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## CHAPTER 2

### HISTORY OF NON-RESIDENT ARTISTE TAXATION

#### 2.1. Income taxation of non-residents

Many countries raise a source tax on the income earned in their territory by non-resident individuals. Non-residents have a limited tax liability, which means that only income with a source in the foreign country can be taxed. It is not only artistes who incur this non-resident income taxation; others, both individuals and companies, can be subject to tax in the country which is the source of their income. This is totally different from the basic unlimited tax liability of residents in their home country; their worldwide income is taxable regardless of where it has been earned.

The territoriality principle allows countries to tax both residents and non-residents. The national taxation of residents is extended by a limited source taxation of non-residents, on the grounds that these non-residents are staying in the country and are making use of its public facilities. Given this contribution argument it sounds reasonable that the non-resident should pay a share of his income as compensation to the government of the country visited. But, non-resident income taxation can also be an anti-avoidance measure, when countries consider it likely that non-residents will not report their income in their home country or will try to evade reasonable taxation by the use of tax havens. Source taxation then works as a defence against non-taxation.<sup>1</sup>

In most countries non-resident income taxation is levied on all income or every profit element resulting from activities in the country. These countries combine the contribution and anti-avoidance arguments.<sup>2</sup> However, a minority of countries levy tax from non-residents on only a limited number of income items; they accept that non-residents need to stay for a longer period in the country and make more than incidental use of its public facilities before they are forced to contribute to the government's budget. The result of this approach is that in these countries

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1. The subject of double non-taxation has received fresh attention because of the initiatives of Prof. Michael Lang from Vienna University. The subject was also discussed as Subject I during the 2004 IFA Congress in Vienna, Austria; *Cahiers de droit fiscal international*, Vol. 89a (Sdu Fiscale & Financiële Uitgevers, 2004).

2. Examples are Germany and Spain.

the contribution argument prevails, while the anti-avoidance argument seems to be ignored.<sup>3</sup> Very often short-term visitors will be exempt and will be subject to taxation solely in their home state.

### 2.2. International double taxation

The extension of the tax base in most countries, to tax not only the worldwide income of residents but also the source income of non-residents, creates the risk of international juridical or economic double taxation. Foreign income can be taxed in the source country, but will in any case also be taxed as part of an individual's worldwide income in the home country. Problems arise when the taxes of two or more countries overlap in such a manner that persons liable to tax in more than one country bear a higher tax burden than if they had been subject to tax in one jurisdiction only. The additional international double tax burden so incurred can arise not merely from differences in tax rates in the countries concerned, but also from the fact that two or more jurisdictions concurrently impose taxes having the same base and incidence without regard to the claims of the other jurisdiction(s). It is called international juridical double taxation when comparable taxes are imposed in two (or more) states on the same taxable person in respect of the same subject matter (and for identical periods).<sup>4</sup> The term "international economic double taxation" is reserved for the situation where the same transaction is taxed in the hands of two different persons.<sup>5</sup>

The two principles can sometimes overlap, leading to a taxable person experiencing both at the same time. This sometimes happens to international performing artistes, as will be shown in chapter 9.

International law does not forbid double (or even multiple) taxation, but it goes without saying that double taxation is harmful in an economic sense because of its negative effects on the exchange of goods and services and the movement of capital, technology and persons. It obstructs the efficient allocation of the factors of production internationally, preventing their use

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3. Examples are Belgium and the Netherlands.

4. Paragraph 1 of the Introduction to the 2003 OECD Model Tax Convention; Paragraph 1 of the OECD Commentary on Articles 23A and 23B.

5. Paragraph 2 of the OECD Commentary on Articles 23A and 23B; *Klaus Vogel on Double Taxation Conventions*, 3rd ed. (hereinafter: Vogel) (Kluwer Law International), at 10, § 3.

to achieve the highest possible productivity (so-called Pareto optimum).<sup>6</sup> It creates an obstacle to working abroad, a hurdle to entering foreign markets. The national rules that tax both “residence” and “source” are considered protectionist and counterproductive. It is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries<sup>7</sup> and, in the case of this thesis, the prosperity of the arts business and the availability of a variety of live performances to the public. The removal of these obstacles will have social, economic and/or cultural benefits.

### 2.3. Double (and multilateral) tax treaties

Individual countries decide how and to what extent they prefer to raise income tax. Only national legislation can create the right to tax income, whether from “residence” or “source”. But countries also see residents suffering from international double taxation and experience stagnating economic growth because economic factors cannot be used efficiently enough. They therefore recognize that it is desirable to clarify, standardize and confirm the fiscal situation of taxpayers who undertake international activities. But with the principle of formal territoriality, which means that international law prohibits the imposition of the sovereign law of one country on a foreign territory, unilateral action cannot be successful. The need for international cooperation has brought countries together and has led to the conclusion of bilateral tax treaties to reduce the risk of possible international double taxation.

But removal of international double taxation is not the sole purpose of the tax treaty policy of many countries. The main objectives are to:

- promote economic development;
- prevent international tax avoidance.

To achieve these objectives, tax treaties between countries have developed some general provisions, such as:

- the removal of international double taxation;
- the provision of legal certainty;
- non-discrimination rules;
- mutual agreement procedures; and
- the exchange of information.

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6. Vogel, at 14, § 13.

7. Paragraph 1 of the Introduction to the 2003 OECD Model Tax Convention.

The requirement to stimulate the development of bilateral economic relations includes avoiding double taxation, but it also goes further. It is essential that source taxation is reduced to a normal level and that any discrimination against non-resident as compared to resident taxpayers is eliminated.<sup>8</sup>

At the international level tax treaties follow the distributive rule, which means that they limit the contracting countries' application of their domestic law. This leads to a restriction of tax claims in areas where overlapping tax claims are expected. Tax treaties normally do not create tax rights or introduce source tax rules, because individual countries decide themselves whether to initiate a source tax. Tax treaties are in the main restricting and not enhancing.

In some countries the restrictive rules of double tax treaties have priority over domestic tax law, but in other countries tax treaties have the same status as internal, domestic tax law.<sup>9</sup>

Discussions about the equitable division of taxation internationally are usually not very rigorous. A distinction should be made between aspects of legitimation, equality and integrity; but one single aspect is usually seized upon to provide the answer. These discussions, however, are complex and rarely produce a clear-cut result.<sup>10</sup>

Originally, the Member countries of the OECD believed that worldwide taxation in the home country was the best option for avoiding double taxation and removing obstacles to economic growth. The predominant view was that the best possible efficiency in the allocation of production factors, such as capital, was obtainable by worldwide taxation in the country of residence and by tax credits being allowed there for taxes imposed by a source country. This practice would ensure "capital export neutrality". The opinion was that "capital import neutrality", achieved by allocating as much taxation as possible to the source country and granting the home country only a secondary taxing right, was economically inefficient. But in recent years some economists have also advanced

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8. Helmut Loukota, Wolfgang Seitz and Gerard Toifl, "Austria's Tax Treaty Policy", 58 *Bulletin for International Fiscal Documentation* 8/9 (2004), at 364-371.

9. Vogel, at 26, § 44. The Netherlands is an example of the former, Germany an example of the latter.

10. See Vogel, Article 17, at 14, § 14.

## 2.4. Oldest tax treaties; income from the “practice of art”

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arguments favouring exclusive taxation at source as economically efficient, at least where business profits are concerned.<sup>11</sup>

The OECD has changed its earlier opinion and has developed a dual system of either territorial taxation or exemption of non-resident income; this is thought to be more respectful of the sovereignty of countries in tax matters, to eliminate distortions of competition in the source country and therefore to contribute to the more efficient use of production factors.<sup>12</sup>

The discussion about capital import neutrality or capital export neutrality, on the basis of whether the tax right lies with the source country or the home country, is attracting fresh attention in the European Union after judgements by the European Court of Justice in recent cases, based on the interpretation of the freedom principles of the EC Treaty. One of these cases is the *Arnoud Gerritse* decision of the ECJ,<sup>13</sup> which was initially only a case about non-resident artiste taxation (in Germany); but this event had consequences for many more types of earnings that are taxed on a gross basis in source countries, such as royalties, dividends and interest, and it is contributing to the discussion about “capital import neutrality”.<sup>14</sup>

Many countries have special tax rules for non-resident artistes in their own national tax laws; but whether they can enforce these national rules in individual cases depends, inter alia, on the allocation rules in their bilateral tax treaties and, for EU Member States, on the EC Treaty. How these allocation rules have developed over the years will be discussed in the following paragraphs.

## 2.4. Oldest tax treaties; income from the “practice of art”

Income taxation was introduced in most countries in the late 19th and early 20th centuries, e.g. in the Netherlands in 1909, in the German *Länder* between 1851 and 1891 and in the United States in 1909 for corporations and in 1913 for individuals. From the start it was not only residents but also non-residents with income from the source state who were caught by the new income tax, with the side effect of international double taxation.

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11. Vogel, Article 17, at 14, § 13.

12. Resolution of the 38th Congress of IFA in 1984 in Buenos Aires, Argentina. See Vogel, Article 17, at 15, § 14.

13. *Arnoud Gerritse*, ECJ 12 June 2003, C-234/01; see 11.4.

14. See chapters 8 and 11 for more information about this and other ECJ cases.

This was not particularly important when countries had low income tax rates, but with tax rates rising after the First World War to finance the reconstruction of the combatant countries the issue of double taxation attracted more and more attention. It caused problems in international economic exchange and had a negative effect on economic cooperation.

In the early 1900s European countries started to conclude bilateral tax treaties to avoid international double taxation.<sup>15</sup> Although these treaties were not directly coordinated they still seemed to have a common structure. The very first treaty “for the avoidance of double taxation” was concluded between Austria and Prussia on 21 June 1899.<sup>16</sup> Later followed treaties between Saar and Germany on 13 July 1921, Germany and Czechoslovakia on 31 December 1921 and Austria and Czechoslovakia on 18 February 1922.<sup>17</sup>

In addition to war taxes and extraordinary capital taxes, these first tax treaties dealt with the allocation of income from work such as business income or salaries or wages. Income from the “practice of art” was put on the same footing as income from other liberal professions such as science, letters, teaching and the professions of physician, architect, lawyer or engineer. This income was only taxable in the source country “as far as the exercise of the profession involved permanent headquarters (business establishment) in that country”.<sup>18</sup> For salaries or wages the oldest tax treaties only had a special rule for payments from public funds (state, provincial district, communal funds, etc.); these payments were solely taxable in the country where the payment was effected.<sup>19</sup> This left open the discussion about salaries or wages from private institutions or companies.

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15. In the 19th century a few countries had already concluded conventions to “regulate the relationships between their administrative services” (France–Belgium in 1843, Netherlands–Belgium in 1845, Prussia–Saxony in 1869, Austria–Hungary in 1870, Austria–Prussia in 1899 and France–United Kingdom in 1907) or to “divide succession or legacy duties” (United Kingdom–Canton of Vaud (Switzerland) in 1872 and France–United Kingdom in 1907).

16. See Hemetsberger-Koller, “Der Wirtschaftspolitische Hintergrund des Doppelbesteuerungsabkommens zwischen Österreich und Preußen 1899”, in Gassner et al., *Die Zukunft des Internationalen Steuerrechts, Schriftenreihe zum Internationalen Steuerrecht*, Vol. 10 (1999), at 13.

17. Summarized in League of Nations document C.345.M.102.1928.II: Double Taxation and Fiscal Evasion, Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, Geneva, October 1928.

18. E.g. Article 4 of the Treaty between Germany and Czechoslovakia (1921).

19. E.g. Article 6 of the Treaty between Germany and Czechoslovakia (1921).

The same allocation rules were found in the tax treaties between Germany and Austria (23 May 1922), Austria and Czechoslovakia (18 February 1922), Hungary and Czechoslovakia (13 July 1923), Germany and Hungary (6 November 1923), Austria and Hungary (8 November 1924), Germany and Italy (31 October 1925) and Germany and Sweden (25 April 1928).

So, in the oldest tax treaties income from the practice of art, including not only fees for stage performers such as musicians, actors and dancers but also the income of sculptors and painters, was treated in the same way as the income of other self-employed persons or employees. There seemed to be no need for any special tax treatment for this category of taxpayer.

### **2.5. The League of Nations: no special rules for artistes**

These older tax treaties demonstrate that double taxation was already a subject of international discussion in the early 1920s. This was continued in the League of Nations. After the First World War countries came together to form the League of Nations, wanting to make a better world. The inauguration of the League occurred with little fanfare on 16 January 1920, as the first session of its Council convened in Paris almost as a sideshow to the meeting of the Supreme Council of the Allies that launched the Treaty of Versailles. The birth of the League was almost aborted by the near-mortal blow of the American failure to ratify the Treaty of Versailles, including the League, which the American President Woodrow Wilson had done so much to establish. Without the United States as a member sharing the Covenant's obligations, the League seemed an altogether less inviting prospect to the United Kingdom and its European allies, and they might well have aborted the experiment before its initiation had that not meant tampering with the whole structure of the Treaty of Versailles.

Despite an inauspicious beginning, the League had several assets that served to sustain it through the first period of development. As well as peace negotiations and disarmament programmes, economic issues were also brought forward. For the first time at the 1920 Brussels International Financial Conference action to eliminate double taxation was requested. In 1921, the Financial Committee of the League of Nations entrusted a team of four economists (Eunaudi (Italy), Bruins (the Netherlands), Stamp (the United Kingdom) and, interesting enough, Seligman (the United States))

with the task of preparing a study on the economic aspects of international double taxation. In 1922, the Financial Committee of the League invited another seven tax officials from European countries to study the administrative and practical aspects of international double taxation and fiscal evasion. In 1925 and 1927 the group was enlarged with officials from Germany, which became a member of the League of Nations in 1926, and from outside Europe, including one from the United States. In the course of the sessions held from 1923 to 1928, the group drafted four Model Bilateral Conventions:

- (1) for the Prevention of Double Taxation in the Special Matter of Direct Taxes;<sup>20</sup>
- (2) for the Prevention of Double Taxation in the Special Matter of Succession Duties;
- (3) on Administrative Assistance in Matters of Taxation; and
- (4) on Assistance in the Collection of Taxes.

At the meeting in Geneva in October 1928 the representatives of 27 countries were present to discuss the Model Conventions. This was one of the achievements that made the years 1925 to 1929 “golden years of opportunity” for the League of Nations.

The Model Bilateral Conventions were a first step towards preventing international double taxation. Countries were asked to take the contents of the Model as a guideline in the negotiations for individual tax treaties. But as with many other international issues in the inter-war period, this recommendation was not taken very seriously and in the first tax treaties, such as the 1939 United States–Sweden tax treaty, the participating countries acted on their own initiative and followed only the broad lines of the Model Conventions.

The Model Conventions of the League of Nations were revised by the Fiscal Committee in 1935, 1943 (Mexico) and 1946 (London).

In general the Model Conventions for Direct Taxes of 1928-1946 specified the following four main principles:

- (1) a taxable person can have his place of residence in only one country, even though he can have houses in different countries;

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20. League of Nations document C.562.M.178.1928.II: Double Taxation and Fiscal Evasion – Report presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion, Geneva, October 1928.



- (2) a company or self-employed person is to be taxed in his country of residence, unless he has a permanent establishment another country;
- (3) an employee can be taxed in the country of work, when he has stayed in that country for longer than a certain period of time; and
- (4) interest, dividends and royalties are taxed in the country of residence.

As well as the allocation aspect, the method of avoiding double taxation was also outlined. When one of the countries was given the right to tax income, the other country had to allow a tax exemption. This could be a full and objective exemption at source in the country where the income was derived, or an exemption with progression in the residence country, bringing the non-resident income under the progression applying to residents. In some special cases the residence country would have to grant a tax credit to avoid double taxation.

There were no special rules for artistes specified in the Model Conventions for Direct Taxes of 1928, 1935, 1943 (Mexico) and 1946 (London). At the level of the League of Nations no special attention was paid to artistes (and sportsmen), which meant that they followed the normal rules for the self-employed or for employees specified in Article VI of the Model Tax Conventions:<sup>21</sup>

### Article VI

1. Remuneration for labour or personal services shall be taxable in the contracting State in which such services are rendered.
2. A person having his fiscal domicile in one contracting State shall, however, be exempt from taxation in the other contracting State in respect of such remuneration if he is temporarily present within the latter State for a period or periods not exceeding a total of one hundred and eighty-three days during the taxable year, and shall remain taxable in the first State.
3. If a person remains in the second State more than one hundred and eighty-three days, he shall be taxable therein in respect of the remuneration he earned during his stay there, but shall not be taxable in respect of such remuneration in the first State.
4. Income derived by an accountant, an architect, an engineer, a physician or other person engaged on his own account in the practice of a profession shall be taxable in the contracting State in which the person has a permanent establishment at, or from, which he renders services.

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21. League of Nations document C.88.M.88.1946.II.A: Fiscal Committee – London and Mexico Model Tax Conventions, Commentary and Text, Geneva, November 1946.

5. If any person described in the preceding paragraph has a permanent establishment in both contracting States, he shall be taxable in each State only on the income for services rendered therein.

This article covered the earnings from all private employment and the practice of all professions. It did not apply to private pensions (Article XI), income from business (Article IV), international navigation (Article V), civil service salaries and pensions (Article VII), dividends (Article VIII) or royalties (Article X). The general rule in Article VI was that remuneration for labour and personal services was only taxable in the country where the services were rendered, but broad exceptions were made for persons staying in the country of work for less than 6 months in a year and for self-employed persons not having a permanent establishment in the country of work. These rules applied to any working persons, whether employees or self-employed, including artistes.<sup>22</sup>

### 2.6. The 1939 United States–Sweden tax treaty

The first sign of special tax rules for artistes (and sportsmen) came during the negotiations concerning the 1939 United States–Sweden tax treaty. The draft version contained in Article XI(d) the following special provision:

#### Article XI

- a) Compensation for labor or personal services, including the practice of the liberal professions, shall be taxable only in the Contracting State in which such services are rendered.
- b) The provisions of paragraph (a) are, however, subject to the following exceptions: A resident of Sweden shall be exempt from United States tax upon compensation for labor or personal services performed within the United States of America if he falls within either of the following classifications:
  - i. he is temporarily present within the United States for a period or periods not exceeding a total of 180 days during the taxable year and his compensation is received for labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Sweden; or
  - ii. he is temporarily present in the United States of America for a period or periods not exceeding a total of 90 days during the taxable year and

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22. See also Daniel Sandler, *The Taxation of International Entertainers and Athletes – All the World's a Stage* (Kluwer Law International, The Hague, 1995), at 177.

the compensation received for such services does not exceed \$3,000.00 in the aggregate.

In such cases Sweden reserves the right of taxation of such income.

c) The provisions of paragraph (b) of this article shall apply, mutatis mutandis, to a resident of the United States of America deriving compensation for personal services performed within Sweden.

d) *The provisions of paragraphs (b) and (c) of this Article shall have no application to the professional earnings of such individuals as actors, artists, musicians and professional athletes.*

e) The provisions of this Article shall have no application to the income to which Article X relates.<sup>23</sup>

In his article “Article 17 of the OECD Model Tax Convention – An Anachronism?”<sup>24</sup> Joel Nitikman described the discussion in the United States about this proposed income tax treaty between the United States and Sweden. The US Senate Foreign Relations Committee submitted a report on 20 July 1938.<sup>25</sup> The report contained the Joint Committee on Taxation’s explanation as well as the Treasury Department’s technical explanation of the proposed treaty. Also included in the report were the president’s transmittal letter, the State Department’s submission letter, and the full text of the treaty. The Committee reported on the treaty favourably to the Senate and recommended that it should advise and consent to its ratification. The Senate adopted the Committee’s report, and the treaty was signed on 23 March 1939 and came into force on 14 November 1939.

Article XI(d) evidently did not attract much attention at the time and was barely mentioned in various articles written about the treaty.<sup>26</sup> It was not referred to in either the Committee’s report or the report of the Joint

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23. Article X: “Wages, salaries and similar compensation and pensions paid by one of the Contracting States to individuals residing in the other State shall be exempt from taxation in the latter State”.

24. Joel A. Nitikman, “Article 17 of the OECD Model Treaty – An Anachronism?”, 29 *Intertax* 8/9 (2001).

25. US Senate Executive Report No. 18, 76th Congress, 1st Session, 20 July 1939, 87 TNI 53-144. This Report is referred to in the discussion of Article VII(2) of the 1942 Canada–United States treaty in the memorandum on that treaty prepared by Dr Eldon King, chief US negotiator of the 1942 treaty, 14 February 1942, unpublished, obtained under the Canadian Access to Information Act (Nitikman).

26. See Wurzel, “A Tax Agreement with Sweden”, 17 *Taxes: The Tax Magazine* (1939), at 460 or in Castimore, “Income Tax Treaties with France, Sweden and Canada, and the Convention with Great Britain and North Ireland”, 4 *NYU Inst. Fed. Tax.* (1946), at 537.

Committee. The only mention of it in the Treasury Department's explanation was as follows:

The subject matter of this article was of particular interest to the Swedish delegation. The objective was one primarily of facilitating the departure of their nationals with the possible inconvenience rather than one of relief from United States tax, though the former was dependent largely upon the latter. With this view the US representatives were in substantial agreement but maintained the position, acquiesced in somewhat unwillingly by the Swedish delegation, that the provision should be framed so as not to permit the moving-picture actor, the professional athlete, or like individuals to escape tax upon earned income from United States sources.

As can be seen, it was the United States that insisted on inserting Article XI(d) over the objections of the Swedish delegation, although no reasons were given for the US position. It has been suggested that the US negotiators in 1939 recognized the possibility of Swedish actors making large sums of money in the United States in a short amount of time, without needing the facilities that would normally give rise to a permanent establishment, and thus found it necessary to capture the tax on such income by inserting Article XI(d). This seems to be somewhat strange, given what must have been the small number of Swedish actors or athletes coming to the United States in 1939. Indeed, in its explanation, just below the above quotation, the Treasury Department admitted that the amount of income involved under Article XI was "trifling". In any case, this provision was insisted upon by the US delegation and agreed to by the Swedish side.

### **2.7. The 1945 United States–United Kingdom tax treaty**

The first extensive discussion<sup>27</sup> on a special treaty article for artistes (and sportsmen) was contained in a transcript of a hearing before a subcommittee of the US Senate Foreign Relations Committee on 17 April 1946, which met to consider the 1945 United States–United Kingdom income tax treaty. Earlier hearings had been held on 23 May and 13 June 1945. On 30 June 1945, the subcommittee reported back to the full Committee with a recommendation that the treaty be transmitted to the Senate for its favourable advice and consent and without amendment. The Committee did so. While the Committee report was awaiting action by the Senate, certain interested groups represented by the Screen Actors Guild, the Artists Managers Guild and others requested that the report be

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27. Nitikman (2001).

resubmitted to the Committee on Foreign Relations so that they could testify on Article XI(3) of the treaty, which was similar to the later Article 17 of the Model Tax Convention. On 6 February 1946, the full Committee recommended that the treaty be returned to the subcommittee for further hearings. By unanimous consent on 6 February 1946, the Senate removed the treaty from the Executive Calendar and returned it to the subcommittee.

The new testimony before the subcommittee made it very clear that, in the opinion of the witnesses, there was simply no justification for Article XI(3). Not surprisingly for witnesses representing actors, the language they chose to express the depth of their feelings was eloquent:

... without figures or prognostications, as actors we say to you, what is there different about our profession that we alone should continue to carry the burden that our Government proposes to lift from the backs of everyone else, like doctors, lawyers, salesmen, businessmen, government representatives, and all other professions, businesses, and activities? There was a time in England, and for that matter, in the early history of some of our States, when actors were officially noted on the statutes as “rogues” and “vagabonds”. That time, we think, is no more. Actors as a class have proved their desire, worthiness, and ability to take their place in civic, community, and national affairs, and in fact in times of emergency or need are particularly called upon by their National Government, the Treasury Department, and the War Department to give freely of their time and talents. They have always responded, and in fact are today responding, to these pleas. They do not then understand why this Government should set them apart adversely from all other occupations.

There was a good deal of discussion in the testimony as to why the witnesses were only now coming forward, in 1946, when the provision had existed since 1939 in the Swedish treaty and 1942 in the Canadian treaty. The explanation given was simply that the witnesses and their organizations had not been aware of the exceptions for artistes in those treaties.

Eldon King, the chief US negotiator of the United States–United Kingdom treaty, attempted to justify Article XI(3) by noting that the US actor taxed in the United Kingdom on UK income would get a credit in the United States:

Very little has been said about our credit system. Much was said about the actor being doubly taxed; then the statement rested there. Our view is that where the one tax is removed through a credit system there is no double tax, consequently our position is that the actors are not doubly taxed. They are it is true paying

the higher of the two taxes incident to the application of the credit system, but I believe that is the fair statement, rather than to say that they are doubly taxed.

In a statement to the subcommittee in the 1946 hearing, Colin Stam, Chief of Staff, Joint Committee on Internal Revenue Taxation, attempted to justify Article XI(3) along the following lines: under the 1936 US Revenue Act, non-US persons working in the United States for a temporary period of not more than 90 days and earning less than USD 3,000 were exempt from US tax on this income. The report of the Finance Committee that approved the provision noted that:

The purpose of this amendment is to permit residents of other countries to make brief visits to the United States for business purposes, such as the buying and selling of goods, without being subject, before leaving the country, to a demand for payment of tax on their compensation during the period of their stay here. Numerous cases of this character arising under the present law have created irritation and ill will quite disproportionate to the slight revenue involved. The limitations contained in the amendment are, it is believed, adequately drawn to prevent any serious abuse of the exemption. This change is consistent in purpose with the amendment to section 211(b) which the committee has recommended.

According to Mr Stam, this legislative history indicated that:

the \$3,000 limitation was also inserted in Article XI(3) so that foreign pugilists or theatrical stars conducting performances in this country for 2 or 3 months and receiving considerable remuneration for their services would still be subject to the United States tax.

Finally, the subcommittee recommended to the full Committee that Article XI(3) be deleted, and this recommendation was eventually adopted by Article I of the 1946 Protocol to the 1945 treaty.<sup>28</sup> After the treaty came in force, the IRS regretted this amendment and the Inland Revenue Department in the United Kingdom initially refused to accept it.<sup>29</sup>

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28. See the report of the Secretary of State that accompanied the 1946 Protocol, Senate Executive F, 79th Cong., 2d Sess., which stated that “The subcommittee of the Committee on Foreign Relations reached the conclusion that a substantial basis existed for the view that paragraph (3) of Article XI is open to the objection that it is discriminatory.” This quotation is referred to in Rev. Rul. 60-313, 1960-2 C.B. 627.

29. According to Joel Nitikman, the bitterness of the IRS was evident in G.C.M. 35446; 1973 *IRS GCM LEXIS* 142, and the refusal by the Inland Revenue was explained in Field, “United Kingdom Tax Treaty and Its Effect on United States Artists”, 30 *Taxes: The Tax Magazine* (1952), at 274.

## 2.8. US treaties with other countries in 1951

The merits of a special article for artistes (and sportsmen) such as Article 17 were next discussed in connection with the hearings of a subcommittee of the US Senate Foreign Relations Committee on proposed US treaties with South Africa, New Zealand, Norway, Ireland, Greece and Canada and estate tax treaties with South Africa, Norway, Ireland and Greece, held on 12 and 13 April 1951.<sup>30</sup>

Mr King again testified before the subcommittee. He called the subcommittee's attention to the fact that unlike the UK treaty as modified by the 1946 Protocol, the proposed South Africa and New Zealand treaties contained a version comparable to Article XI(d) of the 1939 United States–Sweden income tax treaty. According to Mr King, in the treaties negotiated between 1946 and 1951 the United States had been successful in following the 1946 directive and excluding the artistes' article,<sup>31</sup> but the South African and New Zealand delegations had insisted on inserting such provisions in their treaties.

Testimony was heard from representatives of the American acting industry to the effect that the proposed treaties that included a version of “Article 17” were discriminatory. Again the language is colourful:

We have never been able to satisfy ourselves that actors are anything but human beings and that they therefore should be treated just like any other human being when the United States, acting on behalf of all of its residents or citizens, negotiates an exemption from income taxes under circumstances such as we are discussing.

Mr King was again pressed with the position that a provision such as “Article XI(d)” was discriminatory, but he refused to accept the point:

Senator Gillette: You feel it is discriminatory, though; do you not? Mr. King: Well, that is a matter, I think, of personal opinion. The opinion is somewhat divided on that. I would say that this test check I just gave you, where we have obtained this point as we like to have it, in 75 percent of the treaties probably just about represents the opinion. About 75 percent of the countries think it is discriminatory, and that there should be no distinction, while the remaining 25 percent think it is not. There is a distinction between the actor, especially, and other entertainers who come into a country and the commercial visitor. Of

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30. Nitikman (2001).

31. E.g. in the 1948 tax treaty (old) between the United States and the Netherlands no special article for artistes (and sportsmen) was inserted.

course you encounter such illustrations as Mr. McCalman gave you where a mixed group goes out to take a picture. But the issue, I think, of whether it is or is not discriminatory is largely a matter of individual opinion.

Mr King justified the South African and New Zealand (and Canadian) exceptions by noting that the United Kingdom, in all treaties other than the 1946 US Protocol, had inserted an artistes and athletes clause, that the South African and New Zealand delegations therefore wanted such a clause in their treaties, that in treaty negotiations the US negotiators had won some points, lost some points and simply felt that they had to give in on this point to get the fixed-base exemption for the majority of US persons working abroad. It appears that this testimony carried the day with the subcommittee, as the treaties were eventually approved with the artistes and athletes exception to the fixed-base provision.

It is very interesting to see that the tax treaty between the United States and the Netherlands, concluded on 29 April 1948, did not contain a special tax rule for artistes (and sportsmen). This might have been on the initiative of the US position, following the 1946 guideline that resulted from the discussions in the United States over the tax treaties with Sweden and the United Kingdom. It did not seem to follow the Dutch position, when the tax treaty between the Netherlands and Switzerland concluded on 12 November 1951 is considered. In this the taxation of income from performances by self-employed artistes (but not by athletes or other sportsmen) had been allocated to the country of performance. It is an inevitable conclusion that neither the United States nor the Netherlands seemed to have a consistent tax treaty policy for the income of artistes (and sportsmen) at that time.

The 1948 tax treaty between the United States and the Netherlands was extensively amended in 1967, but even then no special article was added for artistes and sportsmen.

From 1951 to 1977 the United States included the artistes clause in all or at least most of its treaties. Other countries did the same. It appears that the US acting industry had one last stab at correcting this in the 1977 hearings. Paul Berger, counsel for the Screen Actors Guild, testified once again in respect of the proposed United States–United Kingdom treaty that was to replace the 1945 treaty. He argued that the proposed Article 17 was discriminatory. He gave the standard example, well worn since 1946, of a US company going to the United Kingdom to make a film and bringing



numerous actors and behind-the-camera personnel. He correctly noted that the actors would be taxed in the United Kingdom, get a credit in the United States for the UK tax and end up paying the higher UK rate, while the non-actors would be exempt from UK tax provided they had no fixed base in the United Kingdom and would only pay the lower US rate on the same income for working in the same place at the same time. It is difficult to argue that this is not discriminatory, yet the subcommittee was (apparently) not impressed with this testimony, as it recommended to the full Committee that the treaty be approved with Article 17 intact and it accordingly entered into force with Article 17.

## 2.9. German tax treaties in the 1950s and 1960s

Germany incorporated the special tax treatment of artistes (and sportsmen) into its tax treaties in the 1950s and 1960s. Within 13 years it concluded comparable tax treaties with Austria (1954), Luxembourg (1958), Norway (1958), the Netherlands (1959), France (1959), Sweden (1959), Denmark (1962), Israel (1964), Greece (1966) and Belgium (1967). In these treaties an interesting distinction is made between artistes/self-employed and artistes/employees. For example, the tax treaty between the Netherlands and Germany<sup>32</sup> contains the following provisions mentioning a special rule for independent artistes (and sportsmen) in the second sentence of Article 9(2):

### Article 9

1. Where a resident of one of the States derives income in respect of present or past independent activities performed in the other State, the said income shall be taxable in the latter State.
2. A person shall not be considered to perform independent activities in the other State unless he makes use, in the exercise of his occupation, of a permanent base regularly available to him there. *This restriction, however, shall not apply to independent activities of artistes, performers, athletes or entertainers.*
3. The provisions of Article 5, paragraph 3, shall apply as appropriate.
4. Where an individual who is a resident of one of the States receives fees as a member of a board of directors or a non-managing member of a similar organ from a body corporate resident in the other State, the said fees shall be taxable in the latter State.

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32. Concluded in The Hague on 16 June 1959 and still in force.

This special regulation did not apply to dependent artistes because they were not mentioned specifically in Article 10 of the tax treaty and were therefore subject to the normal rules for employees:

### Article 10

1. Where an individual who is a resident of one of the States derives income from employment, the said income shall be taxable in the other State, if the employment is exercised in that State.
2. Notwithstanding paragraph 1, income derived from employment shall be taxable solely in the Contracting State of which the employed person is a resident if:
  1. he is present in the other State temporarily, for a total of not more than 183 days in one calendar year;
  2. the remuneration for his employment activities during that time is paid by an employer who is not a resident of the other State; and
  3. the remuneration for his work is not borne by a permanent establishment or fixed base which the employer has in the other State.
3. Where an individual's services are performed exclusively or predominantly on board a ship or aircraft of a shipping or air transport enterprise, they shall be deemed to have been performed in the State in which the place of management of the enterprise is situated. In case the latter State fails to tax the income derived from such services, the State of which the employee is a resident, shall be entitled to do.

According to this tax treaty (and those with the other named countries) German source tax can, for example, be applicable to Dutch resident, self-employed artistes. While Article 9(2), first sentence, allocates the taxing right over the self-employed in general to the source country, when there is a permanent establishment in that country, the second sentence removes this normal condition for self-employed artistes. This means that Dutch self-employed artistes may be taxed in any case when they perform in Germany (and vice versa).

Dutch artistes who are employed by a Dutch employer and are temporarily working in Germany are only taxable in the Netherlands (and vice versa) when the three conditions are met. But Dutch artistes directly employed by a German employer for performances in Germany are, like normal employees, taxable in Germany (and vice versa).

It is unclear why this exceptional treatment entered the tax treaty policy of Germany during the period 1954-1967. And it is strange that the special treatment of artistes did not seem to be based on the avoidance of double

taxation, because the Netherlands did not even have an artiste source tax at the time when the tax treaty was concluded. The tax rules for non-resident independent artistes were not introduced in the Netherlands until the year 1971.<sup>33</sup>

German tax treaty policy on artistes (and sportsmen) was interrupted by the 1964 Germany–United Kingdom tax treaty. In this treaty both countries agreed to tax non-resident artistes in the country of performance, regardless of whether they were self-employed or employees. After this new-style tax treaty Germany still concluded old-style tax treaties with Greece and Belgium, because the negotiations had started before Germany changed its policy and the other countries wanted to keep to the old proposals.

Recently four of the old-style German tax treaties have been renegotiated and renewed, removing the typical artiste clause of the 1950s and 1960s. This was the case for the tax treaties with Norway (1991), Sweden (1992), Denmark (1995) and Austria (2000),<sup>34</sup> in which Article 17 of the OECD Model was followed. Germany is in the process of renegotiating its tax treaties with some other European countries.

## 2.10. The 1963 OECD Model Tax Convention; introduction of Article 17

The research of the League of Nations was picked up after the Second World War by the OEEC<sup>35</sup> and its successor, the OECD.<sup>36</sup> A number of countries had not concluded bilateral tax treaties or had concluded tax treaties covering certain fields of taxation only. The rules in existing bilateral treaties were by no means uniform. Many taxpayers had a feeling of insecurity, which did not encourage the development of international economic relations.<sup>37</sup> The increasing economic interdependence and cooperation of Member countries of the OEEC in the post-war period showed increasingly clearly the importance of measures to prevent

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33. Law of 16 November 1972, *Staatscourant* 613-614. Earlier court decisions had restricted the tax right to domestic artistes only (e.g. *Hoge Raad* 19 November 1952, *BNB* 1953/12).

34. The new treaty with Austria came into force on 1 January 2003.

35. The Organisation for European Economic Co-operation.

36. The Organisation for Economic Co-operation and Development.

37. Paragraphs 5 and 6 of first Report of the Fiscal Committee of the OEEC (May 1958).

international double taxation. The need to extend the network of bilateral tax conventions was recognized.<sup>38</sup> The OEEC (OECD) Committee on Fiscal Affairs submitted a series of four reports between 1956 and 1961. The 2nd Report of July 1959, issued under the aegis of the OEEC, introduced a special provision for artistes (and athletes):<sup>39</sup>

### Article XI

Notwithstanding anything contained in this Convention, income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised.

The 2nd OEEC Report gave in its Commentary an explanation for the introduction of this new Article XI:

11. The provisions of Article XI relate to public entertainers and athletes and stipulate that they may be taxed in the State in which the activities are performed, whether these are of an independent or of a dependent nature. This provision is an exception, in the first case, to the rule laid down in Article VI (Independent activities), in the second case, to the rule laid down in paragraph 2 of Article VII (Salaries and wages)

12. By this provision the practical difficulties are avoided which often arise in taxing public entertainers and athletes performing abroad. Certain Conventions, however, provide for certain exceptions such as those contained in paragraph 2 of Article VII. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of Article XI to independent activities by adding its provisions to those of Article VI relating to professional services and other independent activities of a similar character. In such case, public entertainers and athletes performing for a salary or wages would automatically come within Article VII and thus be entitled to the exemptions provided for in paragraph 2 of that Article.

Apart from the cryptic justification (“... practical difficulties ...”) for the introduction of this new article, the 2nd OEEC Report did not give any evidence or examples of the problems that national governments had experienced with taxing non-resident artistes (and athletes). Where did this concern about artistes (and athletes) come from? With its reasoning the Fiscal Committee seemed to have its eye more on securing taxation than on eliminating double taxation.

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38. Paragraph 5 of the Introduction to the 2003 OECD Model Tax Convention.

39. See also Sandler (1995), at 177.

Already the 2nd Report made it implicitly clear that the allocation of the taxation of artistes to the source country would lead to obstacles in the international arts world: the new article contained a very strict provision and the reporters were afraid of impeding cultural exchanges. This meant that the cultural world was going to suffer from a tax measure for which no evidence of need had been given.

The solution given in Paragraph 12 of the Commentary looked similar to the contents of Articles 9 and 10 in the Netherlands–Germany tax treaty discussed in 2.9. (the second sentence of Paragraph 12 refers). Unfortunately the solution applied only to artiste employees and not to self-employed artistes. No reason was given why this division was necessary. And how could an exception for employees only sufficiently reduce the inefficiency of this tax measure?

Furthermore the possible exception was only mentioned as an option in the explanatory Commentary and not in the proposed text of the article. This did not give it much weight.

A summary report was published in 1963 to which the complete model treaty (the “OECD Model”) and an official commentary were appended. The artistes (and sportsmen) article was renumbered as Article 17 and the text was slightly changed while still having the same meaning:

Article 17 (of the 1963 OECD Model Tax Convention)

Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

The Commentary interpreted the OECD Model, allowing OECD members which did not wish to follow particular recommendations in the model to enter their reservations. For the new Article 17 the same Commentary was given as published earlier in the 2nd OEEC Report of 1959; no changes were made for the official Commentary to the 1963 OECD Draft Model and no reservations were appended.

The OECD Council recommended the Model Tax Convention and the Commentary to its Member countries for adoption as the basis for their bilateral treaty negotiations. Many countries followed this advice after 1963 in their treaty negotiations and inserted Article 17 without much

discussion. But did the countries which entered into double taxation treaties really have practical difficulties with taxing performing artistes? Unfortunately only a few countries seem to have taken notice of the critical remarks in the Commentary about the strictness of Article 17, because the possible exception for artiste employees was seldom used.

The conclusion is that after the earlier US treaties, starting in 1939, and the German treaties in the 1950s and 1960s, the special treatment of artistes really took off in 1963 with the Draft Model Tax Convention of the OECD. At first sight this was a very simple measure, but the Commentary to the 2nd OEEC Report of 1959 had already explained its inefficiencies. Unfortunately the negative effects of the new Article 17 on the (economic) circulation of international performing artistes were not taken seriously when the 1963 Model Tax Convention was concluded by the OECD.

### 2.11. The object and purpose of Article 17(2) in 1977<sup>40</sup>

Article 17(2) was introduced in the 1974 Report of the OECD Committee on Fiscal Affairs updating the 1963 Draft and was included in the 1977 OECD Model. The 1974 Report added a new paragraph to Article 17:

Article 17

1. Notwithstanding ...
2. Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.

This change to the OECD Model was explained in Paragraph 4 of the 1977 Commentary on Article 17, stating:

4. The purpose of paragraph 2 is to counteract tax avoidance devices in cases where remuneration for the performance of an entertainer or athlete is not paid to the entertainer or athlete himself but to another person, e.g. a so-called artiste-company, in such a way that the income is taxed in the State where the

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40. See also Dick Molenaar and Harald Grams, “Rent-A-Star – The Purpose of Article 17(2) of the OECD Model”, 56 *Bulletin for International Fiscal Documentation* 10 (2002), at 500, and Harald Grams and Dick Molenaar, “Zum Regelungsinhalt des Art. 17 Abs. 2 OECD-Musterabkommen – Meistbegünstigung im Abkommensrecht”, *Internationales Steuerrecht* 11/2002, at 378.

activity is performed neither as personal service income to the entertainer or athlete nor as profits of the enterprise in the absence of a permanent establishment. Paragraph 2 permits the State in which the performance is given to impose a tax on the profits diverted from the income of the entertainer or athlete to the enterprise where for instance the entertainer or athlete has control over or rights to the income thus diverted or has obtained, or will obtain, some benefit directly or indirectly from that income. It may be, however, that the domestic laws of some States do not enable them to apply such a provision. Such States are free to agree to alternative solutions or to leave Paragraph 2 out of their bilateral convention.

With Article 17(2), so-called “star companies” could be targeted. Some countries had reported to the OECD that top artistes and sportsmen were more and more often being loaned out by companies which paid the artistes and sportsmen a small salary and took the major part of the performance income as company profits. These companies were based mostly in tax havens without normal income or corporation tax. It also appeared that the artistes or sportsmen were themselves the actual shareholders of these offshore companies or received a large share of their profits. That was often combined with the personal change of residence of artistes and sportsmen to tax havens.<sup>41</sup>

Some countries already had in their national legislation the ability to look through such arrangements with Article 17 of the 1963 Draft, which became Article 17(1) after the 1977 change.<sup>42</sup> They did not need the extension of Article 17 with a second paragraph, especially because the measure did not have any effect on the “star companies” that were based in tax havens, because there were no tax treaties with such jurisdictions.

It is a moot point whether this look-through approach may constitute a treaty override if Article 17(2) has not been inserted in a bilateral tax treaty. Paragraph 8 of the Commentary on Article 17 seems to accept the

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41. A classic example is the Swedish heavy-weight boxing champion Johansson, who was knocked out by the US tax authorities, *Johansson v. United States*, 14 *American Federal Tax Reports* 2d (AFTR 2d.) 5605 (1964). See also Frantisek J. Safarik, “Entertainment Company: Simulated Employment”, 30 *European Taxation* 9 (1990), at 307, about a Swiss-based “star company”.

For more recent examples, see Carmine Rotondaro, “The Pavarotti Case”, 40 *European Taxation* 8 (2000), at 385, or Boris Becker, who was in the newspapers after his 2002 conviction by the court in Munich, Germany. Both stars pretended to live in Monaco, but were in fact living in Italy and Germany, respectively.

42. The Netherlands: *Hoge Raad* 23 November 1983, *BNB* 1984/33. See also Paragraph 8 of the OECD Commentary on Article 17.

look-through approach for one-person companies, but this is in contrast with the commentary on “conduit companies” and “base companies” in the Paragraphs 7 to 26 of the Commentary on Article 1 of the OECD Model Tax Convention. These paragraphs tend to suggest that specific treaty provisions might be necessary to deal with such companies, or at least to preserve the effect of domestic anti-avoidance rules, whereas Paragraph 8 of the Commentary on Article 17(1) suggests that a domestic look-through rule automatically applies for treaty purposes.

The legislation of many other countries, however, was not as flexible; it could not combat the tax avoidance schemes and required extra international ammunition. With Article 17(2), these countries were able to widen the scope of performance income that was taxable in their country, although this did not mean that the extended rules were automatically effective in these countries.<sup>43</sup>

Paragraph 4 of the Commentary on Article 17 shows that in 1977 the OECD did not have in mind normal employer-employee relations in Article 17(2). There seemed to be no threat that artistes and sportsmen employed by companies or non-profit organizations, such as orchestras, theatre groups, dance companies, football clubs, baseball teams, etc., were trying to evade taxation. These employers were normally based in a treaty country and did not have any intention of relocating to a tax haven. For such artistes and sportsmen as employees, a change of residence was also not very likely because they were closely linked to the central base of an organization and had to attend rehearsals, home matches, and go on group trips, etc. The text of the 1977 Commentary made it clear that the new rule did not target these artistes or sportsmen and their employers; rather, the purpose was to counter the tax avoidance schemes of self-employed top artistes and sportsmen. According to Paragraphs 2 and 3 of the 1977 Commentary on Article 17, cultural exchanges and subsidized artistes and sportsmen could suffer from the far-reaching impact of the article:

2. This provision makes it possible to avoid the practical difficulties which often arise in taxing entertainers and athletes performing abroad. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of paragraph 1 to independent activities by adding its provisions to those of Article 14. In such a case, entertainers and

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43. The different approaches to the relationship between domestic law and treaty provisions are discussed in Sandler (1995), at 204, with examples from the United Kingdom and France.



athletes performing for a salary or wages would automatically come within Article 15 and thus be entitled to the exemptions provided for in paragraph 2 of that Article.

3. The provisions of the Article do not apply when the entertainer or athlete is employed by a Government and derives income from that Government. Such income is to be treated under the provisions of Article 19. Certain conventions contain provisions excluding entertainers and athletes employed in organisations which are subsidised out of public funds from the application of Article 17. The provisions of the Article shall not prevent Contracting States from agreeing bilaterally on particular provisions concerning such entertainers and athletes.

Strangely enough, however, the wording of Article 17(2) itself was much broader than necessary for this object and purpose in 1977; there was more scope in the text of the article than the limited explanation in the Commentary required. This was already the case in the 1963 OECD Draft Model and it was extended in 1977 with the introduction of Article 17(2). Unfortunately many countries did not recognize the subtlety of the Commentary and just inserted the new Article 17, including Paragraph 2, in their new tax treaties.

In 1977 Canada and the United States already seemed to be suspicious of the new provision in Article 17. They registered an observation on the Commentary in Paragraph 6 of the 1977 Commentary on Article 17:

6. Canada and the United States are of the opinion that paragraph 2 of the Article applies only to cases mentioned in paragraph 4 above and these countries will propose an amendment to that effect when negotiating conventions with other Member countries.

The United States also added a reservation in Paragraph 9 of the 1977 Commentary on Article 17:

9. The United States reserves the right to limit paragraph 1 to situations where the entertainer or athlete is present in the other State for a specific period or earns a specified amount.

Most OECD Member countries followed the 1977 recommendation to add Article 17(2) to their tax treaties, because they believed it gave them the means to combat tax avoidance by the top stars. Other than Canada and the United States, no country seemed to be concerned that the actual text of Article 17(2) added more to Article 17 than was needed. Unfortunately the inefficiencies that had already arisen after the introduction of Article 17 in

the 1963 OECD Draft Model were increased by the introduction of Article 17(2) into the 1977 OECD Model Tax Convention.

It is in any case doubtful whether Article 17(2) is necessary. It intends to create new taxing rights for countries that have insufficient national tax rules, while the general opinion is that tax treaties only restrict the national taxing rights of countries where these overlap and cause double taxation.<sup>44</sup> It should be recommended to all countries that they implement a broad national tax system for artistes, covering all payments to any party for performances of non-resident artistes in the country. This tax would fully apply when no tax treaty was applicable, but be restricted to only the artistes' salaries or personal income when Article 17 (of the 1963 Model Convention) was present in a tax treaty.

Now the very strange effect of Article 17(2) is that it taxes artiste companies in treaty countries, where normal taxation can be assumed and the risk of tax avoidance does not exist, while it has no effect on “star companies” in tax havens.<sup>45</sup>

## 2.12. Reversal in the 1987 OECD Report<sup>46</sup>

### 2.12.1. Mistrust, tax avoidance schemes

The mistrust of artistes (and sportsmen) became more evident in the 1987 OECD Report, which used phrases such as: “clear evidence of non-compliance”, “rarely disclose casual earnings”, “sophisticated tax avoidance schemes, many involving the use of tax havens, are frequently employed by top-ranking artistes and athletes”, “relatively unsophisticated people, in the business sense, can be precipitated into great riches”, and “travel, entertainment and various forms of ostentation are inherent in the business and there is a tendency to be represented by adventurous but not very good accountants”.<sup>47</sup>

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44. See 2.3.

45. This discussion will be continued in the next paragraphs and in chapters 14 and 15.

46. “Taxation of Entertainers, Artistes and Sportsmen”, in *Issues in International Taxation* No. 2, OECD (Paris, 1987) (hereinafter: the 1987 OECD Report). A study by the Committee on Fiscal Affairs, based upon 19 country submissions, referring to the year 1986. The report was prepared by both the Working Party on Tax Evasion and Avoidance and the Working Party on Double Taxation.

47. Paragraphs 6, 7 and 8 of the 1987 OECD Report.

The report acknowledged that the entertainment industry covers a larger entourage than only the performers and includes "managers, various administration and publicity staff and road crews". "Besides performance fees also music and/or writing royalties and fees are involved." Sources of income are taken through different companies, "crossing international boundaries". The report found it "likely that the inventiveness and complexity of the industry will continue to expand".<sup>48</sup>

The international world represented at the OECD believed in 1987 that rich and famous artistes and sportsmen in particular tried to escape from normal taxation via avoidance schemes and that less well-known artistes failed to report their non-resident income in their home country. The 1987 OECD Report mentioned that systematic audits in Canada and the Netherlands and studies in Canada had been undertaken, but figures were not disclosed.<sup>49</sup>

The suspicion became more marked when the use of "slave agreements" with "slave companies" was explained: "rent-a-star companies", based in tax havens, were assumed to employ top artistes (and sportsmen) for a small salary, while the main part of the performance fee remained in the company in a tax haven, and was fully controlled by the artistes themselves, directly or indirectly.<sup>50</sup>

This was mentioned as if Article 17(2) had not been introduced 10 years earlier. Resident countries had reported having problems with gathering information about the foreign performance income of their taxpayers.

### 2.12.2. Equal treatment as principle, but still expanding the deviating treatment

The OECD Committee on Fiscal Affairs, responsible for the 1987 OECD Report, put forward two principles, namely:

- (1) as a general principle underlying the report, "income from entertainment and sporting activities should be taxed in the same way as income from any other activities. Exceptions to this principle should be kept to a minimum";<sup>51</sup>

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48. Paragraph 9 of the 1987 OECD Report.

49. Paragraph 6 of the 1987 OECD Report.

50. Paragraphs 25 and 26 of the 1987 OECD Report.

51. Paragraph 14 of the 1987 OECD Report.

- (2) as a secondary principle, “artistes and athletes are, as are other taxpayers, fully liable to tax in their country of residence and, ideally, should be taxed accordingly”.<sup>52</sup>

But because of the lack of trust and “the difficulties for the country of residence in identifying the activities of its residents abroad”, the 1987 OECD Report concluded that taxation of artistes and sportsmen in the source country was still the right procedure, although this was an exception to the normal international tax allocation rules. The main purpose of the 1987 Report was therefore “to help Member countries to establish a system by which the income of artistes and athletes could effectively be taxed in the country of performance”.<sup>53</sup> In the fight against non-compliance and tax avoidance, even a distortion of competition turned out to be acceptable.<sup>54</sup>

The Committee also decided to make more use of the wording of Article 17(2). Not only star companies but also incorporated teams, troupes, etc., would fall within the scope of Article 17(2), meaning that, in addition to the artistes’ and sportsmen’s salaries for their personal performance, the profits of the (separate) legal entity were also taxable in the country of performance. Thus, even if it did not have a permanent establishment in the source country, a separate production company or legal entity could be taxed in that country, although it was not itself performing as an artiste or sportsman. The Committee realized that the original intention of Article 17(2) in 1977 was different, but decided in favour of a reversal to the unlimited approach.<sup>55</sup> No further arguments were given to support this reversal.<sup>56</sup>

### 2.12.3. Gross taxation, no deduction of expenses, appropriate tax rate

The 1987 OECD Report also discussed the deduction of expenses from the performance income in the source country, because “Article 17 says

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52. Paragraph 15 of the 1987 OECD Report.

53. Paragraphs 16 and 17 of the 1987 OECD Report.

54. Paragraph 61 of the 1987 OECD Report.

55. Paragraph 89 of the 1987 OECD Report; see also Dick Molenaar and Harald Grams, “Rent-A-Star – The Purpose of Article 17(2) of the OECD Model”, 56 *Bulletin for International Fiscal Documentation* 10 (2002).

56. It should be noted that Canada and the United States kept their reservations to this element of Article 17(2) and that Switzerland also added this reservation per 1992.

nothing about how the income in question is to be computed”. The report concluded that some countries “provide for taxation at source at an appropriate rate based on the gross amount paid to artistes and athletes”, but did not want to interfere with these national tax rules: “it is for a Contracting State to determine the extent of any deductions for expenses”.<sup>57</sup>

Can this be considered as an OECD position supporting gross taxation? Not from the text, because the OECD left this issue to its Member countries. But the lack of a position in the 1987 OECD Report might have been the reason why many countries have changed their artiste taxation rules over the years into gross taxation without allowing the deduction of expenses. Unfortunately, this gross taxation often leads to excessive taxation internationally because the effective tax rate in the source country is too high for a full tax credit/exemption in the home country and because, with the flat and final source tax, non-resident artistes and sportsmen are, in most cases, taxed more heavily in the source country than its normal residents are.<sup>58</sup>

Furthermore, and importantly for purposes of this chapter, it is unclear how this gross taxation at source relates to the earlier expression in the 1987 OECD Report that the *profit* of a legal entity can be taxed.<sup>59</sup> Using the word “profit” assumes that expenses would be deductible. And the gross taxation also seems to be contrary to another earlier expression in the 1987 OECD report, stating that the income from entertainment and sporting activities should be taxed in the same way as income from any other activities.<sup>60</sup>

### 2.12.4. Tentative conclusions, suggested improvements

The Committee was honest in its conclusions in the 1987 OECD Report when it stated that the difficulties in effectively taxing artistes and sportsmen had led to tentative recommendations.<sup>61</sup> It is beyond doubt that an unlimited taxable base for active income without any exceptions for

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57. Paragraph 94 of the 1987 OECD Report.

58. See Dick Molenaar, “Obstacles for International Performing Artists”, 42 *European Taxation* 4 (2002), at 149.

59. Paragraph 89 of the 1987 OECD Report.

60. Paragraph 14 of the 1987 OECD Report.

61. Paragraph 105 of the 1987 OECD Report.

persons or deductions is without parallel in the tax world.<sup>62</sup> What have artistes (and sportsmen) done to deserve this treatment?

In its final paragraphs, the 1987 OECD Report suggested improvements, especially in the exchange of information and assistance in collection. The Committee recommended that Member countries should “make a more intensive use of such exchanges, either upon request, or preferably spontaneously, when tax authorities of a Contracting State come to learn that some of their residents are about to visit the other State, or when a resident of that State has performed services in the first-mentioned State”. But this exchange of information was mainly to be used to track missing tax earnings, because “in the absence of effective exchanges, income of artistes and athletes is likely to go very lightly taxed, or not even taxed at all when exemption is provided for in the State of performance”.<sup>63</sup>

Unfortunately, this part of the 1987 OECD Report also paid attention only to the possibility of undertaxation and did not initiate a discussion about the possible excessive taxation of international performing artistes.

### **2.13. Implementation in the Commentary to the 1992 OECD Model**

The 1987 OECD Report was implemented in the 1992 Commentary on Article 17 of the OECD Model, and the Commentary was adjusted in length and content. In the years after 1992 some (minor) adjustments have been made to the Commentary, leading to the text of the current Commentary.

Six main elements from the 1987 OECD Report have been transferred to the 1992 Commentary on Article 17 of the OECD Model:

- (1) Paragraphs 3 and 4: a clearer definition of the term “artiste”.<sup>64</sup> This will be further discussed in chapter 3 of this thesis.

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62. Gross taxation is quite normal for passive income, such as royalties, dividends and interest.

63. Paragraphs 106-109 of the 1987 OECD Report.

64. Coming from Paragraphs 67-69 of the 1987 OECD Report.

- (2) Paragraph 7: the income received by impresarios stays outside the scope of Article 17.<sup>65</sup> This will be further discussed in chapters 3 and 4 of this thesis.
- (3) Paragraph 9: performance fees are treated differently from royalties, but special attention is needed for sponsorship and advertising fees.<sup>66</sup> This will be further discussed in chapters 3 and 4 of this thesis.
- (4) Paragraph 10: the approval of gross taxation.<sup>67</sup> In the Commentary this is linked to a “low” tax rate, instead of the “appropriate” tax rate that was mentioned in 1987 OECD report. Countries seem to interpret this in practice as a 15%-25% withholding tax rate. This is much higher than the mere 3% that Richard Doernberg suggests for gross source taxation on the royalties from electronic commerce, where business expenses also seem to play an important role.<sup>68</sup>
- (5) Paragraphs 8 and 11: the reversal from the limited to the unlimited approach of Article 17(2). First, under Article 17(1) a “look-through” approach for payments to third parties is mentioned.<sup>69</sup> But, secondly, with many countries not being able to look through legal entities the specific tax right under Article 17(2) on the profits of persons other than artistes has been extended.<sup>70</sup>

Paragraph 11 of the Commentary gives three examples for the use of Article 17(2). The third illustration (Paragraph 11(c)) mentions the original and limited purpose of Article 17(2): to counteract tax avoidance schemes. In the first two illustrations, the unlimited

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65. From Paragraph 73 of the 1987 OECD Report.

66. From Paragraphs 77-82 of the 1987 OECD Report.

67. From Paragraph 94 of the 1987 OECD Report.

68. Richard L. Doernberg, Luc Hinnekens, Walter Hellerstein and Jinyan Li, *Electronic Commerce and Multijurisdictional Taxation* (Kluwer Law International, The Hague, 2001).

69. E.g. the United Kingdom and Germany tax the performance income of artistes as personal earnings, regardless of whether the payment has been made to an independent or related third party. The text of Article 17(1) is not explicitly clear in its wording, so these countries can allow their national tax rules to prevail, whether or not they refer to Art. 3(2) of the OECD Model Tax Convention. See Klaus Vogel, “Künstlergesellschaften und Steuerumgehung”, *Steuer und Wirtschaft (StuW)* 3/1996, at 248.

70. E.g. Belgium does not have the national right to look through a legal structure. See *Bericht van de belastingadministratie voor de inrichters van optredens door podiumkunstenaars*, 25 April 1997 and Philip Hinnekens, “Buitenlandse artiestenvennootschappen: kritiek”, *Fiskoloog Internationaal* 162, 31 May 1997, at 6.

approach that made payments to all third parties for the performance of artistes taxable under Article 17(2) was added.

- (6) Paragraph 14: more explicitly than before this paragraph allows countries to agree an exception to Article 17 for (cultural) events that are supported from public funds. The paragraph also gives a text proposal for applicable situations.<sup>71</sup> See 5.5. for an overview of the use of “Article 17(3)”.

Canada, Switzerland and the United States registered their reservations to the unlimited approach of Article 17(2).<sup>72</sup> Their opinion is that Article 17(2) should apply only to the cases mentioned in Paragraph 11(c), i.e. “rent-a-star” constructions.

### 2.14. The limited approach in the 1996 US Model

#### 2.14.1. Article 17 for artistes and sportsmen

The United States issued a new Model Income Tax Convention in 1996, replacing the 1981 Model. In general, the 1996 US Model differs from the OECD Model, because it is not only based on the OECD Model and its Commentaries as they existed in 1995, but also on the withdrawn 1981 US Model, on existing US tax treaties, recent negotiating experience, current US tax laws and policies, and the opinion of tax practitioners and other interested parties.<sup>73</sup>

Regarding the taxation of non-resident artistes (and sportsmen), there are remarkable differences between the OECD Model and the 1996 US Model. Article 17 of the 1996 US Model provides:

#### Article 17

1. Income derived by a resident of a contracting State as an entertainer, such as a theatre, motion picture, radio, or television artiste, or as a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, which income would be exempt in the other Contracting State under the provisions of Article 14 (Independent Personal Services) and

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71. From Paragraph 98 of the 1987 OECD Report.

72. Paragraph 16 of the 2003 Commentary on Article 17.

73. Paragraph 2 of the Technical Explanation to the United States Model Income Tax Convention of 20 September 1996.



Article 15 (Dependent Personal Services) may be taxed in that other State, except where the amount of the gross receipts derived by that entertainer or sportsman, including expenses reimbursed to him or borne on his behalf, from such activities does not exceed twenty thousand United States dollars (\$20,000) or its equivalent in the currency of the Contracting State for the taxable year concerned.

2. Where income in respect of activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income, notwithstanding the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services), may be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised, unless it is established that neither the entertainer or sportsman nor persons related thereto participate directly or indirectly in the profits of that other person in any manner; including the receipt of deferred remuneration, bonuses, fees, dividends, partnership contributions, or other distributions.

With this wording, the United States puts into practice both its observation on and its reservation to Article 17 of the OECD Model, as mentioned in the 1977 Commentary, the 1987 OECD Report and the 1992 Commentary.

### 2.14.2. The *de minimis* rule in Article 17(1)

First, the *de minimis* rule of USD 20,000 gross earnings per person per year catches the eye. This rule applies when earnings remain below this amount during a taxable year, but when earnings exceed the amount the full fee becomes taxable in the country of performance. Reimbursed expenses and expenses borne on behalf of the artiste need to be included in the earnings. This is more than the gross artiste fee in money terms, because hotels, flights, travel, meals, drinks, etc. also qualify for inclusion. This does not seem strange, because very often in practice an artiste contract offers not only just money, but also free accommodation, travel and food. But unfortunately the reach of the clause “expenses borne of behalf of the artiste” is unclear. What about sound and light equipment (rental), the accompanying orchestra, security to protect top stars, venue rent, posters, ticketing? The artiste often receives a percentage of the ticket sales when he exceeds his guaranteed fee, and is therefore involved with all the local production expenses. Do these (huge) expenses also qualify for the requirement of the Article 17(1) *de minimis* rule?

The Technical Explanation of the 1996 US Model just gives a vague explanation in Paragraph 226:

[226] The OECD Model provides for taxation by the country of performance of the remuneration of entertainers and sportsmen with no dollar or time threshold. The United States introduces the dollar threshold test in its treaties to distinguish between two groups of entertainers and athletes – those who are paid very large sums of money for very short periods of services, and who would, therefore, normally be exempt from host country tax under the standard personal services income rules, and those who earn relatively modest amounts and are, therefore, not easily distinguishable from those who earn other types of personal service income. The United States has entered a reservation to the OECD Model on this point.

Unfortunately, this explanation does not clearly give the motives behind the introduction of this *de minimis* rule. In practice it allows lesser and medium-ranking artistes, who have more than average expenses while on tour, to avoid difficult discussions in the country of performance about the deductibility of their expenses. The calculation of the profits from a foreign tour can normally be settled in their own national annual accounts and brought within the scope of domestic income tax. A loss, if any, can be normally be offset against other positive income items.

For bigger artistes the idea behind the *de minimis* rule seems to be that the United States wants a share of the income from their performances, even when they stay in the United States for only a short period and do not have a permanent establishment there. Perhaps this reflects a combination of the contribution and anti-avoidance arguments, as discussed in 2.1. of this thesis, although this is not specified in the text of Paragraph 226 of the Technical Explanation.

Not all the American tax treaties contain an amount of USD 20,000. This amount seems to differ with the size of the country that is contracting a double tax treaty with the United States; see 5.6.2. for a complete picture of US tax treaties.<sup>74</sup>

The provision about the equivalent of USD 20,000 (or less) in the foreign currency is not so clear in the 1996 US Model Tax Convention. The exchange rate with the US dollar can fluctuate over a year and what exchange rate is then applicable? Some US tax treaties, like the 1992 treaty with the Netherlands, have solved this problem by stating that the

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74. For a complete picture of the *de minimis* rule in the US treaties, see 5.6.2.

equivalent in Dutch currency is set at the exchange rate of 1 January of the taxable year.

When Article 17 does not apply because of the *de minimis* rule, another treaty article can apply. This can be Article 14 (Independent personal services) when the artiste has a fixed base in the country of performance, or Article 15 (Dependent personal services), when the artiste is employed by a company in the country of performance.

Very often it will be unclear until the year-end whether the income of the artiste from performances in the foreign country will exceed the USD 20,000 limit. Countries can therefore decide to use a withholding tax on the artiste's income during the taxable year and make a refund after the year-end if the threshold has not been exceeded.<sup>75</sup>

### 2.14.3. The limited approach in Paragraph 2

Secondly, the United States has chosen to follow the limited approach to Article 17(2), which means that only tax avoidance schemes are confronted. The United States is not impressed by the reversal in the 1987 OECD Report and the 1992 OECD Commentary to the unlimited approach. Separate legal entities with normal employer-employee relationships fall outside the scope of Article 17(2) of the US Model, although the salaries of the artistes/employees remain taxable in the source country under Article 17(1) of the US Model. Separate legal entities fall under Article 7 and cannot be held taxable in the source country if they do not have a permanent establishment there.<sup>76</sup>

[235] Paragraph 2 seeks to prevent this type of abuse while at the same time protecting the taxpayers' rights to the benefits of the Convention when there is a legitimate employer-employee relationship between the performer and the person providing the services. Under paragraph 2, when income accrues to a person other than the performer, and the performer or related persons participate, directly or indirectly, in the receipts or profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 14). Thus, even if the "employer" has no permanent establishment or fixed base in the host country, its income may be subject to tax there under the

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75. Technical Explanation of the 1996 US Model, Paragraph 228.

76. Technical Explanation of the 1996 US Model, Paragraphs 233-239.

provisions of paragraph 2. Taxation under paragraph 2 is on the person providing the services of the performer. This paragraph does not affect the rules of paragraph 1, which apply to the performer himself. The income taxable by virtue of paragraph 2 is reduced to the extent of salary payments to the performer, which fall under paragraph 1.

The Technical Explanation also explains whether there is a connection between the limitation of Paragraph 2 and the *de minimis* rule of Paragraph 1. When a payment to an independent third party is not taxable in the country of performance, does this payment still have to be added to the income of the individual artiste as “expenses reimbursed to him or borne on his behalf”, before applying the *de minimis* rule of USD 20,000 (or lower in some tax treaties)? The last sentence of Article 237 of the Technical Explanation makes it clear that this is not the case:

[237] Paragraph 2 does not apply if it is established that neither the performer nor any persons related to the performer participate directly or indirectly in the receipts or profits of the person providing the services of the performer. Assume, for example, that a circus owned by a US corporation performs in the other Contracting State, and promoters of the performance in the other State pay the circus, which, in turn, pays salaries to the circus performers. The circus is determined to have no permanent establishment in that State. Since the circus performers do not participate in the profits of the circus, but merely receive their salaries out of the circus' gross receipts, the circus is protected by Article 7 and its income is not subject to host-country tax. Whether the salaries of the circus performers are subject to host-country tax under this Article depends on whether they exceed the \$20,000 threshold in paragraph 1.

### 2.14.4. Extensive use in the various US tax treaties

The bilateral tax treaties concluded by the United States with various countries usually include Article 17 of the US Model, with both the *de minimis* rule of Paragraph 1 and the limited approach of Paragraph 2. Paragraphs 5.1. and 5.6.2. will show that of the 49 US tax treaties that contain an artiste article such as Article 17 of the 1996 US Model, 46 have the *de minimis* rule (= 94%) and 37 have a limited Paragraph 2 (= 86%).

Other countries use both restrictions only rarely in their tax treaties, which might lead to the conclusion that the contracting partners of the United

States seem to be more convinced by the arguments of the 1996 US Model than by those of the OECD Model.<sup>77</sup>

### 2.15. Discussion after the 1987-1992 changes

#### 2.15.1. Publications in the early years after the 1992 implementation

The reversal of Article 17(2) of the OECD Model did not cause much disturbance in the tax world in the early years after 1992. Short comments were written in 1992 by Lüthi, Kolb and Stiefel<sup>78</sup> and Long and Tyrrell,<sup>79</sup> but they only explained the change to the Commentary in a technical manner.

#### 2.15.2. Book by Daniel Sandler and IFA Congress in 1995

Much more attention was paid to the subject in 1995 by Daniel Sandler in his book on artistes and sportsmen<sup>80</sup> and at the 1995 IFA Congress in Cannes.<sup>81</sup>

Daniel Sandler explained in his book that artistes and sportsmen are among the most mobile individuals in the business world. But he also believes that the concern about the collection of tax from non-resident artistes and sportsmen is not unique and asks why the different treatment is not also applicable to others, such as architects, engineers, contractors, models, film directors. The purpose of his study was to review taxation by source countries, not taxation by the residence countries of the artistes and sportsmen. He studied the tax systems for non-resident artistes and sportsmen in seven countries: Australia, Canada, France, Germany, Japan, the United Kingdom and the United States. Not only direct performance

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77. This could, however, also reflect the United States' negotiating position.

78. Daniel Lüthi, Andreas Kolb and Christian Stiefel, "The Revision of the 1977 OECD Model Convention – an Overview", 19 *Intertax* 653 (1992).

79. Yves Long and Patrick Tyrrell, "Taxation of Employees, Artistes and Sportsmen (Articles 15 and 17)", 19 *Intertax* 688 (1992).

80. Daniel Sandler, *The Taxation of International Entertainers and Athletes – All the World's a Stage* (Kluwer Law International, The Hague, 1995).

81. IFA, "Taxation of Non-Resident Entertainers", 49th IFA Congress, Cannes, France; *Cahiers de droit fiscal international*, Vol. 20d (Kluwer Law International, The Hague, 1995).

income, but also sale of “concert paraphernalia” (merchandising) and royalties for record sales were discussed. He recognized the issue of the deduction of expenses, but preferred a high withholding tax from the gross income of non-resident artistes to avoid undertaxation. Countries could permit the filing of a normal income tax return at the end of the year.

Daniel Sandler acknowledged that double taxation was possible because with Article 17(2) income could be taxed in the hands of both the artiste (source) and the company (residence). He also recognized that the vast majority of international artistes and sportsmen do not live the nomadic life which was explained in the 1987 OECD Report.

At the end of his book Daniel Sandler came up with alternatives to the current system of taxation of non-resident artistes and sportsmen. He mentioned that Article 17 could be abolished, but only with other measures to counteract tax avoidance behaviour. He also suggested that Article 14 for self-employed persons could be abolished and that the scope of Article 17 could be expanded to include all individuals performing professional services. He recommended adding an anti-treaty shopping provision to the OECD Model Tax Convention, saying that the condition for a tax exemption in the source country had to be that the income was subject to tax in the residence country.

The 49th IFA Congress in Cannes in 1995 organized a seminar on the “Taxation of Non-Resident Entertainers”. The chairman was Jürgen Kilius (Germany) and the other panellists were Stephane Carrère (France), Richard Dukes (Australia), Toshio Miyatake (Japan), Daniel Sandler (Canada) and Alfonso Trivoli (Italy). Daniel Sandler gave an introduction to the subject, which was very much in line with the book that he had published in the same year. He explained his preference for source taxation for non-resident artistes and sportsmen, but also suggested that the source country could pay a portion of the withheld tax to the residence country. He asked for harmonization of the tax rules in the various countries, because the differences in treatment led to distortion of competition. And he did not believe that non-resident artistes and sportsmen made sufficiently more use of the facilities in source countries than other non-residents to justify a special source taxation.

The panellists explained the tax rules in their countries. At the end they discussed some examples of artistes and sportsmen performing outside their residence country. Some panellists (e.g. Trivoli) believed that artistes

and sportsmen were better off than other taxable persons, because their tax rates were lower than the normal marginal tax rates, while others argued (e.g. Kilius) that it was not unlikely that artistes paid more taxes than ordinary residents.

### 2.15.3. Rijkele Betten and Marco Lombardi on triangular situations in 1997

The interesting issue of triangular situations was discussed by Rijkele Betten and Marco Lombardi in 1997.<sup>82</sup> This article will further be discussed in 5.7.3.

### 2.15.4. Harald Grams on the German artistes tax rules in 1999

Harald Grams published his doctoral thesis on the German artiste tax system in 1999.<sup>83</sup> He explained the origin of the German system, gave a good overview of the current set of German tax rules and criticized these comprehensively, not only from the German point of view but also from the perspective of the European Community. His conclusions were that the German tax rules for non-resident artistes led to unequal treatment and should be changed.

### 2.15.5. Decision by the Tax Court of Canada

On 7 December 1999, the Tax Court of Canada decided the case of *Sumner (a.k.a. Sting) v. The Queen* (the Canadian tax administration).<sup>84</sup> The artiste, who was a resident of the United Kingdom, performed in the United States and Canada in 1991, and his performance fee was paid partly via a Dutch company Wyneco BV to Roxanne Inc., a Delaware company. The artiste was entitled to 95% of the profits of Roxanne Inc. In Canada, he declared only his fixed salary for the performances, and he maintained that the

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82. Rijkele Betten and Marco Lombardi, "Article 17(2) of the OECD Model in Triangular Situations", 51 *Bulletin for International Fiscal Documentation* 12 (1997), at 560.

83. Harald Grams, *Besteuerung von beschränkt steuerpflichtigen Künstlern* (Verlag Neue Wirtschafts-Briefe, Herne/Berlin, 1999).

84. *Gordon Sumner, Roxanne Inc. v. The Queen*, 7 December 1999, 2000 D.T.C. 1667, [2000] 2 C.T.C. 2359.

profits of Roxanne Inc. were not taxable in Canada because of its tax treaty with the United States.

The Court referred to the 1984 Technical Explanation of Article XVI(2) of the 1980 United States–Canada treaty and to the 1992 Commentary on Article 17(2) of the OECD Model and ruled that Canada had the right to tax an appropriate part of the artiste’s salary and of the company’s profits from the tour.<sup>85</sup>

This can be seen as a decision in a typical “rent-a-star company” case for which Article 17(2) was inserted in 1977.<sup>86</sup>

### 2.15.6. General criticism of Article 17

In 1999, Harald Grams opened a new discussion about the need for Article 17 of the OECD Model.<sup>87</sup> He stressed the practical difficulties that arise from the existence of Article 17 in bilateral tax treaties and the severe national artiste tax rules. He made a comparison with the international treatment of royalties and advised changing Article 17 into a provision like Article 12, together with an exemption procedure in the source country.

This criticism was echoed by Joel Nitikman in 2001,<sup>88</sup> who first explained the history of non-resident artiste taxation in the United States and secondly put forward the opinion that Article 17 might be unconstitutional in Canada. Nitikman followed the suggestion made by Grams and called for the deletion of Article 17 OECD.

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85. With the artiste Gordon Sumner (a.k.a. Sting) being a resident of the United Kingdom and Roxanne Inc. being a resident of Delaware, United States, this seems to be a triangular situation for treaty interpretation. See 5.7. for a discussion of triangular situations.

86. A comparable classic case was about the place of residence of the Italian opera singer Luciano Pavarotti, who claimed to live in Monaco (Carmine Rotondaro, “The Pavarotti Case”, 40 *European Taxation* 8 (2000), at 385).

87. Harald Grams, “Artist Taxation: Article 17 of the OECD Model Treaty – a Relic of Primeval Tax Times?”, 27 *Intertax* (1999), at 188.

88. The article was published twice, as Joel Nitikman, “Article 17: An argument for repeal”, *International Tax Review*, June 2001, and “Article 17 of the OECD Model Treaty – An Anachronism?”, 29 *Intertax* (2001), at 268.



### 2.15.7. Taxation of payments to “star companies” in Spain

In 2001, Prof. Dr Vogel described the reversal of the taxation of artistes and sportsmen in Article 17(2) in the context of the September 2000 decision of the Central Economic and Administrative Court of Spain.<sup>89</sup> In that case, a Dutch company loaned out an artiste for several concerts in Spain. The artiste earned a salary for his performances, and the company received compensation for the contractual rights to publish pictures and use the name of the artiste. The Court ruled that the latter part of the payments did not constitute royalties (as the organizer argued), but was additional compensation for the personal activities of the artiste.

Article 18 of the Spain–Netherlands tax treaty (corresponding to Article 17(1) of the OECD Model) does not have a second paragraph because the treaty was concluded in 1971, years before the introduction in 1977 of Article 17(2) of the OECD Model. In earlier cases, the Spanish Court had decided not to look through the foreign entity, but to apply Article 7, which meant that the profits of the foreign company were not taxable in Spain since the company did not have a permanent establishment there. With its September 2000 decision, the Court drastically reversed its earlier opinion and interpreted Article 18 of the treaty as if it were identical to the entire Article 17, e.g. including Article 17(2), of the later OECD Model. Prof. Vogel argued that this went beyond the ordinary rules of interpretation because the contracting states in 1971 could not have intended a rule identical to Article 17(2) to apply. According to Prof. Vogel, the Court should have examined more closely who the owner of the Dutch company was and the business reasons for the transfer of the rights to the company. A tax avoidance scheme could have justified the Court’s reversal.<sup>90</sup>

### 2.15.8. Taxation of non-resident artistes’ income in Finland

A short article in 2001 described the decision of the Supreme Administrative Court of Finland of 29 January 2001.<sup>91</sup> In that case, a Dutch production company was contracted by a Finnish promoter for a

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89. Klaus Vogel, “Taxation of payments to ‘star companies’ in Spain”, in: “Tax Treaty News”, 55 *Bulletin for International Fiscal Documentation* 8 (2001), at 319.

90. See also Angel J. Juárez, “Limitations to the Cross-Border Taxation of Artistes and Sportsmen under the Look-Through Approach in Article 17(1) of the OECD Model Convention”, 43 *European Taxation* 11 (2003), at 416.

91. Rytöhonka, Risto, “Finland: Taxation of Non-Resident Artists’ Income”, 41 *European Taxation* 9 (2001), at 344.

large-scale opera production in Helsinki. The Dutch company employed the performing artistes, who had no share in the profits of the Dutch company. The 1995 Finland–Netherlands tax treaty follows the OECD Model and contained the full text of Article 17 (i.e. Article 17(1) and (2)). The Court ruled that only that part of the total fee that corresponded to the payments to the performing artistes for their personal activities was taxable in Finland. The rest of the performance fees, production expenses and profits of the Dutch company were taxable in the Netherlands, not in Finland. In this decision, the Court used the older limited approach to Article 17(2) and did not follow the reversal in the 1992 Commentary on Article 17 of the OECD Model, even though the tax treaty was concluded in 1995.

### 2.15.9. 2001 IFA Congress in San Francisco

At the IFA Congress in San Francisco in October 2001, a joint IFA/OECD Seminar (Seminar B) was held on the effect on treaty interpretation of OECD Commentaries that are adopted after the conclusion of a treaty.<sup>92</sup> Four hypothetical cases were presented and discussed by five panel members. The third case was about entertainers and described the position of Armoury, a company resident in State R, which owned a professional football club. In 2001, Armoury entered into a contract by which its team would play two exhibition games in State S for a very large amount of money.

The dispute was whether Article 7 of the State R–State S treaty prevented State S from taxing the performance income or whether Article 17(2) allowed State S to tax the full income. The treaty had been concluded in 1985 and followed the existing OECD Model. After the 1987 OECD Report, State S changed its domestic law in 1988, making it possible for it to tax all foreign companies deriving income from sporting and artistic events taking place in State S. Before 1988, this would have been possible only for star companies; this did not apply to Armoury because the football players were not shareholders of the company.

State R was one of the three countries referred to in Paragraph 16 of the 1992 Commentary on Article 17 of the OECD Model.

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92. Summarized in Avery Jones, John, “The Effect of Changes in the OECD Commentaries after a Treaty is Concluded”, 56 *Bulletin for International Fiscal Documentation* 3 (2002), at 102.

Of the panellists, Jacques Sasseville (OECD) took the position that the full performance fee was taxable in State S. He referred to the Canadian case *Sumner v. the Queen* (see 2.15.5.), in which the Tax Court of Canada accepted the 1992 reversal in the Commentary on Article 17 (after the 1987 OECD Report) in connection with a 1980 treaty. The Court found that Article 17(2) allowed taxation of both the artiste and the company.

Michael Lang (Vienna University of Economics and Business Administration) followed the wording of Article 17(2) and concluded that there were no restrictions on specific activities or persons. He also concluded in favour of taxing the full performance fee in State S.

Philippe Martin (*Conseiller d'Etat*, France) thought that Armoury (the taxpayer) should win. The purpose and object were always useful in case of doubt and even when the words appear clear, if the result would be unreasonable or absurd. The 1977 Commentary on Article 17 had a clear statement of the purpose of Article 17(2), excluding companies such as Armoury from taxation in the source state.

Richard Vann (University of Sydney) was of the opinion that the taxpayer should lose because of the clear wording of Article 17(2). The 1992 Commentary could be used to show that the previous interpretation in the 1977 Commentary was incorrect.

Dr John Avery Jones finally concluded that the taxpayer should win because the older 1977 Commentary should apply to a treaty that was concluded in 1985.

The panellists did not discuss the effect of the observation on Article 17(2) that State R had made in the 1992 Commentary.

The discussion led to a two-to-three result for the exhibition games in favour of the unlimited approach of Article 17(2).

### 2.15.10. Obstacles for international performing artistes

In 2002, the author published an article about the obstacles that many international artistes experience when performing in countries where they

are not resident.<sup>93</sup> These obstacles mainly arise because of the non-deductibility of expenses in the country of performance. The article gives calculations of excessive international taxation together with figures from a survey about the production expenses of performing artistes and tests the existing gross withholding tax rates against normal income tax rates. It also started a discussion about unequal treatment under the European Treaty.<sup>94</sup> The article gives a new view on the issue of artiste taxation by focusing on the majority of performing artistes, who cannot be considered top stars who try to escape from reasonable taxation, but are the normal next-door neighbour kinds of artistes, suffering from the overkill of the strict anti-avoidance measures of Article 17 of the OECD Model.

### 2.15.11. Jörg Holthaus in Germany

Also in Spring 2002, the German author Jörg Holthaus, working with the tax administration in Münster, wrote an article about the tax problems of performing artistes (and sportsmen).<sup>95</sup> His article criticized the unlimited approach of Article 17(2), after which not only the salaries of the artistes/employees but also the profit of the artiste company is taxable. He recommended changing the tax treaties so that Article 15(2) for employees had preference over Article 17, which would effectively make only self-employed artistes taxable in the country of performance.

### 2.15.12. Rent-a-star – the object and purpose of Article 17(2)

Also in 2002, the author published together with Harald Grams an article about the historical development of Article 17(2) and the excessive taxation that results from the reversal into the unlimited approach.<sup>96</sup> The article discusses the history of non-resident artiste taxation, as repeated

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93. Dick Molenaar, “Obstacles for International Performing Artists”, 42 *European Taxation* 4 (2002), at 149.

94. The later *Arnoud Gerritse* decision of the European Court of Justice (12 June 2003, C-234/01) will be discussed in 11.4., together with other pending cases before the ECJ.

95. Jörg Holthaus, “Besteuerung international tätiger nichtselbständiger Berufssportler und Künstler: Ein totgeschwiegenes Problem der Umsetzung der Regelungen der DBA in der Praxis”, *Internationales Steuerrecht* 18/2002, at 633.

96. Dick Molenaar and Harald Grams, “Rent-A-Star, The Purpose of Article 17(2) of the OECD Model Treaty”, 56 *Bulletin for International Fiscal Documentation* 10 (2002), at 500.

and extended in the earlier paragraphs of this chapter, calculates the tax problems for tax-exempt theatre groups and orchestras and shows the administrative inefficiencies in the country of residence for artistes/employees. The proposal to make radical changes to Article 17 of the OECD Model was also put forward.

### 2.15.13. The *Arnoud Gerritse* decision by the European Court of Justice

On 12 June 2003 the European Court of Justice (ECJ) decided that the main aspects of the German non-resident artiste tax rules were in breach of the freedom principles of the European Treaty. The ECJ was asked to answer the following question:<sup>97</sup>

Is there an infringement of Article 52 of the EC Treaty (now Article 43 EC) where, under Paragraph 50a(4), first sentence, point (1) and second sentence, of the Einkommensteuergesetz (Law on Income Tax) as in force in 1996 (EStG 1996), a Netherlands national who earns in the Federal Republic of Germany taxable net income of approximately DM 5,000 (approx. EUR 2,500) from self-employed activity in the calendar year is subject to deduction of tax at source by the person liable to pay his fees at the rate of 25% of his (gross) revenue of approximately DM 6,000 (approx. EUR 3,000) plus solidarity charge, where it is not possible, by means of an application for a refund or an application for a tax assessment, for him to recover, in whole or in part, the taxes paid?

The answer by the ECJ was twofold:

1. Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and Article 60 of the EC Treaty (now Article 50 EC) preclude a national provision such as that at issue in the main proceedings which, as a general rule, takes into account gross income when taxing non-residents, without deducting business expenses, whereas residents are taxed on their net income, after deduction of those expenses;
2. However, those articles of the Treaty do not preclude that same provision in so far as, as a general rule, it subjects the income of non-residents to a definitive tax at the uniform rate of 25%, deducted at source, whilst the income of residents is taxed according to a progressive table including a tax-free allowance, provided that the rate of 25% is not higher than that which would actually be applied to the person concerned, in accordance with the progressive

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97. *FG Berlin*, 28 May 2001, 9 K 9312/99, *Internationales Steuerrecht* 14/2001, at 443.

table, in respect of net income increased by an amount corresponding to the tax-free allowance.

In short, two decisions were made, namely:

- (1) deduction of expenses needs to be possible; and
- (2) final income tax settlement needs to be allowed when the income tax rates are lower than the withholding tax rate.

The decision is not only important for Germany, but also for other EU Member States, because – with the exception of the United Kingdom and the Netherlands – none of the countries complies with the (new) rules of the ECJ. The decision has direct effect in all EU Member States, but can also influence other countries and even Article 17 of the OECD Model Tax Convention, because e.g. the first answer by the ECJ with respect to the deduction of expenses explicitly questions the legitimacy of Paragraph 10 of the Commentary on Article 17.

Many articles have been published about the *Arnoud Gerritse* case, initially by the author and Harald Grams,<sup>98</sup> but later also by other authors.<sup>99</sup> The decision may affect other taxes on gross earnings, such as royalties and dividends, in EU countries.<sup>100</sup>

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98. E.g. Harald Grams and Dick Molenaar, “Diskriminierender Besteuerung ausländischer Künstler (Gerichtshof von Amsterdam)”, *Internationales Steuerrecht* 12/2002, at 420; Dick Molenaar and Harald Grams, “The *Arnoud Gerritse* Case of the European Court of Justice”, 31 *Intertax* 5 (2003), at 198; Dick Molenaar en Harald Grams, “Artists and Sportsmen after the *Arnoud Gerritse* Decision”, 43 *European Taxation* 10 (2003), at 381.

99. E.g. Eva Burgstaller and Walter Loukota, “Der Steuerabzug beschränkt Steuerpflichtiger – Welche Konsequenzen hat der EuGH-Fall *Gerritse*?”, *SWI* 2003, at 244; Wilhelm Haarmann and Sven Fuhrmann, “Konsequenzen aus der EU-Rechtswidrigkeit der abgeltenden Abzugsbesteuerung auf Bruttobasis für beschränkt Steuerpflichtige innerhalb der Europäischen Union”, *Internationales Steuerrecht* 16/2003, at 558.

100. See also Luc Hinnekens, “European Court challenges flat rate withholding taxation of non-resident artist: comment on the *Gerritse* decision”, *EC Tax Review* 2003/4, at 207; CFE Opinion Statement on the Decision of the European Court of Justice, *Arnoud Gerritse v. Finanzamt Neukölln-Nord*, C-234/01, 44 *European Taxation* 4 (2004), at 184.

#### 2.15.14. Limited approach of Article 17(2) in Sweden

A very short article by Klaus Vogel describes the decision by Sweden's *Regeringsrätt* (Supreme Administrative Court) about the scope of Article 17(2) in the tax treaty between Sweden and the Netherlands.<sup>101</sup> A company resident in the Netherlands presented the show "Holiday on Ice" in Sweden, where artistes were taxed on their salaries in accordance with Article 17(1) of the tax treaty. In addition, the Swedish authorities wanted to tax, on the basis of Article 17(2), the entrance fees charged by the company. The Court decided that this paragraph, as it was intended to prevent tax avoidance by means of "artistes' companies", referred only to compensation paid for the activity of the artistes and sportsmen, not to the additional income derived by their employer through putting the activity on in public.

Klaus Vogel considers this decision correct. But it can also be seen as opposing the reversal of Article 17(2) to the unlimited approach as explained in 2.12. and 2.13., even though the Swedish authorities did not make any observations in the Commentary on Article 17 of the OECD Model Tax Convention with regard to the scope of Article 17(2).

#### 2.15.15. Angel Juárez, LLM in Leiden in 2003

The Spanish Angel J. Juárez published a comprehensive study of Article 17(1) in his final paper for the LLM degree at the International Tax Center in Leiden in 2003.<sup>102</sup> He explained that some countries did not use the extra clause of Article 17(2), because they were already with Article 17(1) able to tax the profit element of a third party involved with the performance. But he also defended the position that other countries needed Article 17(2) to counteract tax avoidance schemes. He mainly focused on France, the United Kingdom and Spain for a more in-depth comparison and also looked at the national rules from the perspective of the European Treaty. He concluded that double taxation was perfectly possible and

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101. Klaus Vogel, "Art. 17(2) Limited to Compensation for the Artistes' or Sportsmen Activity", 57 *Bulletin for International Fiscal Documentation* 10 (2003), at 475.

102. Angel J. Juárez, "Limitations to the Cross-Border Taxation of Artistes and Sportsmen under the Look-Through Approach in Article 17(1) of the OECD Model Convention", 43 *European Taxation* 11 (2003), at 409 (Part I); and 43 *European Taxation* 12 (2003), at 457 (Part II).

therefore recommended some amendments to the Commentary on Article 17 of the OECD Model.

### 2.15.16. Further publications

Other articles have been published recently, but they will be discussed in the following chapters:

- Dick Molenaar and Harald Grams, “How To Modernize Income Taxation of International Artistes and Sportsmen”, 33 *Tax Management International Journal* 4 (2004), at 238; and
- Dick Molenaar, “The illusions of international artiste and sportsman taxation”, in *A Tax Globalist – Essays in honour of Maarten J. Ellis* (IBFD, 2005), at 90.

## 2.16. General discussion and conclusions

Non-resident artiste taxation exists in most countries of the world. Some countries tax all the source income of non-residents, while other countries tax only some specific income items from their territory; but almost all countries have implemented a withholding tax on the performance income of non-resident artistes, either as a contribution to their budget or as a safety measure against tax avoidance.

There will also be taxation in the residence country, based on worldwide income. Without adequate relief for foreign tax liability, this would lead to double taxation.

Countries conclude bilateral tax treaties to allocate the taxing rights to specific income items. While one country gets the initial right to tax the income, the other country will either exempt the income, give a tax credit for the source tax or will be granted a secondary tax right or right of progression. With these tax treaties the risk of double taxation is reduced, but not always removed entirely. Besides the avoidance of double taxation, countries also try to meet other objectives with their tax treaties, such as the promotion of economic growth and the prevention of tax avoidance.

The first tax treaties go back to the late 19th century, but coordinated action took place under the authority of the League of Nations in the period 1920-1946. Tax treaties from that time did not contain a special



artiste tax clause, but treated artistes in the same way as other self-employed persons or employees. The first artiste clause can be found in the 1939 United States–Sweden tax treaty. Joel Nitikman has described the discussions in the US Senate about the draft of the treaty, of which the basic elements are still current. The artiste clause in the draft of the 1945 United States–United Kingdom treaty was rejected during the Senate discussion; but this was just an isolated incident and from 1951 onwards the United States (and many other countries) has concluded bilateral tax treaties with special provisions for artistes. These were different from each other: countries such as Germany had their own policies regarding the taxation of non-resident artistes.

Coordination by the OECD started with the 1963 Draft Model Tax Convention. This Draft contained a special artiste clause in Article 17, together with an official Commentary. Although this Commentary mentioned possible negative side effects, such as impediments to cultural exchange, OECD Member countries and non-members started following the recommendation of the OECD after 1963 and as far as possible inserted Article 17 without any reservation in their new tax treaties.

Article 17 was extended in the 1977 OECD Model Tax Convention with a second paragraph which made payments for performances to persons other than the artistes also taxable in the source country. The text of Article 17(2) was quite broad, but the Commentary limited the scope to the mere “rent-a-star” situations, where tax avoidance was the main objective.

A further extension took place with the 1987 OECD Report on artistes (and sportsmen). The report expressed mistrust, not only of entertainers but also of their managers, accountants and other advisers. It seems as if everyone was trying to evade taxation by claiming to live in tax havens or by not declaring foreign income in their home country. Although the report would basically prefer to follow the normal allocation rules, it gave preference to a special artiste (and sportsman) rule to “avoid practical difficulties”. But strangely enough the report also recommended widening the scope of Article 17(2) to the unlimited approach, meaning that for any payment to a person other than the artiste himself the country of performance would have full taxing rights, not only in “rent-a-star” situations.

The 1987 Report also discussed the deductibility of expenses. It purported to stay neutral, but unfortunately its position was taken by many countries

as a recommendation for gross taxation. At the end of the report it was admitted that the recommendations were tentative and suggestions were made for improvement, but they did not go further than a plea for better exchange of information and assistance in tax collection.

An important conclusion is that the 1987 Report only paid attention to possible undertaxation and did not initiate a discussion about the overtaxation resulting from the measures.

Most of the recommendations, such as the reversal to the unlimited approach for Article 17(2), were taken up in the renewed 1992 Commentary on Article 17. This led to a glaring contrast with the 1996 US Model and its Technical Explanation, which promoted the limited approach of Article 17(2), together with other measures, such as a *de minimis* rule for small artistes.

After these coordinated actions, discussion began in books, articles and court decisions about the reach and the necessity of international artiste taxation. Clear “rent-a-star” cases, limitation of Article 17(2), dynamic interpretation of tax treaties, triangular situations, obstacles to the free market in the European Union, examples of overtaxation and criticisms of the general allocation rule of Article 17 were put forward. This discussion is far from finished and will be continued in this study.