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## CHAPTER 4

### WHAT IS PERFORMANCE INCOME?

#### 4.1. Different types of (performance) income

When it has been decided that a person can be categorized as an artiste, the question arises of what income is taxable under the special artiste provisions. As in the wording of Article 17 of the OECD Model, what is the “*income* derived by an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, from his personal activities as such”? This description in Article 17 does not give a definition of the term “performance income” and leaves much room for interpretation. Some clarification has been provided in the Commentary on Article 17 of the OECD Model, based on a more in-depth discussion in the 1987 OECD Report. But for some types of income the description in Article 17 itself and the OECD explanations may not be sufficiently clear; in those situations, according to the interpretation rule of Article 3(2) of the OECD Model, the national tax rules of treaty countries will prevail.<sup>1</sup>

Various types of income are more or less related to the performance of an artiste; but when do they fall under the scope of Article 17 of the OECD Model?

Examples of the different types of income are:

- fees for the performance of the artiste himself;
- fees for rehearsals, studies, meetings, negotiations at home or in the country of performance;
- parts of performance fees that are attributable to rehearsals;
- compensation to the artiste for the production expenses of his performance;
- compensation to the artiste for agency fees and/or management commission;
- direct payment of production expenses and fees to third parties;
- inducement payments, such as retainers;
- cancellation fees and insurance cover;
- advertising and commercials;
- sponsorship;

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1. See also 3.1.

- endorsement by suppliers of equipment;
- subsidies;
- royalties for record or movie sales;
- tour support from record companies;
- publishing copyright;
- neighbouring copyrights;
- sales of merchandising; and
- pensions and other insurance benefits.

This chapter will give an overview of the scope of Article 17 of the OECD Model and discuss whether the various income items fall under other articles of the OECD Model Tax Convention, such as Article 7 (Business profits), Article 12 (Royalties), Article 15 (Income from employment) or Article 18 (Pensions). It will also make an inventory of some national tax rules and their possible conflict with tax treaties. In some situations double taxation or double non-taxation can be likely.

### **4.2. The Commentary on Article 17 of the OECD Model and the 1987 OECD Report**

The definition and description of taxable performance income has been the subject of commentary by the OECD. The early Commentaries on Article 17 did not contain any special paragraphs about the nature of the performance income. In the 1987 OECD Report,<sup>2</sup> based on 19 country submissions referring to the situation in 1986, eight paragraphs paid some attention to the different types of performance income. Two possible interpretations were discussed, a narrow and a broad one, and finally a general recommendation was given on how to decide which types of income could fall under more than one article of the OECD Model:

77. In view of the difficulties inherent in taxing artistes and athletes, who receive a large variety of types of income from different sources, from the viewpoint of double taxation, the first question which arises concerns the scope of Article 17, i.e. what types of income are, or may be, subject to its provisions.

78. One possible interpretation, the narrowest, is that only income deriving directly from an exhibition – normally in public or on television, in respect of live performances or of the first transmission of a recording – of the artistes' or athletes' talents falls under Article 17, and all other types of income should be

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2. "Taxation of Entertainers, Artistes and Sportsmen", in *Issues in International Taxation* No. 2 (OECD, Paris, 1987).

taxed in accordance with other relevant rules of the 1977 Model Convention. The argument advanced in support of this interpretation is that, subject to the provisions of Article 17, artistes and athletes should not in principle be taxed differently from those in other professions, whether self-employed or in dependent employment.

79. Thus, income derived from contracts for the reproduction of an artiste's work (for example, on record, cassette or video-cassette), being in the nature of a royalty, should be governed by Article 12 (cf. paragraph 13 of the Commentary on Article 12). Income from other independent personal services would come under Article 14. This would apply in particular to income from sponsorship and to remuneration received from commercial enterprises for using, and therefore promoting, sports equipment and clothing. As to business not expressly mentioned in Article 17, it would come under Article 7.

80. The contrary opinion is that the links which exist between the different activities of performers, the complexity of the contracts (often so-called package deals) governing the exercise of these activities, and the forms or payment received (frequently qualified as "royalties" for tax avoidance purposes) make it impossible for tax authorities to identify each of them separately, and since the payments are connected, they should all be brought within the scope of Article 17.

81. The Committee recognized that the complexity of such situations does indeed give rise to serious difficulties even though some of the problems were not specific to this area. It felt that resorting systematically to the solution proposed in paragraph 80 above would however render meaningless many of the provisions – in particular Articles 12 and 14 – dealing with other indirect income habitually received by artistes and athletes over and above monies paid as direct remuneration. Moreover, there will frequently be substantial administrative difficulties in taxing such indirect income in the country where the performance takes place, as contracts concluded with a firm in one country (for example, for advertising) will very often cover the exercise of activities throughout the world. The country where the performance takes place will frequently not be informed of the existence of such income and any apportionment of it (e.g. on the basis of the relation to a specific performance) would be problematic, with a risk of double taxation.

82. The Committee considered that it would not be appropriate to bring genuine royalties into the scope of Article 17. It was noted that the definition of "royalty" under Article 12 was rather restrictive and a number of countries would not consider advertising and sponsorship fees as royalty income. Countries would of course be able to check that what was described as royalty by the taxpayer really was a royalty in the meaning of Article 12: if it were not, then Article 17 might apply.

83. It was therefore agreed that, with regard to the application of Article 17, account should be taken of the extent to which the income was connected with the actual activity of the artiste and athlete in the country concerned. In general, Articles other than Article 17 would apply whenever there were no direct link between the income and a public exhibition by the performer in the country concerned. On the contrary, advertising and sponsorship income paid especially in connection with a performance (whether before or after the event) or a series of performances, would fall under Article 17.

84. Finally, it was agreed that compensation paid to an artiste and athlete when a performance had to be cancelled by the organizer came under Article 21 dealing with “other income”. Such compensation is therefore taxable only in the artiste’s or athlete’s country of residence.

This discussion unfortunately did not lead to a definition of the term “performance income”, but it made it clearer whether a broader or more restrictive explanation should be given to the term. The conclusion is that the OECD requires that “performance income” has a direct connection with a public appearance by the artiste in the performance country.

The 1987 OECD Report was inserted in a very condensed form in the 1992 Commentary, and the above recommendations were reduced to two paragraphs, giving the OECD Member countries the beginnings of a decision procedure for defining the performance income of non-resident artistes.<sup>3</sup> The text remains somewhat general, with just a few specific examples:

7. Income received by impresarios, etc. for arranging the appearance of an artiste or sportsman is outside the scope of the Article, but any income they receive on behalf of the artiste or sportsman is of course covered by it.

9. Besides fees for their actual appearances, artistes and sportsmen often receive income in the form of royalties or of sponsorship or advertising fees. In general, other Articles would apply whenever there was no direct link between the income and a public exhibition by the performer in the country concerned. Royalties for intellectual property rights will normally be covered by Article 12 rather than Article 17 (cf. paragraph 18 of the Commentary on Article 12), but in general advertising and sponsorship fees will fall outside the scope of Article 12. Article 17 will apply to advertising or sponsorship income, etc. which is related directly or indirectly to performances or appearances in a given State. Similar income which could not be attributed to such performances or appearances would fall under the standard rules of Article 7 or Article 15, as appropriate.

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3. According to the latest issue of the Commentary on Article 17 of the OECD Model.

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Payments received in the event of cancellation of a performance are also outside the scope of Article 17, and fall under Articles 7 or 15, as the case may be.

The Commentary gives a very brief description, which in actual practice is often not sufficient and causes problems in the allocation of the taxing rights of certain types of performance income to the appropriate country. There is a need for further definition from the OECD.

The clearer explanation of the term “performance income” in the 1987 OECD Report and the Commentary on Article 17 of the OECD Model gives interpretation guidelines for OECD Member countries. But the explanation is not comprehensive, which gives scope for the general interpretation rules of Article 3(2) of the OECD Model to be followed.<sup>4</sup>

### **4.3. Practical implications for different types of performance income**

#### **4.3.1. List of examples**

In 4.1. a list of examples of possible performance income was given. In this paragraph these examples will be examined along the lines of the 1987 OECD Report and the Commentary on Article 17 of the OECD Model, combined with the current opinions in the literature and court decisions.

At first glance, the extent to which a performance fee falls within the scope of Article 17 of the OECD Model looks quite obvious. But questions can still arise about elements of a specific performance fee.

#### **4.3.2. Performance fee versus rehearsal fee**

Any financial reward or remuneration for the actual performance of an artiste will fall under Article 17; the taxing right will be allocated to the country where the performance takes place.

But a separate fee for rehearsals, at home or in the country of performance, will very often not fall under the scope of artiste taxation because

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4. See 3.1. for a discussion of Article 3(2) of the OECD Model.

rehearsals are not meant to be listened to or watched by an audience.<sup>5</sup> This might be questioned for rehearsals for specific performances, because a direct link between the income and a public appearance of the artiste can be assumed. It very often happens that a rehearsal fee is not agreed upon separately, but is incorporated in the performance fee. Given that a few or many rehearsals are needed before an artistic or entertainment event, the question arises whether a part of the performance fee needs to be allocated to rehearsals and taken out of the taxable base.<sup>6</sup> Sometimes contracts specify a percentage or a fixed amount for rehearsals.

But because neither Article 17 nor the Commentary or the 1987 Report discusses the taxability of rehearsal income, countries need to apply their national tax rules and national tax courts need to follow their own reasoning before deciding whether or not rehearsal income falls under the non-resident artiste tax rules.

### 4.3.3. Production expenses for a performance

Very often the organizer of a performance does not pay one fixed amount to the artiste from which he pays all his production expenses, agency fees, management commission, etc., but agrees in a contract to pay the agent or manager of the artiste separately on an invoice, to hire the production personnel and equipment himself in his own local environment or to hire the production from a company based in a foreign country which tours with the artiste, and to pay the artiste a fee only for his personal performance. This leads to two very different approaches: an all-inclusive performance fee *or* a breakdown into separate payments. The result of the latter is that the artiste can make use of all these services, whilst indirectly paying for it himself. The issue is whether the payments to people other than the artiste can also be considered as performance income and fall within the scope of Article 17 of the OECD Model.

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5. This can be derived from Paragraph 4 of the Commentary, discussing the performance element in the activities of a person who is both director and actor in a performance. There are also national court cases supporting this opinion, e.g. in the Netherlands *Gerechtshof Arnhem* 26 May 1970, *BNB* 1971/120 and *Gerechtshof Den Bosch* 29 August 1990, *V-N* 1991/652.

6. See also Vogel at 980, § 21, mentioning a split pro rata of the artiste fee that would also cover rehearsals, practice sessions, etc. But he also mentions a contrary US court decision that required the extension of the taxable performance fee to a portion of the income for (foreign) rehearsals, practice sessions and time spent in training camps (Court of Appeals (2nd Circuit), *Stenkowski v. Comm.*, 690 F. 2d 46 (1982)).

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Here the issue of the deductibility of production expenses plays an important role. Paragraph 10 of the Commentary on Article 17 discusses the problem of determining the amount of production expenses for a performance, especially during international tours, and gives countries the option to tax gross income without deductions for expenses but at a low tax rate. Many countries have followed the first part of the advice, but have raised the tax rate to a normal (or even high) level.<sup>7</sup> Whether or not production and other expenses for a performance are included in the performance fee makes a significant difference to the amount of tax due. Those countries have specified in their legislation that the value of the services contracted by the performance organizer but to be used by the artiste has to be added to the artiste's fee to compute the taxable performance fee.<sup>8</sup> This may lead to strange results, because very clear examples of business services, not paid for but only used by the artiste, are being taxed in the artiste's hands as personal profit.<sup>9</sup>

Other countries have concluded that payments by the organizer of a performance directly to people other than the artiste are not taxable as "performance income", as these expenses are borne on behalf of the organizer and not on behalf of the artiste.<sup>10</sup>

Taxing a separate payment to an agent or a manager would be in conflict with Paragraph 7 of the Commentary on Article 17 of the OECD Model. There is in any case a considerable difference between this Paragraph 7 and Paragraph 10 of the OECD Commentary.

The problem of production expenses (and split contracts) is a major topic in this thesis and will be discussed further in the following chapters.

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7. See chapter 6 for an overview of the national artiste tax rules.

8. The Netherlands, Germany, Belgium, France, Spain, and many others (see chapter 6). The German legislation was confirmed in the decision *Bundesfinanzhof* 25 November 2002, *I B 69/02*, setting aside the earlier decision *Bundesfinanzhof* 27 July 1988, *I R 28/87*, *BSiBl. II* 1989, 449.

9. For a good description see Harald Grams, *Besteuerung von beschränkt steuerpflichtigen Künstlern*, Neue Wirtschafts Briefe (Herne/Berlin, 1999), at 155.

10. Australia: *F C of T v. Robinson* (1992) 23 ATR 364, 92 ATC 4424, followed by Taxation Ruling IT 2323 (1994).

### 4.3.4. Inducement payments, options, retainers and restrictive covenants

Sometimes inducement payments are made to persuade an artiste to be available to perform during a certain period. In this case no clear artistic or entertainment activity can be identified, leading to the question of whether such inducement payments fall under the scope of Article 17 of the OECD Model.<sup>11</sup>

With an option payment the artiste agrees to open negotiations about the terms of a contract that may lead to an actual performance in the foreign country. If a contract results, there will be a clear link between the option payment and the (future) artistic or entertainment activity, also making the option payment taxable in the country of performance under Article 17. When the option is not used, the option payment seems to fall outside the scope of Article 17 of the OECD Model.<sup>12</sup>

An artiste can also receive a so-called “retainer” to keep him available for performances during a period of time for which he promises not to enter into agreements with others to perform. When he is called on to perform, his retainer will be replaced by a normal performance fee. The retainer will normally fall outside the scope of Article 17 of the OECD Model, because no artistic or entertainment activity in the country is requested from the artiste.<sup>13</sup> This changes when the artiste is called on to perform during the period, because the replacement, normal performance fee will be taxable in the country of performance under Article 17 of the OECD Model.

Where an amount is paid to a non-resident artiste to restrict his activities, this payment may not be considered a payment in respect of personal activities exercised in the country of performance. With the payment the artiste agrees not to perform and quite clearly undertakes no artistic or

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11. In the United States a sign-on bonus was found taxable, based on performances that took place in the first year of a 6-year employment contract (*Linseman v. Commr.*, 82 T.C. 514, 522 (1984)).

12. Sandler (1995), at 185.

13. Sandler (1995), at 329. See for a different view Vogel at 980, § 21, quoting a US case justifying the position that the source state is also entitled to tax work days on which an actor merely had to be ready to work if called on to do so (California Court of Appeals, *Newman v. Franchise Tax Bd.*, 208 Cal. App. 3d 972 (1989), 256 Cal. Rptr. 503 (1989), on the law of California; cf. *Feinschreiber, R.* 18 ITJ No. 2, at 51 (1991)).



entertainment activities.<sup>14</sup> These payments are often used by advertising agencies to pay an artiste for his exclusivity to a certain brand during a period of time, although they can also be seen as payment for the use of the personality right of the artiste, i.e. his name and likeness, therefore qualifying as royalties and falling under Article 12 of the OECD Model.

#### 4.3.5. Cancellation fees and insurance cover

When a performance contract is terminated by the organizer, the artiste can receive a compensation payment for not being allowed to perform. Both the 1987 OECD Report<sup>15</sup> and the OECD Commentary<sup>16</sup> state that a cancellation fee does not fall under Article 17. This opinion is understandable because no entertainment or artistic activity takes place in the source country.<sup>17</sup> The 1987 OECD Report considers Article 21 of the OECD Model applicable, while the Commentary refers to Articles 7 and 15 of the OECD Model. Both lead to the same result, because the conditions for taxation in the source country, namely a permanent establishment (Article 7) or exercise of employment (Article 15) in the source country are not fulfilled. A cancellation fee will therefore solely be taxed in the country of residence of the artiste.<sup>18</sup>

Cancellation of the performance can also be initiated by the artiste, if he is unable to perform because of health problems or for any other reason. The organizer will not be obliged to pay a fee, so the artiste can try to cover this risk with an insurance contract. This will have the same effect as a cancellation fee, i.e. there will be no taxing right in the performance country because no performance has taken place.

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14. See Sandler (1995), at 185. He quotes the UK court case *Higgs v. Olivier* [1952] 1 Ch. 311, in which the actor Lawrence Olivier received an amount from a film production company not to perform in any film for a period of 18 months. This was not considered to be taxable in the source state. He also gives an example of contrasting Australian legislation, but speculates whether this would be in conflict with the OECD Model.

15. Paragraph 84 of the 1987 OECD Report.

16. Last sentence of Paragraph 9 of the Commentary on Article 17 of the OECD Model.

17. In most cases there is no activity at all in the country where the performance had to take place.

18. See also Vogel at 980, § 22a. More discussion can be found in Ashlee Mann, "Finding a Nexus for Nonperformance of Services: The Assignment of Primary Taxing Authority under the OECD Model", 11 *Emory International Law Review* 1 (1997).

### 4.3.6. Advertising and commercials

When the artiste plays an active role in advertisements for a company or product his income normally falls under Article 17 of the OECD Model.<sup>19</sup> Because of his position as an artiste his activity is considered to be artistic or entertaining not only when the advertisement is linked to a normal concert or performance of the artiste, but also when the artiste is just acting in the advertisement. This seems to create an arbitrary difference between an artiste and a model performing in the same advertisement.<sup>20</sup> The tax treatment of the same activity is different merely because of the other activities undertaken by the person concerned.

In 3.12.5. it was described how the American IRS took the position in 1999 that such activities would not qualify for non-resident artiste taxation because their primary purpose was to promote and sell the company's products.<sup>21</sup> This opinion seems to deviate from the general opinion of the OECD.

### 4.3.7. Sponsorship

The tours of bigger artistes are very often sponsored by companies that want to identify themselves with artistes, introducing the products of the company to a (perhaps) interested segment of the audience. If there is a link between the sponsorship and performances, which will definitely be the case in the venue or stadium itself, on the entrance tickets or on the posters where clear signs are on display with the name of the sponsor or the product, the sponsorship fee can be taxed in the country of performance.<sup>22</sup>

But it will not be easy for the tax authorities in the country of performance to obtain information about sponsorship and to calculate what part of the sponsorship fee is linked to a specific performance. Therefore in practice taxation of this type of income most often does not take place in the country of performance. This can lead to a situation of double non-taxation

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19. According to Paragraph 3 of the Commentary on Article 17 of the OECD Model. See also Vogel at 972.

20. See also Sandler, at 180.

21. United States: IRS Field Service Advice 30 September 1999, FSA 199947027, 19 *Tax Notes International*, at 2146.

22. See also Paragraph 83 of the 1987 OECD Report and Paragraph 9 of the Commentary on Article 17 of the OECD Model.

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if the tax exemption method is used for foreign-source income in the home country.

Sponsorship income can also be paid in more general terms to the artiste, not being linked directly to any performance.<sup>23</sup> It is important to distinguish this kind of sponsorship from an advertisement in which the artiste plays a role with his personality.<sup>24</sup> In the more general type of sponsorship the artiste allows the sponsor to use his name, likeness and personality to present the company or its products, without playing an active role himself in the promotion.<sup>25</sup>

But what if the artiste is wearing a shirt or cap with the name or logo of a manufacturer? For the public, this might seem to be coincidental or hip and trendy, but it is possible that the artiste might receive financial compensation for this exposure. It will in most cases not be easy for the country where the artiste appears to find a way to tax these earnings.<sup>26</sup> See also the paragraph below.

#### 4.3.8. Endorsement by suppliers of equipment

Many musicians get their equipment free from the supplier and use it during performances. The supplier can use the name and likeness of the artiste in his advertising and very often the musician plays an active role in promoting the equipment at trade fairs and exhibitions. Sometimes the supplier will also pay a fee for these activities. The latter seems to be a performance such as acting in an advertisement and falls under the scope of Article 17 of the OECD Model, but even the first activity is very likely to qualify for Article 17, because it reduces production expenses and needs to be added to the performance fee in an artiste taxation system where the total gross fee is taxable, following the recommendations of Paragraph 10 of the Commentary on Article 17 of the OECD Model . It will not be easy to calculate this advantage and allocate an appropriate proportion to the country of performance.

In the United States the IRS has discussed the taxability of endorsement income and followed the OECD approach with the connection with public

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23. See also Vogel at 972, § 8c.

24. See 4.3.6.

25. See for a good overview, Grams (1999), at 165.

26. United States: IRS Field Service Advice 199947028 (1999).

performances being the decisive factor.<sup>27</sup> In a specific (older) case the decision was reached that endorsement income should be allocated at arm's length for each of the activities, leading to 70% royalty income and 30% personal services income.<sup>28</sup>

In two UK court cases the endorsement income of tennis players was discussed. The first case was about three international tennis players who had entered into endorsement contracts with the manufacturers and resellers of tennis equipment. They not only received free tennis equipment but also received payments for the use of the equipment in tennis tournaments. The UK Inland Revenue did not agree with the amount of endorsement income that was accounted for in the self-assessment tax return and started an inquiry. This led to the conclusion that an equivalent part of the worldwide endorsement income also had to be allocated to the UK performances. The taxable income of these three tennis players was substantially increased.<sup>29</sup>

The second case concerned the tennis player Andre Agassi, who had played at Wimbledon. His personal company, Agassi Enterprises Inc., had entered into agreements with Nike Inc. and Head Sports Inc. regarding the endorsement of sports clothing and tennis equipment. Neither Nike Inc. nor Head Sports Inc. had a tax presence in the United Kingdom. As with the three tennis players, Andre Agassi filed a self-assessment tax return after the year 1999 and declared only direct endorsement earnings for UK tennis tournaments. He had earnings of GBP 54,601 gross, but after the deduction of his expenses a loss of GBP 63,689 resulted. The UK Inland Revenue started an inquiry and decided to allocate a part of the endorsement fee that Agassi Enterprises Inc. had received outside the United Kingdom to the UK performances. The loss was thereby transformed into a profit of GBP 27,250, and André Agassi did not get a UK tax refund.

The High Court approved the correction on the self-assessment tax return and dismissed Andre Agassi's claim for a tax refund.<sup>30</sup> Even though no tax was due above the withholding tax, the judge of the High Court, the honourable Mr Justice Lightman, expressed his doubts about the

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27. United States: Technical Assistance Memorandum 199938031 (1999).

28. United States: *J.A. Kramer v. Commr.*, 80 T.C. 768 (1983).

29. United Kingdom: *Mr Set, Miss Deuce & Mr Ball v. Robinson (HMIT)* (SPC No. 0373)(2003).

30. United Kingdom: *Andre Agassi v. Robinson (HMIT)* (High Court of Justice, 17 March 2004, [2004] EWHC 487 (Ch)).

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enforceability of the UK tax on the extra assessable income. First, Andre Agassi could not be forced to pay the extra tax, because his self-assessment tax return could not lead to a tax liability. And secondly, Mr Justice Lightman expressed in his decision, that “the liabilities imposed on Nike and Head may prove unenforceable, but that does not mean section 555(2) does not apply on Nike and Head to pay”,<sup>31</sup> leaving the Inland Revenue with the task of collecting the tax money somewhere abroad.

On 19 November 2004 the Court of Appeal in this case decided to reverse the decision by the High Court and accept Andre Agassi’s appeal. It ruled that the payments by the German sportswear makers Nike and Head Sports to the US-based company, Agassi Enterprises, were not taxable in the United Kingdom, because none was resident or had a “tax presence” in the United Kingdom.<sup>32</sup> This means the Court of Appeal decided the case on the issue of jurisdiction rather than characterization.<sup>33</sup>

#### 4.3.9. Subsidies

Orchestras, ensembles, and theatre and dance companies may be subsidized to some extent by the government in their home country. The subsidy can be given in general for the activities of the company, but can also be based on individual projects such as performing in other countries. In the latter situation there will be a direct link with a performance, resulting in the allocation of the tax right on the subsidy under Article 17 of the OECD Model to the country of performance. But also in the former situation a portion of the subsidy can become taxable in the country of performance when the activities of the orchestra, ensemble, or theatre or dance company consist only of performances, at home and abroad. In that situation the general exploitation subsidy is indirectly linked to performances and on the basis of Paragraph 84 of the 1987 OECD Report the argument can be supported that the subsidy needs to be divided equally over the performances, giving the country of performance the right to tax a portion of the subsidy for the operating costs.

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31. Paragraph 16 of the High Court decision. Section 555(2) is a part of the 1988 Finance Act 1988 and regulates together Section 556 the taxation of Entertainers and Sportsmen.

32. United Kingdom: *Andre Agassi v. Robinson (HMIT)* (Court of Appeal, 19 November 2004, [2004] EWCA Civ 1518, Case C3/2004/0829).

33. See 4.4. for further discussion.

But it will not be easy for the tax authorities in the country of performance to identify both subsidies for projects and general subsidies. As with sponsorship and endorsement income a situation of double non-taxation can be likely when the exemption method is used in a tax treaty.

### 4.3.10. Royalties for record or movie sales

When an artiste records an album for a record company or an actor performs in a movie for a film company his income can be a fixed fee for the performance and/or a royalty percentage for the sales of the album or movie. The recordings may have been made in a studio or during a live performance. The fixed fee is normally considered to be a performance fee falling under Article 17 of the OECD Model,<sup>34</sup> “genuine” royalties fall under Article 12 of the OECD Model<sup>35</sup> and for mixed contracts an allocation needs to be made.<sup>36</sup> This is supported by Paragraph 18 of the Commentary on Article 12 of the OECD Model:

18. The suggestion made above regarding mixed contracts could also be applied in regard to certain performances by artistes and, in particular, in regard to an orchestral concert given by a conductor or a recital given by a musician. The fee for the musical performance, together with the simultaneous radio broadcasting thereof, seems to fall to be treated under Article 17. Where, whether under the same contract or under a separate one, the musical performance is recorded and the artist has stipulated that he be paid royalties on the sale or public playing of the records, then so much of the payment received by him as consists of such royalties falls to be treated under Article 12.

<sup>37</sup>Where, however, the copyright in a sound recording, because of either the relevant copyright law or the terms of contract, belongs to a person with whom the artiste has contractually agreed to provide his services (i.e. a musical performance during the recording), or to a third party, the payments made

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34. Vogel at 973, § 10a. The tax right is then allocated to the country of the performance/recordings, which will not always be the country of the record company that is paying the session fee.

35. According to Paragraph 82 of the 1987 OECD Report.

36. In almost all cases the artiste needs a performance for the recording, and the royalties can then be linked to a performance. But a clear decision was given in the Dutch case *Gerechthof Amsterdam* 27 June 1990, *V-N* 1991/2128, in which the court decided that the artiste had entered into a contract with the record company containing many more obligations than just the recording and that the record agreement “sui generis” by far surpassed a simple performance agreement. This meant that the performance was a just a part of the artiste’s total activities, including promotion, distribution and local sales activities.

37. Addition in the 2003 Commentary.

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under such a contract fall under Article 7 (e.g. if the performance takes place outside the State of source of the payment) or 17 rather than under this article, even if these payments are made contingent of the sale of the recordings.

This recommendation would have helped in the American case *Boulez v. Comm.*,<sup>38</sup> in which the German resident Pierre Boulez conducted an orchestra in the United States under a recording agreement. He agreed to receive a royalty percentage from the record sales. Germany taxed the income as royalties in the home state, but the United States also taxed the income as performance income under the artiste tax rules. Unfortunately the governments of the two countries failed to reach agreement to avoid double taxation and the case was brought before the US Tax Court. This court decided to follow the US interpretation and did not allow exemption in the United States under the royalties rule in the existing United States–Germany tax treaty. It supported its decision with the opinion that the fact that Boulez’s remuneration was based on a percentage of future sales did not prove that a licensing or sale of property rather than compensation for artistic services was intended. The contract between Boulez and the record company supported this, because it stated that the copyright of the recordings belonged to the record company.

After the clear wording in the 1987 OECD Report and the Commentary on Article 17 the American IRS has issued a statement acknowledging that the facts and circumstances of the *Boulez* decision will rarely arise and that in most cases royalties for live recordings will qualify for treatment as royalties under Article 12 of the OECD Model.<sup>39</sup>

The German government has gone even further regarding live recordings, not only for records but also for radio and television broadcasts, and assumes that one third of the sum total represents remuneration for personal services, while two thirds represent exploitation earnings and can be treated as royalties. In recordings of videos and DVDs, however, the main part of the work is considered to be the entertainer’s personal activity and is therefore still taxable as artiste performance income.<sup>40</sup>

But it can be questioned whether both countries need to reconsider their positions after the addition in 2003 of the last sentence to Paragraph 18 of

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38. (1984) 83 TC 584. See Sandler at 185.

39. IRS (1994), at 46.

40. See Vogel at 979, § 20a. Based on *FinMin NRW* 22 November 1974, S 2303-13-V B 2.

the OECD Commentary on Article 12. Without reconsideration the OECD Model Tax Convention and Commentary would entitle the United States and Germany to more taxing rights than their national legislations allow. For artistes from countries with the tax exemption method in bilateral treaties this could lead to double non-taxation of royalty income from live recordings.

The discussion about the different tax treatment of performance income and royalties for record or movie sales has large implications, because these activities can interact. Performances can be a good advertisement for a new record or movie; sometimes the main purpose of an artiste's performances is to promote his new album. But on the other hand an album or movie can attract so much public attention that it is easier for an artiste to ask for a higher performance fee. And both sides can also have their positive (or negative) effects on other earnings, such as from publishing copyrights, neighbouring rights and even the sales of merchandising, as will be discussed in the following paragraphs.

This not only has implications for the taxation of earnings but also for the allocation of expenses for both performances and royalties. Discussion on this subject will be continued in 8.4.2.

### 4.3.11. Tour support from record companies

When an artiste undertakes an international tour, it is likely that a financial loss is budgeted. Very often variable performance fees (with a guaranteed minimum) are agreed and the financial success depends on the popularity of the artiste in a certain territory and other factors that can influence the sales of tickets. The artiste's manager will only put guaranteed income into the tour budget, and this will not be sufficient to cover the full production expenses. Therefore the record company may be asked for tour support, because record sales can also profit from an international tour.

Many record contracts specify whether the record company is obliged to pay tour support from its share of the profit from record sales or whether tour support is fully or partly recoupable from (later) earned artiste royalties. Although tour support originates from the record contract and in the latter situation is paid as an advance against royalties, the connection with the performances is so clear that many countries believe that these earnings should fall under taxable performance income in their



jurisdiction. Nothing has been specified in the Article 17 of the OECD Model, the 1987 OECD Report or the Commentary, thus giving countries according to Article 3(2) of the OECD Model the right to impose their national tax rules on these earnings.

In practice countries will not know of the existence of these earnings when they are not paid in their country, because the record company will be based in a foreign jurisdiction, very often the same jurisdiction as the country of residence of the artiste.

#### 4.3.12. Publishing copyright

Publishing copyright protects composers, authors, choreographers, etc. against violation of their rights. The use of material such as compositions and other work will normally be authorized against a payment or a royalty, the amount depending on the way the material is used. It can be printed, broadcast, reproduced or used in any other medium.

Composers, authors, choreographers, etc. are not performing artistes, which means that their earnings from these copyrights definitely do not fall under Article 17 but under Article 12 of the OECD Model.<sup>41</sup>

Publishing copyrights can also apply to performances and are normally paid as a percentage of the box office earnings minus VAT or sales tax. This clear distinction between Article 12 and Article 17 can become vague when an artiste composes or writes his own work or when he is the choreographer or director of his own play. It will be problematic to split the artiste into two persons and, if that were possible, to make a division between copyright and performance fees “at arm’s length”.

#### 4.3.13. Neighbouring rights

Until the early 1990s there was a missing element in the field of music and other cultural copyright, with the undesirable effect that a radio, television or cable broadcast gave rise to copyright earnings for the composer/author of a song but not for the artiste who had performed the song. Neighbouring rights were introduced to give recording artistes a comparable right to

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41. See for a clear statement Paragraph 9 of the Commentary on Article 17 of the OECD Model; see also Sandler (1995), at 7.

authors and composers when a recording was broadcast. The earnings are linked to a studio (or live) recording that has taken place in the past, but are based on the radio, television or cable broadcast.

The United States has not signed up to the convention regarding neighbouring rights, which means that its residents do not receive earnings from foreign sources, nor will non-residents receive earnings from US sources.

It could be argued that the *Pierre Boulez* case<sup>42</sup> is applicable to neighbouring rights, the earnings being seen as deferred compensation for an earlier performance. But there is no transfer of copyright made for neighbouring rights; payments by the radio, television and cable stations derive from a legal obligation and not from a contractual relationship. Therefore, taxation in the source country based on Article 17 of the OECD Model is not realistic, because there is no direct link between performance and payment. It is also important that the country in which the payments for the neighbouring rights occurs does not have to be the country in which the performance for the recording has taken place.

Distribution of the earnings of neighbouring rights goes through national neighbouring-rights organizations, which collect the monies in various countries and pay them out to their members, who are mainly residents of the same country. International money transfer normally exists between these national collecting societies.

In practice neighbouring-rights earnings should be considered as royalties that fall under Article 12 of the OECD Model. Because of the weak link between the performance and the earnings, this seems to be a good practical solution.

### 4.3.14. Sales of merchandising

Venue merchandising can be an important item of income for performing artistes. Most often the sales of merchandising<sup>43</sup> in or around the venue are handled by persons other than the artiste himself. Bigger artistes in particular therefore transfer the right to sell t-shirts, posters, badges, caps, etc. to a specialized merchandise company in exchange for a percentage of

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42. See 4.3.10.

43. Also called “concert paraphernalia”; see Sandler (1995), at 8, 184 and 328.

### 4.3. Practical implications for different types of performance income

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the revenue.<sup>44</sup> This company travels with the artiste on tour and tries to recover its costs and make a good profit. Smaller artistes do their merchandising themselves, hiring a salesperson or asking e.g. the bus driver to take care of the merchandising stall.

Merchandise income can be treated as royalty income and can fall under Article 12 of the OECD Model, especially if the earnings are a percentage of the sales of the independent merchandise company. But the link with the personal performance of the artiste in the venue, leading to the sales of the merchandising, is also quite plausible. Whether it would be possible to tax the earnings under Article 17 of the OECD Model depends on how far-reaching the phrase in Article 17(1) is: “income derived by an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, from his personal activities as such”. Most countries have decided to treat merchandise income as royalties under Article 12 of the OECD Model or business income under Article 7 of the OECD Model.<sup>45</sup> The United Kingdom seems to be one of the few countries that has introduced national tax rules bringing merchandise income under taxable performance income.<sup>46</sup> As these earnings are not clearly specified either in the text of the OECD, countries can follow the general interpretation rule of Article 3(2) of the OECD Model and apply their own national tax rules on these earnings.

#### 4.3.15. Pensions and other insurance benefits

An artiste can also receive deferred payments, such as special early retirement schemes, pensions from employment, personal schemes or other insurance benefits, e.g. for becoming unemployed or disabled. It needs to be determined when these payments fall under Article 17 of the OECD Model.<sup>47</sup>

The subject of pensions receives special attention from the OECD. During the 2003 IFA Congress in Sydney, Australia the OECD presented its work on tax treaties in Seminar C and the pension situation of a former football

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44. Normally against an advance or guarantee.

45. Sandler (1995), at 8 and 328; also Grams (1999), at 352.

46. FEU50 “A Guide to Paying Foreign Entertainers”, Paragraph A2, Foreign Entertainers Unit, Solihull, West Midlands, United Kingdom. Also Sandler (1995), at 138, questions whether Article 17 of the OECD Model is applicable on sales of “concert paraphernalia”.

47. See also Vogel at 980, § 22a.

player was presented as an example in Case 4. The panellists were not unanimous in their opinions about the taxing rights for the various types of deferred payments from the contract, insurance benefits and pension schemes, which led to an interesting discussion during the panel session, but some confusion still remained afterwards.<sup>48</sup>

With regard to artistes a division into three categories can be made:

- (1) *Pension schemes from employment.* Pension schemes from employment do not seem to fall under Article 17 of the OECD Model, but under Article 18 or 19(2). The text of Article 17 overrules Articles 7 (Business and self-employed income) and 15 (Employment income), but no exception is made for the allocation rules of Articles 18 (Pensions from employment) and 19(2) (Pensions from governments). When the income from performances has been transferred into a pension right, the qualification of the income has changed. An official pension right is different from the right to receive performance income.

According to Article 18 of the OECD Model the right to tax pension income from earlier employment is allocated to the country of residence of the pensioner; Article 19(2) leaves the right to tax government pensions to the country that pays the pensions, unless the pensioner is resident in and a national of the other country.

- (2) *Deferred payments for early retirement.* Some countries have special schemes for top artistes (or sportsmen) who earn a high income during their active career, but can set aside a percentage of this income into a specific fund and receive deferred payments from this fund when their active career is over. These special schemes have enough of an (in)direct link with performances to make the deferred payments taxable in the country of the original performances under the allocation rule of Article 17 of the OECD Model.<sup>49</sup>

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48. See Catherine Bobbett and John F. Avery Jones, “Treaty Issues related to the Treatment of Cross-Border Pension Contributions and Benefits”, 58 *Bulletin for International Fiscal Documentation* 1 (2004).

49. See e.g. a decision in the Netherlands regarding a special early retirement scheme for football players (*CFK-regeling*), *Hoge Raad* 3 May 2000, *BNB* 2000/328. The court ruled that this early retirement scheme was not a pension scheme, but a method of funding a period of transition after active football life in order for the player to become adjusted to a new career and income.

This does not mean that the taxing right always belongs to the country in which the employer of the artiste is based, because when artistes perform in other countries the right to tax the performance income is normally allocated to the country of performance. This could lead to a complex tax situation.

- (3) *Personal pension schemes.* Income from a personal pension scheme that does not have its source in a former employment relationship and does not come from a government institution will normally fall under Article 21 of the OECD Model. The taxing right for the personal income is then allocated to the country of residence.
- (4) *Other insurance benefits.* A non-resident artiste can be entitled to insurance benefits, such as in the case of unemployment or inability to perform. Because there is no link with specific performances, the insurance benefits cannot fall under Article 17 of the OECD Model, but will fall under Article 7 (for self-employed artistes), Article 15 (for employees), Article 19 (for governmental insurance benefits) or Article 21 (in other situations).

#### 4.4. The “territoriality” principle

In the process of deciding whether an item of income qualifies as (taxable) performance income of the non-resident artiste, not only the place of the performance but also the place of the payor is important. When the payment is made by a payor not based in the country of performance to a recipient who is based outside the country of performance, the question can be raised whether the country of performance is entitled to levy tax on the income item. How far does the “territoriality” principle stretch with regard to taxable performance income?

Unfortunately, neither Article 17 of the OECD Model nor the Commentary gives an answer to this question. But the 1987 OECD Report recognizes the problem, saying:

there will frequently be substantial administrative difficulties in taxing such indirect income in the country where the performance takes place, as contracts concluded with a firm in one country (for example, for advertising) will very often cover the exercise of activities throughout the world. The country where the performance takes place will frequently not be informed of the existence of

such income and any apportionment of it (e.g. on the basis of the relation to a specific performance) would be problematic, with a risk of double taxation.<sup>50</sup>

This issue has been subject of a UK court case recently for Andre Agassi, as explained in 4.3.8., on endorsement income from suppliers of equipment. The High Court and the Court of Appeal gave different decisions about whether the endorsement income that the limited companies of Andre Agassi in the United States received from racket and shoe manufacturers outside the United Kingdom could be allocated partially to the UK performance (at Wimbledon). It was evident that there had been no payment within the United Kingdom and that the payors did not have a UK presence. There was also no discussion about whether the endorsement was (indirectly) linked with the UK performances, because Andre Agassi received the income when he was using the material during the tournaments, and displaying clear signs on his tennis clothes.

The High Court decided in favour of the UK Inland Revenue that the territoriality principle in the United Kingdom had to cover this foreign income, because otherwise the taxation of income would be “unenforceable”.<sup>51</sup> But the Court of Appeal decided in favour of Andre Agassi, stating that there had to be a UK payor of the (endorsement) income for the income to be taxable in the United Kingdom.<sup>52</sup> They preferred a stricter interpretation of the “territoriality” principle.<sup>53</sup> Even though the court understood that the United Kingdom had difficulties in collecting tax from non-resident artistes and sportsmen, the judges did not understand why the stricter “territoriality” principle only had to be applied to artistes and sportsmen, and not to “all other traders, be they merchant bankers or bricklayers”.<sup>54</sup>

This issue will be dealt with in many other countries, although it depends very much on the reach of national tax rules. These are quite broad in the United Kingdom, but are usually more restricted in other countries. But the “territoriality” principle can play its role with several types of

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50. Paragraph 81 of the 1987 OECD Report; see also 4.2.

51. United Kingdom: *Andre Agassi v. Robinson (HMIT)* (High Court of Justice, 17 March 2004, [2004] EWHC 487 (Ch)).

52. United Kingdom: *Andre Agassi v. Robinson (HMIT)* (Court of Appeal, 19 November 2004, [2004] EWCA Civ 1518, Case C3/2004/0829).

53. The Court of Appeal based its decision on an earlier decision of the House of Lords in *Clark v. Oceanic Contractors Inc.* [1983] 2 AC 130 [*Oceanic*].

54. Paragraph 22 of the decision of the Court of Appeal (and repeated in the conclusion (Paragraph 33)).

performance income, such as inducement payments, insurance cover, advertising, endorsement income, subsidies, tour support, copyrights and pension benefits. It will not be easy to tax the income of a non-resident artiste in the country of performance if the payment is made outside the country of performance, even when there is a clear (indirect) link with the performance.

#### **4.5. General discussion and conclusions**

The preceding paragraphs have discussed how the term from Article 17 of the OECD Model, “income derived by an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, from his personal activities as such”, has been defined. This term has been abbreviated to “performance income” and has been tested against a list of 14 different types of income which relate directly or indirectly to performances of artistes. The conclusion needs to be that qualification problems exist with some of these income items. It may be that another article of the OECD Model should apply, which leads to tension when the allocation of the taxing right for the two articles is different.

As in chapter 3, double taxation may be the result of these qualification problems, while on the other hand the chance of double non-taxation is not very likely, because most countries have followed the recommendation of the Commentary on Article 17 of the OECD Model to use the tax credit method (and not the exemption method) for the elimination of double taxation.

These qualification problems may partly be resolved with the use of Article 3(2) of the OECD Model, which is taken over into most bilateral tax treaties.

Altogether, it needs to be concluded that a better and more unambiguous definition of the term “performance income” is needed. And although some repair may be possible with the general treaty interpretation rule of Article 3(2), the risk of double taxation remains imminent.

