold of 300 to 100 would result in a 40% decrease in the number of annual sales tax exemption certificates issued, a reduction of 65 certifications. This suggests a decrease in tax exempt sales of \$1,393,563. Given the increased price for that art and the price elasticity, artists who are not granted these certificates would lose \$61,944 in sales.

Benefit Estimation

The newly taxable sales under this alternative would result in \$97,549 in additional sales tax revenue. There is also the possible benefit of better adherence with the statutory intent of only exempting non-commercial art. However, the General Assembly has already held that art can still qualify as fine art when 300 copies are produced. In addition, the statute that establishes these exemptions allows types of art, including books, musical compositions and photographs, that are often produced in multiple copies. And the statute establishes that eligible art can be of “limited production.” Setting an extremely low copy threshold – of one copy, for example – would ensure compliance with the “one-of-a-kind” requirement. However, it may have the unintended consequence of functionally excluding other types of art that are clearly contemplated by the statute as eligible.

Determination

The Division determined there is little benefit to this alternative, and that the alternative might have unintended consequences. There is a cost to that alternative that outweighs any possible benefit.

Alternative 3: Allow Online Marketplace Sales

The proposed regulations state that art sold through online marketplaces cannot be eligible for tax exempt status. The sales tax exemption regulation does carve out sales from art gallery websites from

this prohibition, although the galleries must be located in Rhode Island. The Division considered an alternative that did not have this prohibition.

Cost Estimation

The main cost of this alternative is noncompliance (either willfully or ignorantly) with the statutory requirement that an eligible work of art be a limited edition or one of a kind, along with the other statutory requirements for qualifying works. Typically, online marketplaces are geared toward providing goods in varying quantities to customers all over the country or world. It would be very difficult for Division staff to determine if an online marketplace listing was for an actual one-of-a-kind artwork, or a copy of a piece of artwork which had already been sold elsewhere. Additionally, the Division would not be able to verify that the art derived from a Rhode Island source. The Division is unable to quantify the possible noncompliance that would result from this alternative.

Benefit Estimation

The benefit of allowing online marketplace sales is the decreased cost (including time savings) to the artist in the process of selling their art. Artists who formerly attended art shows or met with clients would be able to sell their art online. The Division was not able to quantify this potential benefit to artists.

Given that eligible art is one of a kind or limited production, it is likely that even if artists were able to sell on online marketplaces, they would need to do substantial outreach and legwork to identify potential clients and complete sales. This is truer of art with higher prices, which is the kind of art that most benefits from a tax exemption.

Determination

The Division has determined that the possible noncompliance costs would likely outweigh any benefit to artists in these programs.