
CHAPTER 8

THE DEDUCTION OF (PRODUCTION) EXPENSES

8.1. Expenses seem to be difficult

When artistes perform in foreign countries they incur expenses. These can vary from simple travel and lodging expenses to the more complex production expenses needed to undertake a tour to other countries or even to other continents. Obviously the amount of these expenses will determine whether a performance fee is financially worthwhile, although performances which make only a small profit or perhaps even a loss can be an investment in the future of the artiste.

To provide an insight into the nature and amount of expenses, this chapter will set out the results of an extensive survey of the amount of expenses of non-resident artistes in the Netherlands and discuss the nature of these expenses. At the end of the chapter the position of amateurs will be discussed.

The issue of the deduction of expenses for international performing artistes seems to be ignored in the tax world. Most countries do not allow a deduction, the OECD considers the determination of the expenses difficult and not much has been studied or written about the amount of expenses.

The author suggests that the impact of expenses on the income of performing artistes is underestimated. This extensive survey was performed to obtain data to clarify the present situation.

8.2. Non-deductibility of expenses for non-resident artistes in most countries

Normally enterprises and professionals can deduct their expenses from their gross earnings and are taxed on the net profit from their activities. A profit and loss account needs to be drawn up to give the tax administration sufficient information to judge the reliability of the earnings and the acceptability of the expenses. This will not only be done after the taxable year to calculate the final tax liability, but also during the year (with

estimated figures), because countries prefer to raise preliminary tax assessments as close to the final outcome as possible to finance their state budget during the taxable year. Enterprises with international operations and branches abroad need to calculate their profits in each country, allocating both the direct and head office expenses “at arm’s length”. Special rules have been developed for transfer pricing between the branches of an international company to arrive at a fair proportion of the international profit that can be allocated to and taxed by each individual country.

Employees can also deduct their employment-related expenses or can have these expenses reimbursed by their employers tax free.¹ In general, taxation of income after the deduction of expenses is entirely normal and seems to be an undisputed general rule.

Unfortunately, this is not the case for international performing artistes. Many countries have decided in the past to tax the gross performance income of non-resident artistes and not to take production and other expenses into account. These countries argue that artiste expenses are difficult to determine, especially when artistes perform in more than one country. This is a strange approach when we consider the attention paid to transfer pricing and expenses allocation rules for normal companies and it is unclear where this conviction, that no information is available to countries that have problems in determining the expenses of artistes, has come from. Countries just do not seem to like the inconvenience, or perhaps consider that the expenses of non-resident artistes cannot be that high and have decided to simplify the taxation of a special group of taxpayers. Chapter 6 contains an overview of these national artiste tax rules.

The OECD has decided not to intervene in these national practices but to follow them. At first in Paragraph 94 of the 1987 OECD Report, later taken over without changes as Paragraph 10 of the Commentary, the OECD provided a neutral description of the non-deductibility of expenses for artistes:

94. The Article says nothing about how the income in question is to be computed. It is for a Contracting State’s domestic law to determine the extent of any deductions for expenses. Domestic laws differ in this area, and some

1. Such as in the Netherlands, where employees have not been able to deduct their expenses since the year 2001, but can ask their employer to reimburse their reasonable business expenses, possibly against a lower salary.

provide for taxation at source, at a low rate based on the gross amount paid to the artistes and sportsmen. Such rules may also apply to income paid to groups or incorporated teams, troupes, etc.

While Paragraph 94 of the 1987 OECD Report speaks of “some” countries, in practice most countries have an artiste tax system that does not permit the deduction of expenses at source, as explained in chapter 6. Only a few countries do not follow this more or less general practice and give non-resident artistes the chance to deduct their expenses before being taxed. Examples given in 6.4. are the special tax departments in the United Kingdom (the Foreign Entertainers Unit in Solihull, West Midlands) and, in the Netherlands, the *Belastingdienst Buitenland* (Tax Office for Non-Residents) in Heerlen, Limburg. These departments are perfectly able to handle applications for deductions of expenses prior to artiste performances. The United States, Australia and New Zealand also accept the deduction of expenses prior to performances.

8.3. The amount of expenses

8.3.1. Survey in the Netherlands

With the experience of the countries mentioned at the end of the previous paragraph a great deal of information about the amount of the expenses is available. The author has used this opportunity to collect and study information from the Netherlands.

The non-resident artiste tax system in the Netherlands allows the deduction of expenses prior to performances. Artistes or promoters of performances can apply for a *kostenvergoedingsbeschikking* (cost reimbursement approval), as explained in 6.4. Non-resident artistes and the organizers of performances can apply for these KVBs, which will be checked and confirmed by the *Belastingdienst Buitenland* (Tax Office for Non-Residents) in Heerlen, Limburg, the Netherlands. The artistes concerned receive an official tax ruling from the tax department about deductible expenses. This means that this amount of the performance fee is not liable to Dutch tax and can be paid gross.

For the survey of expenses the author has contacted three big players in the Dutch live music industry and asked them to provide information about their approved KVBs. These parties were the biggest pop music and

theatre promoter in the country, Mojo Concerts in Delft, the biggest classical concert venue, the *Concertgebouw* in Amsterdam, and a specialist consultant, All Arts Tax Advisers, in Rotterdam. The survey comprises the details of 1,605 approved applications for 2,498 performances in the Netherlands, over a period of 3 years, 2001-2003.

A wide variety of artistes are included, ranging from the very small to the very big, according to the pyramid that was given in 1.2. According to officials from the *Belastingdienst Buitenland* (Tax Office for Non-Residents) the collected information represents around 50% of the total applications by non-resident artistes (and sportsmen) in the Netherlands in this period.

The selection is considered to be representative for all performing artistes, because of its size of 50% of the market and the approval by the Dutch tax authorities. But it can also be criticized, because only successful applications have been included and little information is available about the artistes who decided not to file an application for the deduction of expenses (or whose applications were rejected). The reasons for not filing may have been that they did not have many expenses, did not know how to file, relied on a sufficient tax credit (or exemption) in their residence country or were not able to pay for a qualified tax adviser. But it should also be noted that the results of the survey show that approximately 10% of the applications in the year 2003 indicated expenses of 10% or lower, which means that artistes with very low expenses are also represented in the survey.

8.3.2. More information about the earnings

The earnings in the database are always the real earnings from performances. This may seem to be an odd remark, but more famous artistes tend to agree a variable deal with the organizer of a performance (= the promoter), resulting in a share of the earnings of e.g. 70%-90% of the ticket sales after deductions for VAT, copyright and local costs. The size of these earnings only becomes clear on the evening of the performance:

ticket revenue
– VAT
– copyright
<hr/>
net revenue
– local costs (venue rent, seats, catering, advertisement, security, etc.)
<hr/>
net left
x 70%-90% = performance fee for artistes

With this variable performance fee the bigger artistes want to profit from the possible upside of their popularity.² This normally goes together with an agreement between the artiste and the promoter of a guarantee fixing the variable fee at a certain minimum level. With this guarantee the artiste can at least pay (a big share of) his production expenses, making the tour financially viable. The organizer then takes on the risk of the project, estimating how many entrance tickets can be sold to the audience and agreeing the guarantee at e.g. 75% of the capacity of the venue. If the concert does not sell as well as expected, the organizer bears the risk and the artiste receives his guaranteed sum (but neither of them is happy, because both lose money); if the concert does better than expected or even sells out, both the organizer and the artiste make a profit (and both will be happy).

This contractual relationship leads to a temporary joint venture between the artiste and the local promoter, with the promoter bearing the risk of the downside, which he needs to assess and minimize with his knowledge of the local market.

Although this is the normal situation for bigger artistes, other artistes in the theatre, dance, classical music and large areas of the pop music business will normally agree just fixed and guaranteed performance fees. The total risk of their performances lies with the organizer, both positive and negative. Many performances do not collect enough ticket revenue to cover all expenses, including performance fees, and need to be complemented with subsidies and sponsorship income, either from the organizer or the artistes.

2. The most popular international artistes can even claim higher percentages with the local promoter, or include a share in the catering or even the parking earnings from the venue.

8.3.3. Expenses in the database

The expenses in the database are mainly based on the budgets prepared prior to tours or individual performances in order to apply for a *kostenvergoedingsbeschikking* (cost reimbursement approval) or KVB. This may lead to uncertainty about the real amount of production expenses, although background information is always available, such as invoices for the rental of sound, light and video equipment, trucks, buses, agency fees, management commission, the payroll of accompanying personnel, insurance and other major expenses. Big international tours in particular are very well budgeted for, prepared and controlled by a staff of financial people. For smaller artistes information about projected expenses is often taken from earlier foreign performances. Random checks by tax offices in the Netherlands and the United Kingdom show that actual expenses come extremely close to the projected budgets.

Not included are the tax advisory costs, in both the Netherlands and the country of residence of the artiste. In the Netherlands, for example, these are not considered as business expenses but as income expenditure, because the expenses are incurred to regulate personal income tax and net income.³ This is a controversial issue, because in the *Conijn* case that has been brought before the European Court of Justice, preliminary questions are asked by the German *Bundesfinanzhof* (Supreme Court) about the deductibility of tax advisory costs.⁴

Tax advisory costs in the Netherlands to obtain a tax ruling are on average approximately 1%-1.5% of performance fees. Most artistes also need to hire a tax advisor in their residence country to gather and hand over the necessary information to the Dutch advisor and collect a reliable tax certificate afterwards, at an extra expense of on average approximately 0.5%-1% of performance fee. This means that an extra 1.5%-2.5% of the performance fee needs to be added to expenses to achieve a complete picture.

Also not included in the expenses are the fees for the performing artistes themselves, because under Article 17 of the OECD Model the earnings of artistes need to be subject to tax in the country of performance. There are five possible situations:

3. *Gerechtshof Den Bosch* 23 June 2004, MK1, 02/04826.

4. *Conijn*, ECJ, C-346/04.

- the artiste performs individually, receives the performance fee and pays his expenses, his profit being what is left over;
- artistes have a partnership, and the profit of the performance is divided equally between the individual artistes and is taxed accordingly;
- artistes have established a limited company, receive salary payments for their performances and are entitled to the profit that remains after all expenses;
- the main artiste has hired accompanying or side artistes for his performances. They will receive their salaries (as employees) from the performance fee, after which the remaining profit accrues to the main artiste, either personally or via his personal limited company; and
- all artistes are hired as employees by a company that produces the performances. These artistes will receive their salaries (as employees), after which the remaining profit accrues to the (independent) producer.⁵ This normally occurs with e.g. (classical) orchestras, operas, and theatre, musical and dance productions.

8.3.4. Total earnings and expenses period 2001-2003

The overall results from the total database for the period of 3 years are shown below.

Year	No. of applications	No. of shows	Performance fees	Expenses	Profit
2001	415	677	16,496,427 100%	– 11,935,509 – 72%	4,560,919 28%
2002	579	891	14,835,054 100%	– 11,855,690 – 80%	2,979,364 20%
2003	611	930	15,313,109 100%	– 11,085,309 – 72%	4,227,829 28%
<i>total</i>	<i>1,605</i>	<i>2,498</i>	<i>46,644,590</i> <i>100%</i>	<i>– 34,876,508</i> <i>– 75%</i>	<i>11,768,111</i> <i>25%</i>

It needs to be stressed that the percentages for expenses and the profit from the various performances are averages in which higher performance fees,

5. Comparable with Paragraph 11(b) of the OECD Commentary on Article 17. See 2.11. and following for the taxation of independent third parties under Article 17(2) of the OECD Model.

with correspondingly high expenses, have more influence on the percentages than the smaller performance fees. A performance fee of EUR 800,000 has eight times more impact on the averages than a performance fee of EUR 100,000 and around 89 times more than a performance fee of EUR 9,000.

This “weighted” calculation of the average of expenses and profit gives more balance to the results than if each performance had been given the same influence. In the following paragraphs more detailed information will be provided about the variation in expenses at different levels of performance fee.

The average expenses of 75% of performance fees may be surprising to many people: artistes perform at very great expense. But the figure of 75% will come as no surprise to those involved in the performing arts world, because they know that performing in other countries is indeed very expensive. This extensive study on the Dutch database for the period 2001-2003 with a very large number of applications (1,605) and performances (2,498) supports the conclusion of high expenses, not only for small but also for medium and bigger artistes.

8.3.5. Confirmation with survey of the Dutch tax authorities over 2002

The Dutch tax authorities published an evaluation of the Dutch artiste and sportsman tax system in May 2004.⁶ The Dutch parliament had asked for an evaluation of the existing system. A survey was carried out for the year 2002 and, amongst other information, figures were given about the use of the *kostenvergoedingsbeschikking* (cost reimbursement approvals) or KVB. From these figures can be calculated the average of the expenses that the tax authorities approved during the year 2002.

A division has been made between performances for which applications have been approved and performances without applications. The figures can be summarized as follows (in million euro):

6. “Evaluatie van de artiesten- en beroepssportersregeling”, *Ministerie van Financiën*, 12 May 2004, *WDB* 2004-00270M; discussed in Dick Molenaar, “De illusies van de artiesten- en beroepssportersregeling”, *Weekblad voor Fiscaal Recht* 2004/6587, at 1111.

Evaluation of the artiste and sportsman tax system in the Netherlands (2002)

		Rate	Tax revenue
performance fees (without applications)	15.5	20%	3.1
performance fees (with applications)	18.0	20%	3.6
gross performance fees	33.5		6.7
deduction of expenses	- 11.6	20%	- 2.3
total taxable fees non-resident	21.9	20%	4.4

It can be calculated from these figures that the expenses of non-resident artistes and sportsmen in the Netherlands in the year 2002 have been 11.6 (expenses) / 18.0 (earnings with applications) = 64%.

Although this percentage of expenses is somewhat lower than the result of 75% from the 3-year survey undertaken for this thesis,⁷ the importance of the expenses has been confirmed by this government survey. Whether 64% or 75% of earnings, both surveys indicate that expenses are very significant in determining the profit from performances.

8.3.6. Specified earnings and expenses for the year 2003

8.3.6.1. Figures for 2003, explanation of the two graphs

The total results from the preceding paragraph can be specified with the detailed figures for a certain period, e.g. the year 2003. The survey includes 611 KVB applications on production expenses for that year, covering 930 performances, ranging from very small to very big performances.

Two graphs can be drawn from the figures for 2003:

- (1) the first graph shows the variance of the percentages of expenses (on the vertical axis) against performance fees (on the horizontal axis). The scale of the performance fees is continued exponentially, to avoid high performance fees dominating the graph and compressing small performance fees into one line; and

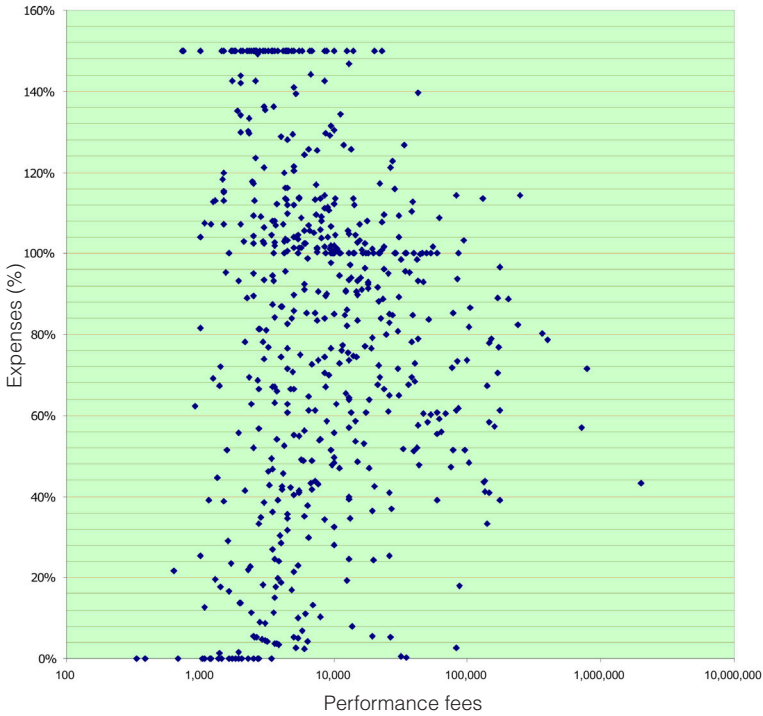
7. The research methods of these two surveys have not been compared until now. One of the reasons for the difference between 75% and 64% may be that KVB approvals of the tax authorities always cap expenses at 100% of the earnings, while real expenses very often exceed earnings. This makes a difference in the calculation of the average expenses.

(2) the second graph shows the number of applications per percentile of expenses. The interval for the expenses is 10%, which means that brackets from 0%-10%, 10%-20%, 20%-35%, etc. are brought together under the average of each bracket, i.e. 5%, 15%, 25%, etc.

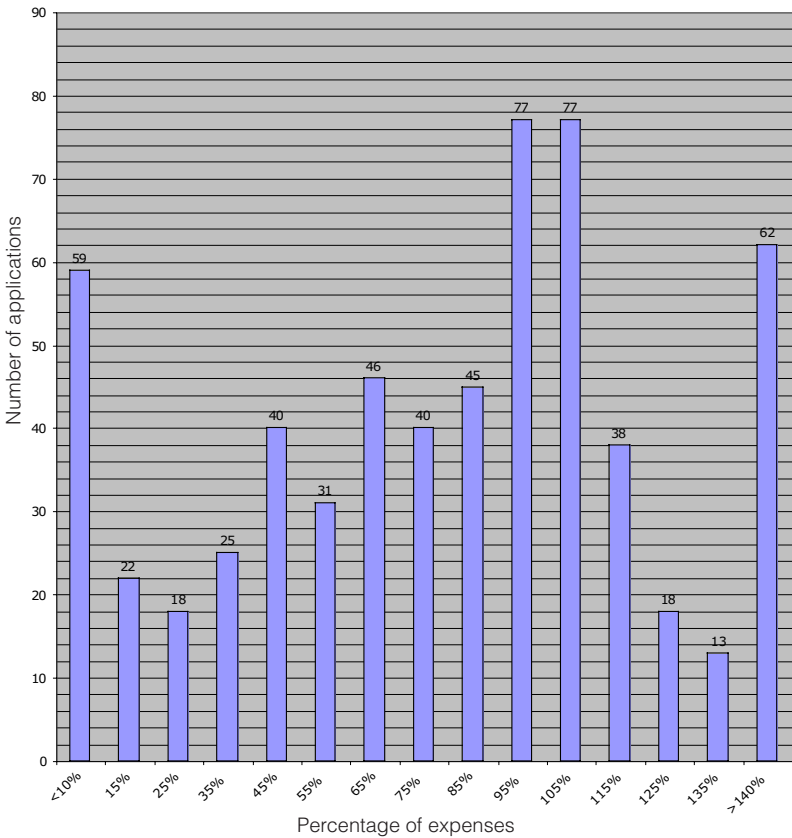
Performances with expenses of more than 150% are capped at the maximum level of 150%, because otherwise the graph would have been too elongated.

8.3.6.2. First graph: variance of percentage of production expenses

Year 2003 – The Netherlands



8.3.6.3. Second graph: number of applications, brackets of expenses



8.3.6.4. Conclusions from the figures and the graphs

The detailed 2003 figures produce interesting results:

- First graph:
 - (1) the variation in expenses is very large, not only for higher but also for lower performance fees;
 - (2) there is a big concentration at and just above 100% expenses;
 - (3) the expenses for performance fees above EUR 100,000 vary less, but stay within the range 35%-110%;
 - (4) the expenses for the five highest performance fees are between 44% and 80%; and

- (5) there is no correlation between the performance fee and the percentage of expenses.
- Second graph:
 - (6) just 40 of the 611 KVB applications (= 7%) are within the bracket of 70%-80% expenses, which equals the average of 72% expenses in 2003;
 - (7) the average of 72% expenses does not lie in the middle of the number of applications: 241 of 611 applications (= 39%) are under the average, while 330 of 611 applications (= 54%) are over the average;
 - (8) at the extremes, 59 of the 611 KVB applications (= 10%) are under 10% and 62 of the 611 KVB applications are over 140% (= 10%);
 - (9) almost two thirds of the KVB applications lie between 40% and 120% expenses, totalling 394 of the 611 KVB applications (= 64%); and
 - (10) the peaks are clearly between 90% and 110% expenses, totalling 154 of the 611 KVB applications (= 25%).

It can be concluded that expenses are very significant, can be quite high and can easily amount to more than 100% of earnings, but that the standard deviation of expenses is also very large.

8.3.6.5. Information about individual performances

The survey consists of the information of individual performances. For this thesis six examples of individual performances from the year 2003 have been selected, two for each of the categories “happy few”, “well-established professionals” and artistes “struggling for recognition”. These examples provide more information about the amount and structure of expenses.

8.3. The amount of expenses

8.3.6.6. "Happy few"

top artiste (A)

venue: stadium with 30,000 capacity (sold out)

	EUR	EUR	Rate 0.94 USD	USD
<i>Performance fee</i>				
guarantee	708,059		750,000	
percentage above guarantee	<u>82,650</u>		<u>87,546</u>	
		790,709	100.0%	837,546
<i>Expenses</i>				
<i>– variable expenses –</i>				
agency commission 5%	<u>39,535</u>		41,877	
		– 39,535	– 5.0%	
<i>– fixed expenses –</i>			<i>show NL (1)</i>	<i>EU tour total (33)</i>
air fares	19,318		<u>20,462</u>	<u>675,246</u>
buses	14,581		15,445	50,685
catering crew	13,684		14,495	478,335
entertainment/ meals	6,820		7,224	238,392
production supplies	6,973		7,386	243,738
freight	13,017		13,788	455,004
hotels	47,316		50,119	1,653,927
insurance	28,252		29,925	987,525
legal/immigration	1,072		1,136	37,488
lighting	26,270		27,826	918,258
local transportation	8,525		9,030	297,990
office supplies	1,852		1,962	64,746
salaries crew	46,001		48,726	1,607,958
per diems crew	11,487		12,167	401,511
photographer	1,260		1,335	44,055
power	25,801		27,329	901,857
pyrotechnics	7,081		7,500	247,500
rigging	9,038		9,573	315,909
security	3,041		3,221	106,293
sound	30,406		32,207	1,062,831
stage	33,418		35,397	1,168,101
telephone/fax/ mobile	4,352		4,610	152,130
trucking	21,911		23,209	765,897
video/projection	88,762		94,020	3,102,660
wardrobe/dry cleaning	5,971		6,325	208,725
rehearsals	50,482		53,472	1,764,576
miscellaneous	<u>0</u>		<u>0</u>	<u>0</u>
		– 526,691	– 66.6%	
<i>Profit/taxable artiste fee</i>	<u>224,483</u>		<u>28.4%</u>	

Chapter 8 – The deduction of (production) expenses

top artiste (B)

venue: stadium with 45,000 capacity

	EUR	EUR	Rate 0.90 USD	USD
<i>Performance fee</i>				
guarantee	720,000		800,000	
reimbursement for production expenses	90,000		100,000	
percentage above guarantee	0		0	
	<u>0</u>	810,000	100.0%	<u>900,000</u>
<i>Expenses</i>				
– variable expenses –				
management commission	5%	40,500		45,000
		<u>- 40,500</u>	- 5.0%	<u>- 45,000</u>
– fixed expenses –				
salaries staff	5,249		5,832	
salaries crew	20,212		22,458	
per diems	4,271		4,745	
gratuities and meals	0		0	
flights	28,800		32,000	
hotels – band	8,280		9,200	
hotels – crew	34,713		38,570	
buses – crew	9,800		10,889	
local/ground transport	3,600		4,000	
stage	120,000		133,333	
barricade rental	1,800		2,000	
trucking & cartage	30,852		34,280	
light company	23,150		25,722	
laser company	7,821		8,690	
sound company	17,325		19,250	
video company	34,275		38,083	
catering	9,562		10,624	
power rental	14,156		15,729	
equipment purchase	2,250		2,500	
rigging rental	2,057		2,286	
wardrobe purchase	90		100	
walkie talkies	321		357	
world phones	90		100	
management services	1,125		1,250	
attorney	1,125		1,250	
insurance – liability	900		1,000	
insurance – damage/ loss	90		100	
passes	90		100	
itineraries	90		100	
shipping/ postage/ phone	225		250	
contingency	0		0	
		<u>- 382,318</u>	<u>- 47.2%</u>	<u>- 424,798</u>
<i>Profit/taxable artist fee</i>		<u>387,182</u>	<u>47.8%</u>	<u>430,202</u>

8.3.6.7. “Well-established professionals”

mid-size artiste (C)

venue: medium-size hall with 5,500 capacity

	EUR	EUR	Rate 0.94 USD	USD
<i>Performance fee</i>				
guarantee		46,978	50,000	
percentage above guarantee		0	0	
		<u>46,978</u>	<u>100.0%</u>	<u>50,000</u>
<i>Expenses</i>				
<i>– variable expenses –</i>				
management commission	15%	7,047	7,500	
agency fee	10%	4,698	5,000	
business management	5%	2,349	2,500	
		<u>– 14,093</u>	<u>– 30.0%</u>	<u>– 15,000</u>
<i>– fixed expenses –</i>				
airfares		1,711	1,821	
freight		794	845	
local transport		32	34	
bus hire		2,875	3,060	
trucking		3,382	3,600	
PA hire		2,449	2,607	
lighting hire		2,181	2,321	
hotels band		3,458	3,680	
hotels crew		2,433	2,590	
per diems		1,409	1,500	
crew salaries		6,271	6,675	
driver per diems		564	600	
rehearsal costs		411	437	
insurance		389	414	
spares and supplies		81	86	
phone/fax/courier/mobiles		65	69	
pre-production/set-up costs		49	52	
dry-cleaning/wardrobe		122	130	
miscellaneous		874	930	
		<u>– 29,550</u>	<u>– 62.9%</u>	<u>– 31,451</u>
<i>Profit/taxable artist fee</i>		<u>3,334</u>	<u>7.1%</u>	<u>3,549</u>

Chapter 8 – The deduction of (production) expenses

mid-size artiste (D)

venue: club with 1,200 capacity (two shows)

	EUR	EUR		Rate 0.91		
				USD	USD	USD
<i>Performance fee</i>						
guarantee	18,312				20,123	
percentage above guarantee		—			—	
		18,312	100.0%			20,123
<i>Expenses</i>						
– variable expenses –						
agency fee	10%	1,831			2,012	
management commission	20%	3,662			4,025	
			– 5,494	– 30.0%		– 6,037
– fixed expenses –						
				NL (2)	Tour (58)	
PRE- PRODUCTION						
rental studio/salaries/travel		282		310	9,000	
office/telephone/ fax/computers		94		103	3,000	
hotels		408		448	13,000	
PRODUCTION						
air fares band		375		412	11,945	
air fares crew		27		29	845	
taxi/local transportation		88		97	2,800	
buses/drivers/per diems		1,835		2,017	58,489	
salaries crew		791		869	25,200	
per diems band/ crew – 13 x USD 30		881		968	28,080	
hotels		408		448	13,000	
mobile phone tour manager		141		155	4,500	
musical supplies		251		276	8,000	
extra travel agent/ tour manager		78		86	2,500	
rental instruments/ equipment		550		604	17,522	
			– 6,209	– 33.9%		– 6,823
<i>Profit/taxable artiste fee</i>		6,609		36.1%		7,263

8.3. The amount of expenses

8.3.6.8. “Artistes struggling for recognition”

new talent (E)

venue: medium-size hall with 5,500 capacity

	EUR	EUR	Rate 0.93	
			USD	USD
<i>Performance fee</i>				
guarantee	13,948		15,000	
percentage above guarantee				
	<u>20,449</u>		<u>21,992</u>	
		34,397	100.0%	36,992
<i>Expenses</i>				
<i>– variable expenses –</i>				
management commission	10%	3,440		3,699
agency fee	10%	<u>3,440</u>		<u>3,699</u>
		- 6,879	- 20.0%	- 7,398
<i>– fixed expenses –</i>				
salaries crew		2,445		2,629
per diems		651		700
air fares		988		1,063
hotels		3,803		4,090
lighting		2,498		2,686
sound		2,568		2,762
lighting design		524		564
banner costs		325		350
freight		379		408
local transportation		186		200
insurances		113		121
telephone/fax/ FedEx		37		39
hair and make-up		122		132
laundry		29		32
visas		49		53
laminates, passes and itineraries		122		132
radios and mobiles		186		200
consumables		137		147
rehearsals and pre-production		2,125		2,285
busses rental		3,209		3,451
truck rental		1,594		1,714
miscellaneous		<u>930</u>		<u>1,000</u>
		- 23,021	- 66.9%	- 24,758
<i>Profit/taxable artiste fee</i>		<u>4,497</u>	<u>13.1%</u>	<u>4,836</u>

Chapter 8 – The deduction of (production) expenses

new talent (F)
venue: club with 1,200 capacity

	EUR	EUR	
<hr/>			
<i>Performance fee</i>			
guarantee	9,500		
percentage above guarantee	—		
	<hr/>	9,500	100.0%
<i>Expenses</i>			
<i>– variable expenses –</i>			
management commission	15%	1,425	
agency fee	10%	950	
business management	5%	475	
		<hr/>	– 2,850 – 30.0%
<i>– fixed expenses –</i>			
administration		159	
salaries crew		1,157	
per diems (8 persons)		272	
hotels		1,440	
rental backline		336	
transportation		881	
truck rental		1,487	
musical supplies		98	
insurance		461	
miscellaneous		135	
		<hr/>	– 6,426 – 67.6%
<i>Profit/taxable artiste fee</i>		<hr/>	224 2.4%

8.4. Why do artistes incur such high expenses?

8.4.1. Variation in expenses

The survey in the Netherlands has shown that expenses for international performances are high. In 80% of the cases in the survey, the expenses were higher than 40% of earnings. This leads to the question of why artistes incur such high expenses. Small artistes are comparatively worse off: in almost every case they have a minimal or negative result, but bigger artistes also tend to have high expenses, perhaps not always as a percentage from their performance fee but in any case in nominal figures:

8.4. Why do artistes incur such high expenses?

- first, travelling to other countries is expensive and includes buses, trucks and sometimes flights to get abroad or even overseas, hotels or other accommodation, and food, drinks and other entertainment for whole days away from home;
- second, the expense of equipment to put on performances properly – the stage set-up, instruments, clothing, sound and light, but also in bigger venues video and laser shows;
- third, artistes are accompanied by personnel operating the equipment during the performances, loading and unloading, securing the safety and well-being of the performers, and taking care of everything around the actual event;
- fourth, agents and managers are essential to plan the foreign performances in the total schedule of the artiste's career, book the dates with local organizers, and do the necessary promotion to reach the audience;
- fifth, insurance may be needed to cover the risk of non-appearance because of illness, accident or any other obstacle; and
- sixth, many other expenses need to be added, such as administration, legal help, accountants on the road controlling the organizers of tickets sales and production expenses – and tax advisers to avoid excessive artiste withholding tax.

This variation in expenses is quite normal when compared to other businesses. It is also understandable that the expenses for international activities are very often higher than for domestic activities. Many artistes run a business in which they can only generate earnings if they invest enough in a good product and a proper organization.

Often the negative result of this travelling to other countries can be covered by subsidies. Classical music, theatre, dance, jazz and sometimes even pop music are subsidized by national governments, not only for national performances but also for travel abroad. Extra funds can be made available for bringing national heritage or modern culture to other countries, sometimes even supported by institutions abroad promoting their national culture.⁸ The tax treatment of subsidies as possible performance income was discussed in 4.3.9.

8. Examples of such institutions are the German *Goethe Institut*, the French *Bureau de la Musique* and the British Arts Council; embassies with special cultural attachés also emphasize the importance of international performances or sometimes cultural exchange.

8.4.2. Connection between expenses and royalties

Performing artistes can also have other aims with their foreign performances. New talents very often see their performances as an investment. They are not yet able to earn enough to cover their production expenses, but they promote themselves to the public with their appearances, hoping to attract good press reviews and a public following. In pop music this is very often combined with the release of records, with videos and television or radio appearances. It is hoped that a rise in popularity will stimulate new demand and that the organizer will take the risk of asking the artistes for more performances, which will subsequently stimulate the sales of records further. The interaction between performances and the sales of records or CDs can be strong. Artistes may undertake a tour to promote their new record and profit with their record royalties from the increase in sales in various territories. Copyright and neighbouring right royalties will follow and also go up. It can sometimes be questioned what the main objective is of specific foreign performances, especially when the record company takes over the deficit with financial tour support.⁹ This synergy can produce important new star artistes, as has happened over the past few years with artistes such as Radiohead, Shakira, Robbie Williams, Coldplay and André Rieu. But established pop artistes also use performances for combined purposes.

This means that the difference in international tax treatment of performance income (Article 17 of the OECD Model) and royalty income (Article 12 of the OECD Model) causes a conflict when it comes to the allocation of the production expenses for the performances. Royalties will normally be exempt in the source country, using the general allocation rule of Article 12 of the OECD Model Tax Convention,¹⁰ whilst the taxing right for performance income is normally allocated to the source country, under Article 17 of the OECD Model. It can be asked whether some of the expenses of the (taxable) performances need to be transferred to (exempted) royalties.

9. This tour support is normally considered as a non-refundable advance against later royalties, but can sometimes be an extra payment by the record company, non-recoupable against royalties. See 4.3.10. and 4.3.11. for a discussion of whether these earnings fall under Article 17 of the OECD Model Tax Convention.

10. According to Article 12 of the OECD Model the taxing right for royalties has been allocated to the country of residence, although in many bilateral tax treaties a low (gross) withholding tax rate of 5%-10% on royalties still exists.

It will not be easy to determine such a split of performance expenses.¹¹ This split depends on the purpose of the artiste in giving his performances, on a connection with a record that has been released shortly before, on the amount of the performance fee or the profit margin (or loss) of the performance and perhaps other reasons behind the public performance. But these reasons will in most cases not be clear and not easy to connect to the performances.

It can also be argued that very often a split in expenses would not be correct. This is the case when the expenses are inextricably and directly bound up with a performance generating a direct income and are only indirectly linked to an uncertain and unclear royalty income. The direct connection would then prevail over the indirect relationship, as is normal with the qualification rules for income under the OECD Model. Income items normally fall under only one article of the OECD Model and are not divided over more articles. This can be the same for expenses.

A more subtle approach would be to follow the division that has been developed for activities with both a performance and a non-performance character, as discussed in 3.7. of this thesis. Paragraph 71 of the 1987 OECD Report¹² recommends an apportionment of the earnings to Article 17 and another treaty article, if the entertainment character in the activity is not predominant. The same paragraph also mentions the Austrian decision procedure, in which an apportionment of the earnings is required if the arts/entertainment activities comprise between 20% and 80% of the total activities. This approach could also be used for the division of expenses over performance and other, such as royalty, income.

It is in any case clear that a split has not been made in the Dutch system of *kostenvergoedingsbeschikkingen* (cost reimbursement approvals), which was described in 6.4. and was used as the information basis for the survey on expenses in 8.3. The Dutch tax administration does not make a connection between expenses for performances and royalty income. This means that the results from the survey need to be put in perspective, because there is inevitably a more or less indirect connection between

11. In some cases it is problematic to qualify the earnings as either royalties or performance income. See 4.3.13., in which the case *Boulez v. Comm.* ((1984) 83 TC 584; see Sandler at 185) was mentioned.

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

these expenses and the sales of records and proceeds from copyrights for non-resident artistes in the Netherlands.

It needs to be emphasized that with the decline of record sales in the music industry over the last few years because of downloads from the Internet and illegal copying, the importance of royalties and copyrights has diminished sharply, while the earnings from (international) performances have become more important.

And there are many artistes who do not have royalty income as a second source of income. To this category belong theatre groups, classical orchestras, dance companies and so on. But these artistes can have other income which is not taxable in the country of performance, such as subsidies or sponsorship.

The discussion in this paragraph shows that the division of expenses which directly relate to a taxable source of income under one article of a bilateral tax treaty (i.e. Article 17), but partially and very often only indirectly also relate to another, non-taxable source of income under another article of a bilateral tax treaty (i.e. Article 12), is not simple and can lead to dispute. This would not be the case if there were no differences in allocation of the taxing rights for royalty income and performance income.

8.5. Special rules and exclusions for amateurs

Many examples can be given of smaller artistes, performing in venues with a capacity of less than 1,000, sometimes with fewer than 100 spectators, or as a support act for a bigger artiste or at a festival before or after the headline acts. It appears that most of these artistes have higher expenses than earnings and do not make a profit. The costs of travel, road crew, lodging, food and equipment are already so high that it would not be realistic to expect a profitable tour.

When small artistes perform abroad their performance fees are normally quite low, very often not even covering the costs. Some countries have put in their artiste tax rules special allowances for small artistes with small performance fees. They do not need an individual tax ruling on their expenses as long as their earnings are below a certain threshold. These are examples in different countries:

8.5. Special rules and exclusions for amateurs

- *The Netherlands*:¹³ EUR 136 per artiste per show + free reimbursement of food, drinks, travel and accommodation.
- *Belgium* ¹⁴ EUR 400 per artiste per show for the first day and EUR 100 per artiste per show for the following days. The first-day allowance is built up as follows:

travel	EUR 300
food and drinks	EUR 40
accommodation	EUR 60
total	EUR 400
- *Germany*:¹⁵ a bracket system for smaller performance fees (per person):

EUR 0 – 250	0% tax
EUR 251 – 500	10% tax (+ 5.5% surcharge = 10.55%) from total fee
EUR 501 – 1,000	15% tax (+ 5.5% surcharge = 15.83%) from total fee
higher than EUR 1,001	20% tax (+ 5.5% surcharge = 21.10%) from total fee
- *United Kingdom*:¹⁶ GBP 1,000 per artiste or group per show.
- *United States*. *De minimis* rule in the national tax legislation of USD 3,000 and in the tax treaties with various countries, according to the 1996 US Model Tax Convention the threshold set at USD 20,000 earnings (including reimbursement of expenses) per artiste per year per treaty country, but in many tax treaties the United States sets a lower level. These tax treaties are specified in 5.6.2.

These (inter)national measures help “small but willing” amateurs¹⁷ to minimize their tax obligation without the administrative burden of declaring their expenses. Interestingly enough the threshold amounts vary per country, even per neighbouring country, and the deductions work in different ways.

13. Art. 35 of the *Wet op de loonbelasting 1964* (Wage Tax Act).

14. *Circulaire* 16.10.01/1 (Ci.Rh. 244/536.588, dated 16 October 2001).

15. Article 50a § 4 of the *Einkommensteuergesetz* (Income Tax Act).

16. Article 4(3)(b) of the Income Tax (Entertainers and Sportsmen) Regulations 1987.

17. If the USD 20,000 threshold of the *de minimis* rule in US tax treaties is sufficiently high to cover more than artistes’ expenses, the artistes involved will not be considered amateurs and the home country needs to tax the profit.

But amateurs are normally not taxable. Under normal rules only positive income from activities is treated as taxable income. Activities with structural deficits are no more than a hobby.

It seems as if the special artiste tax rules of Article 17 of the OECD Model deviate from this general tax rule. This is not mentioned in the text of the article, but in Paragraph 2 of the Commentary on Article 17. As an exception to the general rule of Article 17, countries “may, by common agreement, limit the application of Paragraph 1 to business activities”. But this means that without this common agreement, and hardly any bilateral tax treaties have made such an agreement, Article 17 entitles countries to tax amateurs.

Vogel¹⁸ refers in his discussion about amateurs to the wording of the older German tax treaties, which were restricted to “professional” entertainers only. This followed the French text of the 1963 OECD Model Treaty, which mentioned “professionnels du spectacle”. He concludes that quite a few German treaties still use the same wording, but that the limits are often not very clear, because with a certain amount of success an amateur can easily become a professional. But the income has to be more than a mere reimbursement of expenses.

At a national level, Reinhard Polläth¹⁹ and Manfred Wieser²⁰ also discuss *Liebhabeerei* (hobby). Polläth believes that hobbies and arts will very often go together, but that a switch from being an uninteresting amateur to a high-earning professional can happen in incidental cases. Wieser refers to the Austrian *Liebhabeerverordnung*, a special tax regulation for amateurs in general, and he defends the opinion that non-resident amateur artistes do not have to fall under the artiste tax rules in Austria.

Australia has issued a special regulation about amateurs,²¹ stating that normally non-resident amateur artistes would have to fall under Australian

18. Klaus Vogel on *Double Taxation Conventions* (3rd ed., Kluwer Law International, 1998), at 985.

19. Reinhard Polläth, “Künstler und Sportler in der beschränkten Steuerpflicht”, in: *Die beschränkte Steuerpflicht* (edited by Wilhelm Haarmann, Verlag Dr. Otto Schmidt KG, Cologne), at 59.

20. Manfred Wieser, “Besonderheiten bei der Besteuerung von Musikern”, *Finanz Journal* 3/99 (Grenz-Verlag, Wien), at 65.

21. “Is income derived by non-profit societies, associations or clubs located outside Australia that promote cultural activities such as arts at Australian cultural festivals and events subject to Australian income tax?”, TD 1997/7, 5 May 1999.

artiste taxation, because of the Australian Income Tax Act and the text of the Australian tax treaties, based on Article 17 of the OECD Model Tax Convention; but Australia makes an exception for overseas non-profit cultural organizations, which are exempt from income tax in their home country. These amateur artistes can apply for an exemption in Australia.

Belgium is clearer about amateurs, because it limits the scope of its non-resident artiste taxation to persons who intend to make a profit.²²

In the Netherlands officially all earnings of non-resident artistes were taxable under the artiste tax rules, but a special regulation was issued in 1982 for amateur artistes.²³ This was followed by a supporting decision by the *Hoge Raad* (Supreme Court) in 1995, stating that artistes receiving no more than just reimbursement for their expenses and therefore not making a profit could not fall under artiste taxation.²⁴ After the change in the Dutch artiste taxation from 2001 the Dutch tax authorities have issued a new regulation for amateur artistes,²⁵ but unfortunately only resident artistes can meet the requirements for this regulation. This may lead to a possible complaint about unequal treatment of non-resident amateur artistes as compared to residents.

In Germany the discussion about amateurs was revitalized by a decision by the *Bundesfinanzhof* (Supreme Court) about *Reitsportler* (equestrian sports).²⁶ Some non-resident sportsmen received a payment from the tournament organizer but demonstrated to the tax administration that their expenses were much higher than their earnings. Under the German sportsman and artiste tax rules withholding tax is taken from the gross fee without the deduction of expenses, but the Court decided that in cases of *Liebhabelei* (hobbies) no tax was due from amateurs, regardless of whether they were residents of a foreign country.

22. Part II of the *Circulaire* 01.02.02/1, Ci.R.9.Div./546.156 (AOIF 3/2002).

23. *Ministerie van Financiën* 27 October 1982, *Infobulletin* 82/571.

24. *Hoge Raad* 5 April 1995, *BNB* 1995/218.

25. *Ministerie van Financiën* 7 February 2002, *V-N* 2002/11.21.

26. *Bundesfinanzhof* 7 November 2001, I R 14/01, *Internationales Steuerrecht* 9/2002, at 307, with comment by Klaus Bockiek.

8.6. General discussion and conclusions

International performing artistes incur high expenses. Very often these expenses are not deductible in the country of performance, either at the withholding stage or in a later income tax return. Paragraph 10 of the Commentary on Article 17 of the OECD Model supports this gross taxation. It seems as if the importance of expenses for artistes is underestimated.

A survey in the Netherlands shows the importance of the expenses. For the survey the information from 2,498 performances in 3 years (2001-2003) was gathered. The results show that the expenses vary a great deal, between 0% and more than 150% of the performance fees, and that their average is 75%. The study includes all kinds of artistes, from classical to pop music, from theatre to dance and from amateurs to very high earners. The figures of the survey are presented in this chapter in various ways – in total, details per year, details per performance and in graphs.

The figures are confirmed by an evaluation which was published by the Dutch tax authorities in May 2004. They have studied the taxation of all artiste and sportsman performances in the year 2002 and the average of expenses from this survey was 64%.

The differences between these two surveys may still need to be explained, but the conclusion of both surveys is that at either two thirds of three quarters of the earnings, the element of expenses plays a major role in the determination of the profit on performances.

The reasons behind these high expenses have also been studied in this chapter. The conclusion needs to be that artistes are no different from other businesses or service providers, which means that they can only generate earnings if they invest enough in a good product and a proper organization. Expenses of 64% or 75% do not seem high compared to those of other businesses, where profits of 10%-15% seem to reflect a very healthy organization.

Artistes can also have other income, such as royalties from sales of records. It has been discussed whether the expenses for performances need to be allocated to this other income, especially when performance income is not sufficient to cover the expenses. But this split of expenses will very often not be easy. And it can also be argued that a division of expenses

would not be correct if the connection with the performance were very direct, while the connection with royalties were indirect and uncertain. In other cases an apportionment would be feasible.

Many countries have made special rules to exclude smaller performance fees from their artiste taxation. Unfortunately, these rules are very different per country.

Normally amateurs are not taxable. But this is different under Article 17 of the OECD Model, which recommends taxing all artistes, unless a specific agreement has been made that the article is restricted to business activities only. Some countries have a general exclusion for amateur artistes in their national tax rules.

