

PART C

PRESENT SITUATION WITHIN THE EUROPEAN UNION

CHAPTER 11

UNEQUAL TREATMENT IN THE EUROPEAN COMMUNITY

11.1. Market integration in the European Community

The artistes in the examples in chapter 9 live and perform in Member States of the European Community. The integration process in Europe gives them more and more opportunity to travel to other countries, without visas and permits, doing performances and since 2002 receiving their fees and paying their expenses in most countries in one single currency, the euro. This integration process started tentatively with a European Community of 6 members in the 1950s, grew gradually to 10 and later to 15, and had a new boost in May 2004 with 10 more countries from Eastern Europe. The Community was created to foster an ongoing process of economic and political integration, which was very important after the Second World War and, more recently, offered the chance to reverse the frosty relationship with the Soviet-dominated eastern part of Europe. The European Community wants to realize its ultimate objectives¹ on the one hand through the establishment of a common market in which the free movement of goods and production factors is ensured, and on the other hand through the harmonization of regulatory frameworks and the coordination of policies that stimulated the functioning of the market. The ideal of the common market is to create a “level playing field” with normal conditions of competition. The Member States decided at the time of the conclusion of the initial EEC Treaty in 1957 to create a supranational Community of law to which they entrusted the responsibility for the process of economic integration.

The Member States enabled the Community to create legislation to remove any discriminatory restrictions to free movement resulting from the legal

1. The ultimate objectives of the European Community are to achieve (1) a harmonious and balanced development of economic activities, (2) sustainable and non-inflationary growth respecting the environment, (3) a high degree of convergence of economic performance, (4) a high level of employment and social protection, (5) the raising of the standard of living and quality of life and (6) economic and social cohesion and solidarity among Member States. See Article 2 of the EC Treaty.

provisions of the individual states, mainly by harmonization and coordination.²

The Community was also endowed with the judicial instrument of directly applicable law, which Community citizens can enforce before national courts. This Community law describes basic rights, such as the freedom of establishment (Article 43 of the EC Treaty) and the free movement of goods (Article 23 of the EC Treaty), workers (Article 39 of the EC Treaty), services (Article 49 of the EC Treaty) and capital (Article 56 of the EC Treaty), making it possible for people to move freely to other parts of the market under conditions of equal treatment and fair competition. These basic rights can be invoked in the national courts of the Member States against national legislation which is incompatible with the fundamental principles of non-discrimination and free movement, and they guarantee a constitutional minimum of economic integration.³

In its attempt to remove obstacles to economic integration the European Community also focuses on the removal of tax obstacles, since taxation, by its price and income effects, has a powerful influence on economic behaviour and thus on market integration. Already in the early days of the integration process the Community made a distinction between indirect taxes on the supply of goods and services (which relate more to trade) and direct taxes on income and capital (which relate more to the movement of international production factors).⁴ For indirect taxation the European Community introduced many Directives on VAT⁵ and customs and excise which must be implemented by the Member States in their national legislation. In the initial stages, the European integration process focused to a large extent on product markets and the harmonization of the VAT in the Member States was a key factor in improving the conditions of trade between countries.

There have been some initiatives for the harmonization of direct taxes within the European Community, but on every occasion one or more Member States has hesitated or refused to follow the initiative. This has not produced much progress, because new Community legislation in the direct tax field can only be adopted by unanimity. Until now, four direct

2. This is usually called “positive integration”.

3. This is usually called “negative integration”.

4. Even though this distinction is theoretically imperfect, because economists have long indicated that not only indirect taxes but, in the long term, income taxes also may be partly shifted forward into prices.

5. With a main role for the Sixth VAT Directive.

tax directives have been accepted: the Parent-Subsidiary Directive, the Merger Directive, the Interest and Royalties Directive and the Savings Income Directive. The Exchange of Information Directive and the Recovery of Tax Claims Directive also concern direct taxation in EC Member States. There have been more initiatives, but these have not produced any results up to now.

The current EC Treaty does not call for further individual and corporate income tax harmonization. It mentions in Article 293 that Member States need to enter into negotiations to secure the abolition of double taxation within the Community, but this article does not have a direct effect.⁶

Although direct taxation remains a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community law.⁷ Member States have retained jurisdiction for their direct taxes, such as income and corporation taxes, but feel the influence of the basic freedom principles of the EC Treaty. The European Court of Justice plays an important role in developing and enforcing the rights of the EC Treaty. National courts can either decide directly whether a national income tax rule is inconsistent with the articles of the EC Treaty (a case of *acte clair*) or can raise preliminary questions with the ECJ (which will lead to an *acte éclairé*). The preceding means that, in a case of non-conformity, European law can override national law.⁸ By applying in its income tax decisions a number of well-known principles of Community law to the way in which the Member States tax cross-border income flows, the ECJ has alerted international tax lawyers to the fact that European law also affects (direct) income tax law.

European law has its impact not only on national income tax laws but also on bilateral treaties concerning the taxation of cross-border income flows between Member States.⁹ The European Court of Justice is extending the

6. See *Gilly*, ECJ 12 May 1998, C-336/96, Paragraph 17.

7. The ECJ confirmed this cohesion e.g. in *Schumacker*, 14 February 1995, C-279/93, Paragraph 21 and in *Wielockx*, 11 August 1995, C-80/94, Paragraph 16.

8. See *ICI*, ECJ 16 July 1998, C-264/96, Paragraph 19, and in *Royal Bank of Scotland*, ECJ 29 April 1999, C-311/97, Paragraph 19. See also Servaas van Thiel, *EU Case Law on Income Tax*, International Bureau for Fiscal Documentation, Amsterdam (2001), at 115.

9. The relationship between bilateral tax treaties (and especially the OECD Model Tax Convention) and European law as regards performing artistes will be discussed in chapter 12.

integration process in the Community where the Community legislator is failing to act in the area of income taxation.

11.2. Obstacles for international performing artistes within the Community

It seems odd that excessive international taxation for performing artistes, as shown in the examples in chapter 9, can occur in the Community of a united Europe that is trying to bring together the markets of the individual Member States into one single market with as few borders and obstacles as possible.¹⁰ Both the European Commission and the Member States, on the one hand, put much effort into legal and administrative measures to stimulate the mobility of their artistes throughout Europe,¹¹ while, on the other hand, the problem of excessive taxation makes these artistes reluctant to accept invitations for foreign performances. Artistes question whether the positive effect of a foreign performance is worth more than the extra expense of excessive taxation. This also affects the organizer of a concert, theatre play or dance performance, who will calculate, when the extra tax burden has been grossed up and shifted to him because the artiste has insisted on a net performance fee, whether foreign artistes provide enough extra value to his programming.

The excessive taxation raises obstacles to the mobility of artistes through the European Community. This was recognized in a study of the University of Paris in April 2002,¹² undertaken at the request of the European Commission.¹³ The study concludes in Chapter III:

10. There may be differences in tax rates within the European Union, which can lead to excessive taxation, because the European Union has not harmonized direct taxes. See also chapter 9.

11. Every year another city is the Cultural Capital of Europe, such as Graz in 2003, Lille and Genoa in 2004, Cork in 2005, Patras in 2006, Luxembourg in 2007 and Liverpool in 2008. The Directorate-General for Culture of the European Commission is also coordinating the project “Culture 2000” for the period 2000-2006, in which artistes are encouraged to perform in other Member States. New proposals are now being prepared for “Culture 2007”.

12. Olivier Audéoud, *Study on the Mobility and Free Movement of People and Products in the Cultural Sector*, University of Paris X, No. DG EAC/08/00, April 2002 (europa.eu.int/comm/culture/eac/sources_info/pdf-word/mobility_en.pdf).

13. The report was published at around the same time as the article by Dick Molenaar, “Obstacles for International Performing Artists”, 42 *European Taxation* 4 (2002), at 149, which was discussed in 2.15.10.

The persons interviewed were fairly unanimous in their criticism of the extreme diversity in tax legislation in force throughout Europe and which can restrict the mobility of performing artists and their productions in the European Community. It is a fact that certain national provisions can create obstacles or at least be a disincentive to the circulation of artists and cultural workers in the EU.

This chapter will discuss whether and to what extent the EC Treaty and the decisions of the European Court of Justice can influence the issue of excessive taxation for European and perhaps also other international performing artistes.

11.3. The role of the European Court of Justice

The basic principles of the EC Treaty that may apply to international performing artistes are, in addition to non-discrimination on grounds of nationality,¹⁴ mainly the freedom of establishment and the free movement of workers and services. These freedom principles benefit European citizens and companies (nationality requirement) who engage in an economic activity within the Community (economic-substance requirement), which is not purely domestic but crosses the borders of Member States (nexus requirement).

Both employment and self-employed activities are covered by the freedom principles, even if they are not particularly gainful or profitable or if profit-making is only an ancillary motive. The European Court of Justice has considered that artistic activities also fall within the scope of application of the Treaty.¹⁵

For the analysis of a possible conflict with the freedom principles of the EC Treaty, the ECJ has developed an examination pattern, also called the “rule of reason test”. Generally, the ECJ starts by assessing whether or not the obstacle at hand that leads to a disadvantage falls within the scope of at least one of the non-discrimination provisions. If it does, the next step of the examination consists of ascertaining whether the national measure is prohibited. If it is found to be in breach of Community law, the last part of

14. Article 12 of the EC Treaty.

15. *P. Steinhauser v. City of Biarritz*, 18 June 1985, C-197/84. This was not a case about (direct) taxation, but about the freedom of establishment for a German artiste in the city of Biarritz in Southern France.

the ECJ's pattern of examination consists of applying possible justifications to the actual situation.

The ECJ has two main lines of reasoning. The first line can be called the *nationality-based approach*, mainly based on the rule of non-discrimination on the ground of nationality. An example of this can be found in one of the earlier decisions of the Court in direct tax matters, i.e. the *Biehl* decision.¹⁶ The second line can be called the *free-movement-based approach*, mainly based on the five freedom principles of the EC Treaty. An example of this approach can be found in the *Terhoeve* decision of the ECJ.¹⁷

But from the ECJ decisions it can also be concluded that the five freedom principles are connected to the non-discrimination principle, which means that non-conformity with the freedom principles leads to covert discrimination.¹⁸

11.4. The *Arnoud Gerritse* decision (C-234/01)

11.4.1. First case about artiste taxation

The first time that the European Court of Justice tested non-resident artiste taxation against the freedom principles of the EC Treaty was the *Arnoud Gerritse* case.

11.4.2. The facts and the preliminary question

Arnoud Gerritse is a Dutch musician who in 1996 performed for a few days as a drummer for a radio station in Berlin, Germany. His performance fee was EUR 3,000, which also covered his rehearsals and expenses. He was taxed under § 50a *Abs. 4 Einkommensteuergesetz* (German Income Tax Law, EStG) at 25% of the gross earnings without deduction of expenses. Because of surcharges the real tax rate rose to 29%, which resulted in a withholding tax of EUR 870. Besides this, Arnoud Gerritse

16. *Biehl-I*, 8 May 1990, C-175/88.

17. *Terhoeve*, 26 January 1999, C-18/95. See also Maria Hilling, *Free Movement and Tax Treaties in the Internal Market*, Iustus Förlag (2005).

18. See also Ben J.M. Terra and Peter J. Wattel, *European Tax Law*, Kluwer, Deventer (2005), at 53.

earned EUR 27,500 in his home country the Netherlands and (partly) in Belgium.

He filed an individual *Einkommensteuererklärung* (German income tax return) for the year 1996 in Germany, because he wanted to (1) deduct his direct expenses for travel and stay of EUR 500 and (2) make use of normal income tax rates, including the tax-free amount (*Grundfreibetrag*) of EUR 6,000 (per year). The *Finanzamt Neukölln-Nord* in Berlin rejected the request for an income tax assessment and refund, because the rule of § 50 Abs. 5 EStG made the withholding tax of 25% (+ surcharges) the final taxation for artistes and other non-residents with limited tax liability in Germany.

In the appeal, the *Finanzgericht* (Tax Court) *Berlin* considered the arguments by the plaintiff positively, but decided because of the impact on the German *Einkommensteuergesetz* to raise the following preliminary questions to the European Court of Justice in Luxemburg on 28 May 2001:

Is there an infringement of Article 52 of the EC Treaty (now Article 43 EC) where, under Paragraph 50a(4), first sentence, point (1) and second sentence, of the *Einkommensteuergesetz* (Law on Income Tax) as in force in 1996 (EStG 1996), a Netherlands national who earns in the Federal Republic of Germany taxable net income of approximately DM 5.000 from self-employed activity in the calendar year is subject to deduction of tax at source by the person liable to pay his fees at the rate of 25% of his (gross) revenue of approximately DM 6.000 plus solidarity charge, where it is not possible, by means of an application for a refund or an application for a tax assessment, for him to recover, in whole or in part, the taxes paid?

11.4.3. Discussion while the case was pending

A first reaction came from Harald Grams and the author, the initiators of the case, in a short comment on the referral by the *Finanzgericht Berlin*.¹⁹ Later they published a German translation of a comparable case in the Netherlands, which had already been decided in April 2000 in favour of the (Belgian) artiste concerned.²⁰ That case was comparable to the *Gerritse* case, i.e. it challenged the Dutch system for non-resident artistes, in which

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

20. Harald Grams and Dick Molenaar, “*Gerechthof Amsterdam*, 25 April 2000, P 99/1188”, *Internationales Steuerrecht* 12/2002, at 420. In the Netherlands the decision was published in *Infobulletin* 2000/489 and *BNB* 2000/369.

no normal income tax assessment was possible, no expenses could be deducted and no tax-free allowance was granted. The Dutch tax court considered that the existing rules for non-resident artistes in Dutch income tax law were incompatible with the general rules of equal treatment.²¹ The Dutch authorities accepted the decision and changed the income tax law shortly afterwards in accordance with the court decision.²² But with this decision the issue unfortunately remained an internal Dutch matter and did not attract any attention in other countries.

The pending case was also reviewed by the German author Axel Cordewener.²³ He explained that the German authorities defended the existing system with arguments of administrative simplicity, the limited means available for controlling the behaviour of non-resident taxpayers without a permanent establishment and the problematic verification of information provided by non-residents. But Cordewener did not consider these arguments as sufficient justification, because alternatives were available that could also lead to reliable taxation for the German authorities and which did not discriminate against non-residents in Germany.

Another discussion was published by Eva Burgstaller and Walter Loukota, both from Austria, in May 2003.²⁴ They compared the case with the Austrian rules for non-residents, both artistes and other taxable persons. Their conclusion was that whereas Austria had some limited options for non-residents to file normal income tax returns at the end of the year, the *Gerritse* case could force Austria to remove these limitations.²⁵

21. The Tax Court Amsterdam did not specifically refer to the EC Treaty, but based its decision on the general principle of equal treatment.

22. There was one important difference in the change of the Income Tax Law per 1 January 2001. The tax-free allowance was no longer granted to non-resident taxpayers unless they earned more than 90% of their income in the Netherlands (“*Schumacker-test*”) or they decided to be treated as resident in the Netherlands, filed their worldwide income and were taxed at progressive tax rates. This applied not only to non-resident artistes but to any non-resident in the Netherlands.

23. See Axel Cordewener in Michael Lang et al., *Direct Taxation: Recent ECJ Developments*, Linde Verlag, Issue 25, 2003, at 77.

24. Eva Burgstaller and Walter Loukota, “Der Steuerabzug beschränkter Steuerpflichtiger – Welche Konsequenzen hat der EuGH-Fall *Gerritse*?”, *SWI* (2003), at 244.

25. An example of these limitations is that the deductions for expenses for non-resident artistes in income tax returns are restricted to payments made to Austrian residents. Payments to foreign service providers are not deductible.

Many more articles have been published in the German tax literature. It has become clear that *Gerritse* may not only have had an impact on the taxation of non-resident artistes but also on other examples of gross taxation, such as on dividends, royalties, interest and (statutory) directors and supervisory board members.²⁶

Harald Grams and the author published an article in *Intertax* in May 2003²⁷ about what they believed were the three main issues in the pending case: the deductibility of expenses, the tax rate (and normal income tax assessment) and the tax-free allowance (*Grundfreibetrag*).

11.4.4. Decision by the ECJ, after conclusion of the Advocate-General Léger

The ECJ reached its decision on 12 June 2003, after a conclusion by Advocate-General Léger.²⁸ The considerations in the decision were to a large extent in accordance with the advice of the Advocate-General. The preliminary question was divided into two parts: (1) the issue of the non-deductibility of expenses and (2) the flat tax rate and the tax-free allowance.

The decision with regard to (1) – the non-deductibility of expenses – was that residents and non-residents were for the purposes of this issue in a comparable situation, especially since the business expenses for both groups of taxpayers were directly linked to the activities that generated the income in Germany.²⁹ The ECJ argued that allowing the deduction of expenses only to residents, and not to non-residents, put the residents of other Member States in a disadvantageous position and therefore

26. See e.g. Wilhelm Haarmann and Sven Fuhrmann, “Konsequenzen aus der EU-Widrigkeit der abgeltenden Abzugsbesteuerung auf Bruttobasis für beschränkt Steuerpflichtige innerhalb der Europäischen Community”, *Internationales Steuerrecht* 16/2003, at 558; Günther Strunk and Bert Kaminski, “Rechtsprechung zum Steuersatz von beschränkt Steuerpflichtigen und sich hieraus ergebende Folgewirkungen”, *Außensteuerrecht*, *Stbg.*, 8/03, at 381.

27. Dick Molenaar and Harald Grams, “The *Arnoud Gerritse* Case of the European Court of Justice”, 31 *Intertax* 5 (2003), at 198.

28. The conclusion of Advocate-General Léger was released on 13 March 2003 and can be found on the web site of the European Court of Justice, <http://curia.eu.int>, under case number C-234/01.

29. Arnoud Gerritse had submitted that the non-deductibility of business expenses had serious consequences for non-resident artistes, because their expenses for foreign performance could be very high. See Paragraph 26 of the ECJ decision.

constituted indirect discrimination on the grounds of nationality, contrary in principle to the freedom to provide services.

The ECJ also considered that no precise argument had been brought forward to justify this difference in treatment. Therefore it was clear in its decision that the non-deductibility of expenses was in breach of Articles 49 and 50 of the EC Treaty, the freedom to provide services. Gerritse had to be allowed to deduct his business expenses from his taxable income.³⁰

The considerations with regard to (2) – the fixed tax rate of 25% – were combined with those regarding the tax-free allowance. Both the Court and the Advocate-General held that the tax-free allowance should normally be reserved for the country of residence, because the income earned in the foreign country was in most cases only part of the total income and the concentration in the country of residence made it easier to take into account personal circumstances and grant an allowance with a social purpose, guaranteeing an essential minimum exempt from tax.³¹ But a fixed withholding tax rate (of 25%) was compatible with Treaty provisions as long as this tax rate was not higher than the normal, progressive income tax rates.³²

Finally, the European Court of Justice gave the following answers to the preliminary question:

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

30. Paragraphs 25-29 of the decision.

31. Paragraph 43 and 48 of the decision.

32. Paragraph 53-54 of the decision. This was the only difference from the conclusion of the Advocate-General, because he found the fixed income tax rate justifiable, while the ECJ ruled that Gerritse should be entitled to a tax refund when the (progressive) income tax rates were lower than the fixed withholding rate of 25%.

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

11.4.5. Reactions and changes after the decision

The decision of the ECJ in the *Arnoud Gerritse* case produced interesting reactions in the tax world. While the initiators only intended to bring the case forward to show the inequalities in the German (and international) artiste tax legislation, tax experts pointed to the fact that other gross tax systems such as those for dividends, royalties, interest and (statutory) directors and supervisory board members were also affected by the considerations of the European Court of Justice. Several authors referred to the decision and believed that countries needed to change their gross taxation systems and allow the deduction of expenses.³³

In Germany, the answers of the European Court of Justice led to a decision by the *Finanzgericht Berlin*, the tax court that had raised the preliminary questions.³⁴ The *Finanzgericht* decided to interpret the answers by the ECJ partly in its own fashion; it accepted the deduction for business expenses, but then jumped from the (net) German income to the total worldwide income of Arnoud Gerritse, in order to bring him under the progression in Germany. Income tax was then calculated in accordance with the *Grundtabelle* (income tax table) that contains the *Grundfreibetrag* (tax-free allowance). This led to an (average) income tax rate of 23.97% on net income and to a small tax refund for *Arnoud Gerritse*.

Both the representatives of Arnoud Gerritse and the German tax authorities appealed against this decision at the *Bundesfinanzhof* (Federal Supreme Court), because they did not agree with the alternative calculation of the income tax by the *Finanzgericht*. But the BFH decided to postpone its (final) decision in this case³⁵ because it already had another case about

33. Examples can be found in Luc Hinnekens, "European Court challenges flat rate withholding taxation of non-resident artist: comment on the *Gerritse* decision", *EC Tax Review* 2003/4, at 207, which trivialized the importance of the case for international performing artistes; the "CFE (Confédération Fiscale Européenne) Opinion Statement on the Decision of the European Court of Justice *Arnoud Gerritse v. Finanzamt Neukölln-Nord*, C-234/01", 44 *European Taxation* 4 (2004), at 184; Dick Molenaar and Harald Grams, "The Taxation of Artists and Sportsmen after the *Arnoud Gerritse* Decision", 43 *European Taxation* 10 (2003), at 381.

34. *FG Berlin*, 25 August 2003, 9 K 9312/99, *Internationales Steuerrecht* 21/2003, at 740.

35. *Bundesfinanzhof* 15 September 2003, I R 87/03.

German non-resident artiste taxation on its list, for which it was planning to ask preliminary questions of the European Court of Justice, i.e. the *FKP Scorpio Konzertproduktion* case, which is discussed in 11.6.

But the *Bundesfinanzhof*, in the meantime, had to decide in other cases on the question of whether the flat income tax rate without the deduction of expenses of § 50a(4) of the *Einkommensteuergesetz* (Income Tax Law) was still enforceable after the decision in the *Gerritse* case. The BFH did not hesitate in its decisions to follow the considerations of the ECJ and ruled that § 50a(4) of the EStG was incompatible with the ECJ Treaty.^{36,37}

The Ministry of Finance in Germany also reacted to the decision in the *Arnoud Gerritse* case.³⁸ It changed the so-called *Vereinfachtes Erstattungsverfahren* (simplified tax refund procedure) of § 50a(5) of the *Einkommensteuergesetz* (Income Tax Law), by crossing out the conditions (1) that the deductible expenses³⁹ had to be more than 50% of the earnings and (2) that the fixed income tax rate was to be set at 50% by allowing tax refunds when the normal, progressive income tax rates were lower than the withholding tax rate. But the Ministry of Finance refused to allow the deduction of business expenses at the time of withholding the income, i.e. prior to performance.

It was not surprising that the decision in the *Arnoud Gerritse* case led to much discussion in Germany, but it was disappointing that the tax authorities only made a minor adjustment to the existing tax system. The European Commission considers this change insufficient and has filed on 13 October 2004 a complaint regarding *Vertragsverletzung* (Infraction of

36. *Bundesfinanzhof* 19 November 2003, I R 34/02 and 28 January 2004, I R 73/02.

37. The chairman of the *Bundesfinanzhof*, Franz Wassermeyer, referred to the *Gerritse* decision in an article about a case in which a German resident had earned income abroad. He could not get a tax exemption in Germany for foreign income because his net income after the deduction of expenses was too low, and therefore ended up with excessive taxation. Wassermeyer wrote in an article that the German resident should be given the chance to file for tax refunds in the source countries (the Netherlands and Finland). This is the same situation from a German perspective as *Arnoud Gerritse* from a Dutch perspective (Franz Wassermeyer, “Keine Erstattung ausländischer Quellensteuern”, *Internationales Steuerrecht* 8/2004, at 279).

38. *Bundesfinanzministerium* 3 November 2003, IV A 5 – S 2411 – 26/03.

39. The *Vereinfachtes Erstattungsverfahren* only accepts expenses that are directly connected to the activities in Germany. This condition is questioned in the case of *Centro Equestre de Leziria Grande Lda*, currently pending at the ECJ (C-345/04). See also 11.7.

the EC Treaty) against Germany.⁴⁰ The results of this complaint have not been published.

At the same time it was odd that there was almost no reaction from the tax authorities in other countries with gross taxation of non-resident artistes comparable to the German income tax law.⁴¹ It is as if many countries did not notice the ECJ decision in the *Arnoud Gerritse* case. Unfortunately, the European Commission has not yet taken initiatives to approach other EU Member States.

11.4.6. Ambiguity following from the second answer

Ambiguity can follow from the second answer to the preliminary question. The European Court of Justice makes a comparison between the tax rates, i.e. 25% deduction at source against the progressive tax rates, but does not take into consideration that the tax base might be different because of the deduction of expenses. Specifically, in the situation of Arnoud Gerritse this leads to the following comparison:

Withholding tax at source: $25\% \times \text{EUR } 3,000 \text{ gross} = \text{EUR } 750$
Income tax (progressive): $26.5\% \times \text{EUR } 2,500 \text{ profit}^{42} = \text{EUR } 663$

The result is that, while taxed at a higher income tax rate (26.5%), a lower amount of income tax is due, when compared to the initial withholding tax. This has to lead to a tax refund, despite the official second answer of the European Court of Justice. The conclusion must be that it is not the tax rates but the tax amounts that need to be compared.

The effect of business expenses cannot be ignored. These expenses can be very high for performing artistes, as was recognized by both the Advocate-General Léger in his opinion and the ECJ in Paragraph 26 of its decision. The expenses for Arnoud Gerritse were low (EUR 500 / EUR 3,000 = 17%), but are much higher for most artistes (75% on average, as discussed in 8.3.4).

40. European Commission 13 October 2004, *Internationales Steuerrecht-Länderbericht* 21/2004.

41. Countries such as Spain, Italy, Greece, Belgium, Sweden and Portugal. See also Björn Westberg, "New Swedish Rules on the Taxation of Non-Resident Individuals", 45 *European Taxation* 2 (2005), at 77, about the passive Swedish authorities. See also chapter 6 of this thesis.

42. The profit is EUR 3,000 gross – EUR 500 expenses = EUR 2,500.

What happens with a non-resident artiste with 75% expenses, who is taxed at 20% from his gross performance fee? What is his effective tax rate? This can be calculated as follows:

Withholding tax at source: e.g. 20% x e.g. EUR 10,000 gross = EUR 2,000 tax
Effective income tax rate from profit: EUR 2,000 tax / EUR 2,500 profit⁴³ = 80% tax

So with 75% expenses, a flat tax rate of 20% from gross is comparable with an average tax rate of 80% from net.

No country has progressive tax rates reaching 80%,⁴⁴ which means that the average artiste from the study on expenses in 8.4.4. is very likely to experience a withholding tax that is (far) too high and he therefore needs to be entitled to a normal income tax settlement (and a tax refund) in the country of performance.

And it is important to realize that the comparable income tax rate is not the marginal (top) rate in the progressive income tax table, but the average tax rate which results from the mix of both low and high income tax rates. In the case of a progressive tax table, the average tax rate will at best be equal to, but will normally be lower than, the marginal top rate.

11.5. New cases pending before the European Court of Justice

People working in the cultural field in Germany were particularly unhappy with the reluctant approach of the German tax authorities and the minor changes that were made to the tax rules for non-resident artistes after the decision in the *Arnoud Gerritse* case. Germany is the biggest music, theatre and dance market in Europe and many artistes from the United States, the United Kingdom, France, the Netherlands and other countries like to perform for German audiences, who are very appreciative.

43. The profit is EUR 10,000 gross – 75% (= EUR 7,500) expenses = EUR 2,500.

44. This high effective (source) tax rate for non-resident artistes has led to the following press statement in Germany: “Auswärtige Künstler zahlen mehr Steuern als Millionäre” (Non-Resident Artistes pay more tax than Millionaires), *Berliner Zeitung* 24 October 2001.

While some concentrated on lobbying the parliament, ministries or other institutions in Berlin, others were pushing new court cases forward. It became evident that the decision in the *Arnoud Gerritse* case was not clear in every respect and that the German *Bundesfinanzministerium* (Federal Ministry of Finance) was using a strict interpretation. But a reluctant approach could also be seen in members of parliament from both government and opposition⁴⁵ and cultural institutions,⁴⁶ trivializing the issue of the excessive taxation that results from German non-resident artiste taxation.

Representatives of non-resident artistes or German organizers brought two new cases to the German tax courts, for which the German *Bundesfinanzhof* (Federal Supreme Court) decided to ask preliminary questions to the European Court of Justice (ECJ). These cases, *FKP Scorpio Konzertproduktion GmbH (C-290/04)* and *Centro Equestre da Leziria Grande Lda. (C-345/04)* continue the discussion which started with the earlier *Arnoud Gerritse* decision of the ECJ.

11.6. *FKP Scorpio Konzertproduktion GmbH (C-290/04)*

11.6.1. The facts of the case and the preliminary questions

The next case following the *Arnoud Gerritse* decision has been pending for many years before the German courts. It was expected to reach the European Court of Justice much earlier, but was held up by its complexity and the many juridical implications. In essence, the case of *FKP Scorpio Konzertproduktion GmbH* is a good example of the effects that taxation has on the business of international performing artistes.

FKP Scorpio Konzertproduktion GmbH is an organizer of pop and rock concerts and festivals and dance music events in Germany. The company is based in Hamburg, but organizes its music activities throughout the whole country. With 80 million inhabitants, Germany is a major market for live music and *Scorpio* is an important, independent player on that market.⁴⁷

45. The coalition in power in Germany was formed by the SPD (social-democrats) and the *Grünen/Bündnis 90* (Green Party), while the CDU/CSU (Christian-democrats), FDP (liberals) and PDS (left-wing socialists) were in opposition. This changed after the elections of September 2005.

46. Such as the *Deutscher Kulturrat* (German Cultural Council).

47. For more information about the activities of the company, see www.fkp Scorpio.com.

Scorpio contracted in the year 1993 with the Dutch tour promoter E for several performances of non-German artistes, such as IC from the United States. Neither E nor any of the artistes has had a permanent establishment in Germany. E was based in the Netherlands and had no other involvement in the groups of artistes than that it contracted them to perform in Europe for local concert promoters. The owners of E were not performing artistes.

The tour of IC in Germany was quite successful and *Scorpio* paid E a gross fee of EUR 224,164. It has not been disclosed what fee E paid through to CS, Inc., the legal entity of IC, what expenses E incurred for the tour and what the profit on the tour was.

In contravention of their legal obligations, *Scorpio* did not withhold or pay any German (withholding) tax on the performance fee. The German tax authorities discovered this in a tax audit and raised a *Haftungsbescheid* (tax assessment) of EUR 35,978.⁴⁸

Scorpio appealed against this tax assessment, initially in an administrative procedure and later before the *Finanzgericht* (Tax Court) Hamburg. Both appeals were denied, the last one in 2001. The lawyer for *Scorpio* raised a revised appeal at the *Bundesfinanzhof* (Federal Supreme Court), using two arguments against the tax assessment, namely that (1) the deduction of business expenses had to be allowed, as in the *Gerritse* case, but this time he focused on the deduction of expenses at the withholding level, and (2) the direct use of treaty provisions had to be allowed, while the German legislation orders an exemption certificate to qualify for treaty provisions.⁴⁹ In both situations tax refund procedures were available after the tax was initially withheld, but *Scorpio* held the opinion that this was still putting him or the non-resident tour promoter or artiste in an unequal position vis-à-vis resident artistes (and their promoters), who did not fall

48. The tax assessment was calculated as follows: DM 438,600 (EUR 224,279) performance fee + 7% VAT = DM 469,302 including VAT. This was considered as a fee net of taxes, so instead of 15% income tax from the gross fee, 16,05% tax of the net fee was taken, i.e. DM 70,395 tax (= equivalent to EUR 35,978). This calculation does not seem to be correct, because 15% from gross equals with $15\% / 85\% = 17.65\%$ from net, but this inaccuracy will not be discussed further.

49. *Scorpio* held the opinion that Article 5(1) of the 1959 Germany–Netherlands treaty allocated the taxing right solely to the residence country of the supplier of the service, i.e. the Netherlands, because the treaty did not have an artiste tax clause comparable to Article 17 of the OECD Model Tax Convention. See also 2.9. But neither *Scorpio* nor the Dutch tour promoter had applied for an exemption certificate at the *Bundesamt für Finanzen* in Germany.

under any withholding obligation but paid their German tax under the normal income or corporation tax system.

The *Bundesfinanzhof* decided on 28 April 2004, I R 39/04⁵⁰ to raise preliminary questions to the European Court of Justice, because it had doubts about the correctness of the German non-resident (artiste) tax system as put forward in § 50a of the German *Einkommensteuergesetz* (Income Tax Law), in the light of the principle of the freedom of services of Article 59 and 60 of the EC Treaty (now Articles 39 and 40 of the EC Treaty). The cash flow disadvantage that results from a system in which tax first needs to be levied on a gross basis with tax refunds being requested later, even when these refunds can be seen to very likely at the withholding stage, attracted the attention of the BFH.⁵¹ But it also considered that a withholding tax for non-residents was in essence not in breach of the EC Treaty, especially when there was no absolute assurance of normal taxation in the home country.⁵²

The *Bundesfinanzhof* decided to bring the preceding issues together in the following preliminary questions to the European Court Justice:

Reference for a preliminary ruling by the *Bundesfinanzhof* by order of that court of 28 April 2004 in the case of *FKP Scorpio Konzertproduktionen GmbH against Finanzamt (Tax Office) Hamburg-Eimsbüttel* (C-290/04)

1. Must Articles 59 and 60 of the EC Treaty be interpreted as meaning that they are infringed if a payment debtor established in Germany of a payment creditor established abroad within the Community (in this case: in the Netherlands), who holds the nationality of a Member State, can be held liable under the fifth sentence of Paragraph 50a(5) of the *Einkommensteuergesetz* 1990 in the version in force in 1993 (Law on Income Tax, hereinafter: 'the EStG') because he has failed to deduct tax at source pursuant to Paragraph 50a(4) of the EStG, whereas payments to a payment creditor liable without limitation to income tax in Germany (that is, a German resident) are not subject to

50. Published in *Internationales Steuerrecht* 16/2004, at 583.

51. The *Bundesfinanzhof* referred to two ECJ decisions, i.e. *Commission v. France*, C-381/93, and *Danner*, C-136/00. In point 29 of the *Danner* case the ECJ ruled that "Art. 59 of the EC Treaty precludes the application of any national legislation which has the effect of making the provision of services between Member States more difficult than the provisions of services purely within one Member State".

52. The *Bundesfinanzhof* discussed the Directive of 15 March 1976 on Mutual Assistance of the recovery of claims relating to certain levies, duties, taxes and other measures (76/308/EEC), which was last been amended on 15 June 2001 by Directive 2001/44/EC, and the Mutual Assistance Treaty between Germany and the Netherlands, which entered into force on 23 June 2001. Before 2001, the Netherlands did not have the obligation to assist Germany in enforcing German tax assessments from its residents.

any deduction of tax at source pursuant to Paragraph 50a(4) of the EStG and therefore no liability of the payment debtor for non-deduction or insufficient deduction of tax at source can arise?

2. Is the answer to Question 1 different if, at the time of providing his service, the payment creditor established abroad within the Community is not a national of a Member State?
3. If the answer to Question 1 is in the negative:
 - a. Are Articles 59 and 60 of the EC Treaty to be interpreted as meaning that business expenses incurred by a payment creditor established abroad within the Community and economically connected with his activities in Germany giving rise to the payments must be taken into account in reduction of tax by the debtor at the time of deducting tax at source pursuant to Paragraph 50a(4) of the EStG because, as is also the case with German residents, only the net income remaining after deduction of business expenses is subject to income tax?
 - b. Is it sufficient for the purpose of avoiding an infringement of Articles 59 and 60 of the EC Treaty if, in deducting tax at source pursuant to Paragraph 50a(4) of the EStG, only the business expenses economically connected with the activity in Germany giving rise to the claim for payment and which the payment creditor established abroad within the Community has reported to the payment debtor are taken into account in reduction of tax, and any further business expenses can be taken into account in a subsequent refund procedure?
 - c. Are Articles 59 and 60 of the EC Treaty to be interpreted as meaning that they are infringed if the tax exemption to which a payment creditor established in the Netherlands is entitled in Germany under the double taxation convention between the Federal Republic of Germany and the Kingdom of the Netherlands is initially disregarded in the deduction of tax at source pursuant to Paragraph 50a(4) in conjunction with Paragraph 50d(1) of the EStG and only allowed in a subsequent procedure for exemption or refund and the payment debtor is likewise not entitled to rely on the tax exemption in proceedings concerning liability, whereas German residents' tax-free income is not subject to any deduction of tax and therefore no liability for non-deduction or insufficient deduction of tax at source can arise either?
 - d. Are the answers to Questions 3(a) to (c) different if the payment creditor established abroad within the Community is not a national of a Member State at the time of providing his service?

In short, the preliminary questions are:

- (1) Is it compatible with EU law to levy a withholding tax from non-resident artistes and not from (German) residents?
- (2) Is this different for artistes from non-EU countries?

- (3) If the answer to question 1 is negative:
- (a) Do expenses need to be deductible before calculating the withholding tax?
 - (b) Is it correct that only direct expenses are deductible at the withholding stage and that other expenses are deductible in a later refund procedure?
 - (c) Can an exemption from source taxation following from a tax treaty be used directly or is a written confirmation by the tax authorities needed?
 - (d) Are the answers to the preceding three questions different for artists from non-EU countries?

11.6.2. Discussion and action while the case is pending

The pending case of *FKP Scorpio Konzertproduktion GmbH* has been discussed by some authors in the tax literature, such as Walter Loukota and Daniela Hohenwarter from Austria.⁵³ They hold the opinion that the ECJ should answer “no” to the first preliminary question, because it can be justified for countries to levy a withholding tax to ensure their tax earnings, but they say “yes” to the third question regarding the deduction of expenses and direct use of tax treaty provisions already at the withholding level. In that respect they conclude that the Austrian taxation of non-residents is discriminatory and needs to be changed, so that non-residents are taxed on the same taxable income as residents.

11.6.3. Official reaction from the German authorities

With this case so evidently questioning the basic correctness of the German tax system of non-resident (artiste) income from German sources, the German tax authorities decided to stipulate how that income was to be treated in the period when the case was pending before the European Court of Justice. More than in the *Arnoud Gerritse* case, they seem to understand that the answers in the *Scorpio* case might have a major influence on the taxation of non-residents, both artistes and others. The *Bundesministerium der Finanzen* issued a statement on 17 October 2004⁵⁴ indicating that payments of the withholding

53. Walter Loukota and Daniela Hohenwarter, “Die Abzugsbesteuerung beschränkt Steuerpflichtiger auf dem Prüfstand des Gemeinschaftsrechts – Die EuGH-Rechtssache Scorpio”, *SWI* (2004), at 539.

54. *Bundesfinanzministerium* 17 October 2004, IV C 8 – S 2411 – 4/04.

tax could be postponed for the duration of the case, either when a periodical tax return had been filed or when a tax assessment had been raised, on the condition that the non-resident was from an EU Member State or from a country with a tax treaty with Germany. At the time of writing, the organizers of performances with non-resident artistes are still withholding the German tax from the performance fees, but are deferring the payment of the tax to the *Finanzämter* (tax administration).

11.6.4. Reactions by the European Commission and some Member States

The European Commission has already officially commented on the *Scorpio* case.⁵⁵ The Commission holds the opinion that a withholding tax on source income of non-residents should be acceptable, but with regard to business expenses it is of the opinion that these should be deductible when the withholding tax is calculated, i.e. at the time when the performance takes place. Other business expenses that are not clear at the withholding stage should be deductible in a refund procedure. Finally, the Commission recommends making no distinction between residents from EU Member States and other countries.

Five Member States have also given their opinions about the preliminary questions in the *Scorpio* case. Belgium, Germany, Spain and Italy have stated that they believe that the withholding tax system and the non-deductibility of expenses are not in conflict with the Articles 49 and 50 of the EC Treaty. These opinions are not surprising, because none of the four countries allows the deduction of expenses to non-resident artistes in their national legislation.⁵⁶

The United Kingdom has only discussed the first issue of the withholding tax for non-resident artistes and holds the opinion that this is correct. It did not discuss the non-deductibility of business expenses, which is unfortunate because the United Kingdom has a good and pragmatic system for approving the deduction of expenses before performances.

55. European Commission 26 October 2004, JURM (2004) 10039.

56. See chapter 6 for an overview of the national artiste tax rules of the various countries.

11.6.5. Oral hearing

The oral hearing in the Scorpio case took place on 6 July 2005. The Spanish and German government, the European Commission and the representatives of *FKP Scorpio Konzertproduktion GmbH* argued before the European Court of Justice the positions which they had already taken earlier in the procedure.

11.7. *Centro Equestre da Lezíria Grande Lda* (C-345/04)

11.7.1. The facts of the case and the preliminary question

The second artiste case following the *Gerritse* decision focuses fully on the deduction of expenses and the tax refund procedure after activities have taken place. This case has also been pending for quite some time before the German tax courts and is a good instance of the fact that the German *Vereinfachtes Erstattungsverfahren* (simplified tax refund procedure) is in practice a complicated and frustrating procedure with many more administrative obstacles than a normal income tax return.⁵⁷

The Portuguese *Centro Equestre da Lezíria Grande Lda* performs horse shows not only in Portugal but also in many other countries. The *Centro Equestre* specializes in *Lusitanos*, the royal horses of Portugal. In 1996 the *Centro Equestre de Lezíria Grande* undertook a tour through Germany, Ireland and Great Britain, in total 14 performances, of which 11 were held in German cities. The gross performance fees were EUR 181,110 and, although § 50a(4) of the German *Einkommensteuergesetz* (Income Tax Law) requires the calculation of the tax on the gross performance fee, in this specific case the withholding tax was only taken on EUR 146,774 x 25% = EUR 36,694 tax plus 7.5% *Solidaritätszuschlag* (solidarity surcharge) of EUR 2,752 = EUR 39,425 tax.

In December 1997 the *Centro Equestre da Lezíria Grande Lda* filed a German tax return for the year 1996 at the *Bundesamt für Finanzen* (BfF) in accordance with § 50a(5) of the German *Einkommensteuergesetz* (Income Tax law), the so-called *Vereinfachtes Erstattungsverfahren* (simplified tax refund procedure). An application is only dealt with by the

57. It might be the German sense of humour to give the special refund procedure this name, but non-resident artistes performing in Germany do not find it funny.

BfF if the expenses exceed 50% of the earnings and an original *Steuerbescheinigung* (tax certificate) and all original invoices are added to the tax return, while only the expenses directly connected with the performances are taken into account. If one of these conditions is not met, the tax return is simply rejected. If the tax return is allowed, the tax rate of *Einkommensteuer* (income Tax) or *Körperschaftsteuer* (Corporation Tax) is 50% of the result of earnings minus directly connected expenses.

The *Centro Equestre da Leziria Grande Lda* did not send original invoices to the BfF, but provided a certified profit/loss account for the year 1996, from which the costs of the tour of 14 shows were extracted, including not only the direct but also the indirect expenses. The figures were originally given in Portuguese escudos and German marks, but for the purpose of this thesis are converted to euro:⁵⁸

Centro Equestre da Leziria Grande Lda.

	% of yearly costs	EUR
Direct expenses: communication, travel, hotels, flights, advertisement		109,355
Salaries for 6 months, 9 persons		46,205
Costs of horses	35	12,473
Water and energy expenses	20	4,284
Veterinarian and medicine	50	2,911
Expenses for blacksmith	35	1,320
Costumes and materials for horses and riders	20	7,260
Depreciation of horses (one horse died during the tour)		45,101
Trucking – repairs	50	1,796
Trucking – expenses	20	5,755
Tax advisers fees	50	2,407
Total for tour (14 performances)		238,867
Allocation of expenses to German shows (11 /14)		187,681
German earnings		181,203
Result		- 6,478

The *Bundesamt für Finanzen* rejected the application for a (full) tax refund, because no original invoices were attached to the tax return.

58. These figures were published in the decision of the German *Bundesfinanzhof* of 28 May 2004, IR 93/03, *Deutsches Steuerrecht* 2004, at 1083.

The administrative appeal against this decision was denied. *Centro Equestre da Leziria Grande Lda* then appealed unsuccessfully to the *Finanzgericht* (Tax Court) *Köln* (Cologne). The tax court supported its decision with the argument that the appellant had not proved that the expenses directly connected with the performances were more than 50% of the earnings.⁵⁹

The *Bundesfinanzhof* considered in its decision of 26 May 2004⁶⁰ that it was doubtful whether a distinction between residents and non-residents was acceptable under the EC Treaty when it led to the limitation of deductible expenses to expenses only directly connected with the activities, and therefore affected the calculation of the taxable profit of the activities. The BFH based its doubts on the ECJ decision in the *Gerritse* case.

It rejected the opinion of the preceding *Finanzgericht* (Tax Court), which had decided that this distinction was acceptable, because otherwise the indirect expenses would be deducted twice, both in the source state and the residence state. The BFH explained that if this were true, it would also be the case for directly connected expenses. And the BFH added that this risk was not present when the residence country used the tax credit method to eliminate double taxation, because then no more than the real foreign tax could be credited in the residence country.⁶¹ But the BFH added that the risk of undertaxation could not be a justification for unequal treatment, as the ECJ had decided in the *ICI* case.⁶²

It needs to be emphasized that the deduction of all expenses in both countries is necessary to arrive at a comparable taxable base and avoid the excessive taxation that would result from differences in the taxable base. This has already been discussed in this thesis.⁶³

59. *Finanzgericht Köln* 18 September 2003, 2 K 7435/00

60. *Bundesfinanzhof* 26 May 2004, I R 93/03, *Deutsches Steuerrecht* 2004, at 1083.

61. With these two arguments the BFH corrected the arguments of the preceding FG. But unfortunately the opinion of the BFH is not completely correct, because even with the exemption method for foreign earnings in the residence country the total of direct and indirect expenses needs to be deductible in both the source and the residence country. When the taxable profit in the source state is higher than in the residence state, because some expenses are not deductible in the source state, the risk of international excessive taxation is likely, depending on the tax rates in both countries. See also chapter 10 for calculations of the examples.

62. *ICI*, ECJ 16 July 1998, C-264/96.

63. See 7.5.8., chapter 9 and 11.4.6.

After its considerations the *Bundesfinanzhof* decided to raise the following preliminary question before the European Court of Justice:

Reference for a preliminary ruling by the *Bundesfinanzhof* by order of that court of 26 May 2004 in the case of *Centro Equestre da Lezíria Grande Lda against Bundesamt für Finanzen* (C-345/04)

Is it contrary to Article 59 of the Treaty establishing the European Communities if a person with restricted tax liability in Germany who is a national of a Member State may claim repayment of tax deducted at source on his income in Germany only when the operating expenses that have a direct economic connection to that income are higher than half of the income?

11.7.2. Administrative obstacles

The *Bundesfinanzhof* has not been exhaustive in raising only this one question in the case of *Centro Equestre da Lezíria Grande Lda*. The condition that *original* invoices should be attached to the special tax return is an important obstacle to using the so-called *Vereinfachtes Erstattungsverfahren* (simplified tax refund procedure).

Residents and non-residents normally just attach a simple profit and loss account (as shown in the previous paragraph) to the German income tax return. If the tax administration has any questions about the figures, it can ask for more details, (copies of) invoices or even undertake an audit of the books of the taxpayer. It can also ask the foreign tax authorities for assistance, which has become easier with the EC Directives and bilateral treaties on mutual assistance the source country. There seems to be no need for original invoices here.

And why should the figures from residents be more trustworthy? Especially after the two *Biehl* decisions⁶⁴ and the *Corsten* case⁶⁵ of the European Court of Justice, this extra administrative measure for non-residents does not comply with the EC Treaty.

64. *Biehl-I*, 8 May 1990, C-175/88, and *Biehl-II*, 26 October 1995, C-151/94.

65. *Josef Corsten*, 3 October 2000, C-58/98. This was not a case about taxation, but it is still relevant when it comes to extra administrative procedures. In the case, a non-resident, self-employed architect had to follow a special application procedure for registration in Germany, necessary to be allowed to work officially in the country. This cost him much time and he also had to pay a registration fee for the procedure. Neither process applied to resident self-employed architects, who could enter the register much more easily and cost-free. The ECJ decided that these rules were in conflict with Article 49 of the EC Treaty regarding the freedom to provide services.

But most relevant is the ECJ decision in the *Futura* case.⁶⁶ Luxembourg required that a non-resident company had to keep accounts (with original invoices) in the source country when a permanent establishment made a loss and wanted to carry this loss forward to other years. In other cases non-residents did not have to fulfil this requirement and could keep their accounts (and invoices) in their home country and provide just a proper and clearly specified profit and loss account with their yearly tax return in Luxembourg.

The ECJ considered in this case that the effectiveness of fiscal supervision constituted an overriding requirement of general interest, which could be a justification for a restriction of the freedom principles of the EC Treaty. It also stressed that the national rules for calculating taxable profits were not the same in the Member States, absent any harmonization by the European Community, which meant that Member States could not rely on the calculation of a profit (or loss) in other Member States. But it also concluded that it was in conflict with Article 43 of the EC Treaty (freedom of establishment) if stricter rules were applied only in specific situations, such as when non-residents wanted to carry forward a loss of a permanent establishment. This refers to the EC Directive 77/799/EEC about exchange of information and acknowledges that a Member State can ask another Member State to provide all the information necessary to arrive at the correct taxation of a non-resident company.

This applies clearly to the pending case of *Centro Equestre*. The German special refund procedure for non-resident artistes and the strict rule that an application can only be taken into account when the original invoices are attached, does not apply to non-residents other than artistes (and sportsmen). Other non-residents in Germany can complete a normal income tax return and attach a normal profit and loss account. After the decision in the *Futura* case, it can only be concluded that the strict treatment of non-resident artistes with the so-called *Vereinfachtes Erstattungsverfahren* (simplified refund procedure) in the *Centro Equestre* case is prohibited because of non-conformity with Article 49 of the EC Treaty, the freedom to provide services.

66. *Futura Participations SA and Singer v. Administration des contributions*, 15 May 1997, C-250/95.

11.7.3. Changes by the German tax authorities in November 2003

It is important to notice that the German tax authorities have changed the *Vereinfachtes Erstattungsverfahren* (simplified refund procedure) after the ECJ decision in the *Arnoud Gerritse* case. They have deleted the condition that the expenses need to be more than 50% of the earnings and the fixed tax rate of 50%. A tax refund is now given if the progressive income tax rates, ranging from 20% to 48%, on the result of the taxable performance minus the directly connected expenses are less than the withholding tax.⁶⁷ The German Ministry of Finance believes that this change in the tax legislation is sufficient after the *Arnoud Gerritse* decision.

But even after these changes it remains the fact that only directly connected expenses are deductible (not indirect expenses) and that original invoices need to be attached to the tax return. This means that Germany has partly removed the obstacles from the *Centro Equestre da Leziria Grande Lda* case, but that there are still two important obstacles remain.

11.7.4. Comparison with transfer pricing and allocation of head office expenses

The *Centro Equestre da Leziria Grande Lda* case acquires an extra dimension if the limited deductibility of the expenses is compared to the discussions on transfer pricing and particularly the allocation of the head office expenses to foreign branches or subsidiaries. There is no doubt that these indirect head office expenses are partly deductible, but international companies may have their problems with the correct allocation. This subject is very important for Article 7 of the OECD Model about business profits. The allocation can be made on the basis of the number of employees, the turnover or the profit per country. It can be queried how head office expenses can be certified in the country of residence of the head office to present reliable figures to the tax authorities in the countries of branches or subsidiaries. When there is doubt about reliability, the foreign tax authorities can ask for assistance from the tax authorities in the residence country and perhaps undertake an audit. This would be a good example for Germany (and other countries) to follow in its approach towards the tax returns of non-resident artistes.

67. *Bundesministerium der Finanzen* 3 November 2003, IV A 5 – S 2411 – 26/03.

11.7.5. Comparison with other ECJ decisions

The European Court of Justice earlier gave its opinion about the deductibility of indirect expenses in *Baxter et al.*⁶⁸ In this case French national tax law stated that international pharmaceutical companies with their headquarters outside France and a subsidiary in France could not deduct research expenses that had been incurred outside France. This was considered to be in breach with the EC Treaty.⁶⁹

The ECJ also discussed the deductibility of expenses in the source country in its *Futura* decision, which was mentioned in 11.7.2.

11.8. Solutions through permanent establishment(s)?

The deductibility of expenses would not be problematic if the artiste created a permanent establishment in the country of performance, which was taxable for the local profit. In that case the performance fees in the country could be received without any tax deduction and both direct and indirect business expenses would normally be deductible. As in normal international business, the overhead expenses of the foreign head office of the artiste could be allocated to the local establishment. The remaining profit in the country of performance would then be taxable against the normal tax rates for residents.

Back in the country of residence the foreign profit needs to be included in the worldwide income of the artiste, but he will be entitled to either a tax exemption for the foreign profit or a tax credit for the foreign tax. Following the well-established rules for transfer pricing and international cost allocation, the taxable base in both the country of performance and the country of residence should not be very different. This would minimize the risk of excessive taxation considerably.

68. *Baxter et al.*, 8 July 1999, C-254/97.

69. The deductibility of foreign research expenses was not the main issue in *Baxter et al.* That was the special levy of 1.5-2% from the gross, pre-tax turnover of pharmaceutical companies, as an extra contribution to the French social security system. This special levy was found to be in conflict with the EC Treaty.

And if the artiste structured his activities in various countries on a specific legal entity with his main business in his home country, he could even make use of the EC Parent-Subsidiary Directive.⁷⁰

In practice some international performing artistes, especially the bigger English and American ones, have already established companies in European countries to avoid the problem of excessive taxation. They can afford the extra expense and can hire experts to establish these structures, which are entirely normal for other businesses. But smaller artistes are not in the position to create an official presence in every country where they perform and to use the expertise of top level international advisers.

This difference in treatment in the source country between foreign companies having and not having a fixed presence had already been highlighted in the *Saint Gobain*⁷¹ and (partly) the *Avoir fiscal*⁷² cases of the European Court of Justice. The ECJ ruled that this difference in tax treatment was not in conformity with the EC Treaty and stressed that economic operators in the European Community needed to be free to choose the most appropriate legal form for their activities. This principle applied not only to the freedom of establishment but also to the freedom to provide services.

And with a permanent establishment the non-discrimination rule of Article 24(1) of the OECD Model becomes applicable. This article normally does not apply to Article 17, but kicks in live when the artiste starts a permanent establishment.

11.9. Can gross taxation of non-resident artistes be a (forbidden) VAT?

In 7.5.3. the problem of the qualification of artiste tax in the country of performance was discussed. It is possible that gross taxation of performance fees can be considered as a VAT. Paragraph 7.5.3. looked at the issue from the perspective of the possible tax credit problems in the country of residence. An example of this problem comes from a Dutch tax court case in the 1950s. The court did not allow a Dutch artiste tax

70. Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (90/435/EEC).

71. *Compagnie de Saint-Gobain.*, ECJ 21 September 1999, C-307/97.

72. *Commission v. French Republic (“Avoir fiscal”)*, 28 January 1986, C-270/83.

11.9. Can gross taxation of non-resident artistes be a (forbidden) VAT?

exemption for Swedish performance income because gross Swedish source taxation was considered an indirect sales tax.⁷³

But this paragraph looks at the issue from the side of the country of performance. It is possible that gross taxation, i.e. taxation of gross performance fees without the right to deduct expenses, even when levied at a considerably lower tax rate than normal, could be considered as a forbidden VAT in the European Community.

Harald Grams discusses the issue of gross artiste taxation as *Umsatzsteuer* (VAT).⁷⁴ He concludes that the German tax system for non-resident artistes (and others) cannot be considered as income tax but has to be VAT. He refers to the principles that income tax is normally levied from taxable income that results from the positive and negative income elements and uses different tax rates, including a *Grundfreibetrag* (tax-free allowance) to reflect its subjective nature, while VAT is normally levied from a rough, gross turnover, not taking any deductions into consideration, to reflect its objective nature. In his opinion, the ECJ should decide, if questions were asked in this respect, that artiste taxation in many countries is (or was) not in accordance with Article 33(1) of the Sixth VAT Directive.

The question may arise whether this discussion is still relevant after the *Arnoud Gerritse* decision of the European Court of Justice.⁷⁵ The ECJ answered on the first preliminary question that expenses need to be deductible before income tax is levied from non-resident artistes. This would make gross taxation not in accordance with the EC Treaty. But the ECJ also answered on the second preliminary question that gross taxation could be acceptable if the tax rate were no higher than the rate(s) for normal income tax settlements. This answer could be interpreted as support for countries that do not want to change their artiste tax legislation after the *Arnoud Gerritse* decision. Examples are France, Spain, Portugal, Belgium, Italy, Greece, Poland and Sweden. But most evident in this discussion is Ireland, which does not levy income tax from non-resident artistes but has replaced this by an extra VAT on the gross performance fee.

The ECJ has come to a decision in various cases about the question of whether a special taxation or levy is comparable with VAT and therefore

73. *Hoge Raad* 5 March 1958, *BNB* 1958/147.

74. Harald Grams, *Besteuerung beschränkt steuerpflichtigen Künstlern*, *Neue Wirtschafts Briefe*, Herne/Berlin (1999), at 35.

75. *Arnoud Gerritse*, ECJ 12 June 2003, C-234/01; see 8.3. and 11.4.

unacceptable. Reference is made to Article 33(1) of the Sixth VAT Directive,⁷⁶ which reads as follows:

Article 33(1) of the Sixth VAT Directive

Without prejudice to other Community provisions, the provisions of this directive shall not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties and, more generally, any taxes, duties or charges which cannot be characterized as turnover taxes.

According to the ECJ, this provision prohibits Member States from introducing or maintaining taxes, levies, duties or charges which can be characterized as turnover taxes.⁷⁷ This is the case if the provision exhibits the following four essential characteristics of a VAT:⁷⁸

- (a) it applies generally to transactions relating to goods and services;
- (b) it is proportional to the price of those goods and services, whatever the number of transactions carried out;
- (c) it is charged at every stage of the production and distribution process;
- (d) it is imposed on the added value of goods and services, since the tax payable on a transaction is calculated after deducting the tax paid on previous transactions.

Gross artiste taxation, as applied in most countries, meets most of the essential characteristics of a VAT and although in general it can be considered as a “turnover tax”, it needs to be reviewed whether the deviations are not so significant as to cause it to fall outside the scope of Article 33(1) of the Sixth Directive:

Ad a. The general application to goods and services means that the provision needs to apply to (almost) all commercial transactions involving production, trade or services. This means that there is no general application when the provision only applies to specific categories of

76. Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (77/388/EEC).

77. See e.g. *Bergandi*, ECJ 3 March 1988, C-252/86 and *Wisselink and others*, ECJ 13 July 1989, C-93/88 and C-94/88.

78. See e.g. the Opinion of Advocate-General Jacobs in the pending case of *Banco Popolare di Cremona*, ECJ C-475/03 about an *Imposta Regionale sulle Attività Produttive* (IRAP, a regional tax on production and services), at number 11.

11.9. Can gross taxation of non-resident artistes be a (forbidden) VAT?

taxpayer.⁷⁹ It can be questioned whether the latter is the case with gross artiste taxation, because many countries apply the same gross taxation to any payment to non-residents. That would make the levy more general than if it only applied to non-resident artistes.

Ad b. The proportionality to the price of goods and services implies a direct connection with turnover. This seems to be the case with gross artiste taxation, which is based on the fee which the artiste receives for his performances.

Ad c. The charge at every stage of the production and distribution process also seems to be the case with the gross artiste taxation, because it does not matter in which part of the chain the artistes are performing.

Ad d. The imposition on the added value, which is the sum of costs of personnel (payroll) and capital and the profit of the taxable person, while all other expenses are deductible, does not seem to be applicable to gross artiste taxation.

The ECJ has decided that the provisions of a concurrent levy or charge must be comparable with the four essential characteristics of VAT to make it an unacceptable tax under Article 33(1) of the Sixth Directive. But it has adjusted its strict definition and has concluded in some cases that levies or charges were unacceptable, although their characteristics deviated slightly from those of VAT.⁸⁰

After this discussion, however, it should be concluded on the gross taxation of non-resident artistes that there are clear comparisons but also major differences. And even though in general the gross artiste taxation in many countries has the appearance of a turnover tax, it can hardly be argued, taking the decisions of the ECJ into consideration, that there is

79. See *Aldo Bozzi*, ECJ 7 May 1992, C-347/90, about a special contribution for Italian lawyers to a special fund (*Cassa Nazionale di Previdenza ed Assistenza a favore degli Avvocati e dei Procuratore Legali*). The contribution was calculated in principle by applying a surcharge (2%) to the earnings making up the turnover of the lawyers, based on the annual turnover for the purposes of VAT. But the contribution was not considered as a general levy; it was not always proportional to the fees payable by clients for professional services rendered, because it was only based on court services and there was a minimum levy, and it was payable at one stage only, with no provision for deduction.

80. See *Dansk Denkavit*, ECJ 31 March 1992, C-200/90, and *Careda and others*, ECJ 26 June 1997, C-370/95, C-371/95 and C-372/95. Also Advocate-General Jacobs in his conclusion in the case of *Banco Popolare di Cremona (IRAP)*, C-475/03, accepts minor deviations from the essential VAT characteristics.

enough conflict with Article 33(1) of the Sixth Directive to set gross artiste taxation aside as an unacceptable tax measure.

11.10. Actions in the cultural field

The pressure on the artiste tax systems in the EU Member States comes not only from the decisions of the European Court of Justice. Although in May 1999 the European Commissioner Frits Bolkestein still answered the question of the member of the European Parliament Ian White about the fairness of the German artiste tax system by saying that everything was well and in order with the freedom principles of the EC Treaty (and so everyone could go to sleep without any worries),⁸¹ by 17 December 1999 the Council of Ministers of the European Community acknowledged that many obstacles frustrated mobility in the cultural sector. The Council decided to undertake a study of these obstacles.⁸² This was executed by Professor Olivier Audéoud of the University of Paris, who published his report in April 2002.⁸³ One of his findings was that the taxation of performance income in the country of performance was heavier for non-resident artistes than for residents.

This alarmed the national cultural institutions in the various EU Member States, which represent the suppliers of cultural performances,⁸⁴ some of the ministries of culture in the European Union as well as the Directorate-General for Culture of the European Commission. At a conference under the Dutch presidency of the European Union on 8 October 2004 in Rotterdam a resolution was accepted that called for removal of the tax

81. 40 *European Taxation* 8 (2000), at EC 28.

82. Council Resolution of 17 December 1999 on the promotion of free movement of persons working in the cultural sector, 2000/C 8/02.

83. Professor Olivier Audéoud, *Study on the Mobility and Free Movement of People and Products in the Cultural Sector*, University of Paris X, No. DG EAC/08/00, April 2002 (europa.eu.int/comm/culture/eac/sources_info/pdf-word/mobility_en.pdf). See also 11.2.

84. These national cultural organizations come together in a European society called Pearle* (European League of Employers' Association in the Performing Arts Sector), which is based in Brussels.

obstacles for non-resident artistes in the EU Member States, with special attention to the implementation of the *Arnoud Gerritse* decision.⁸⁵

The Council of the European Community has taken over this resolution in its meeting on 15/16 November 2004 in Brussels and inserted it in its Work Plan for Culture 2005/2006:

Topic	Actor(s)	Objective (specific)	Result	Deadline
5. Mobility (persons) Solving obstacles caused by taxation of mobile artists	Member States, European Commission	Define and assess taxation problems specific to mobile artists in the EU Include the findings in the report on Economics of Culture	Report	first half 2006

With these actions in the cultural field the pressure on the Member States to change their rigid non-resident artiste tax rules is mounting further.

11.11. General discussion and conclusions

The European Community tries to realize its objectives by market integration. It has created a common market without borders and with as few formalities as possible, together with secondary legislation that supports the principles of freedom, equal treatment and fair competition. The European Union was extended to 25 members on 1 May 2004.

Indirect taxation, such as VAT, is harmonized within the European Community, which means that every Member State needs to draw up its legislation in accordance with EU Directives. Direct taxation still remains the responsibility of individual Member States, although national tax rules

85. Resolution of the EU conference “Artists on the Move”, held on 8 October 2004 in Rotterdam (www.sicasica.nl/pdf/conclusions_and_recommendations_conference_artists_onthe_move.pdf). Besides the *Arnoud Gerritse* decision, also the *Matthias Hoffmann* decision of the European Court of Justice (3 April 2003, C-144/00), regarding the applicability of VAT exemptions not only to resident but also to non-resident artistes.

are influenced by the (general) EC Treaty and some positive integration has occurred. The European Court of Justice plays an important role in the negative integration process.

Non-resident artistes are very often treated differently from resident artistes and other (non-)residents. A report from the University of Paris, prepared at the request of the European Commission, confirms the tax obstacles that artistes experience when performing in other EU Member States.

The *Arnoud Gerritse* case of the European Court of Justice was decided in June 2003 and shows the unequal treatment of non-resident artistes. In this case Germany was the example with the non-deductibility of expenses and the exclusion from a normal income tax settlement; but other countries also have these limitations in their legislation. The ECJ decided that expenses should be deductible and that a tax refund should be possible if the income tax was lower than the withholding tax.

This decision started a discussion about gross taxation for artistes (and others). It is continuing in two other cases that are pending at the time of writing of this thesis before the ECJ, *Scorpio Konzertproduktionen* and *Centro Equestre da Leziria Grande Lda*. Besides other issues, these cases again focus on the deductibility of expenses. In *Scorpio Konzertproduktionen* the question is whether expenses can be deducted at the time of the performance and withholding of the tax, in *Centro Equestre da Leziria Grande* the discussion concerns whether indirect expenses are also deductible. The latter case also discusses the extra administrative measures needed for the special tax refund procedure.

The author expects the ECJ to decide that any limitation in the treatment of non-resident artistes with regard to the timing and the scope of the deductible expenses, as compared to residents, will be considered not in conformity with the freedom principles of the EC Treaty. This has to lead to the deduction of expenses at the withholding level, no stricter rules for the acceptance of expenses and no special refund procedure with extra administrative conditions. A withholding tax may be acceptable, because of the international allocation rules of the taxing right for artistes,⁸⁶ but equal treatment between residents and non-residents needs to be guaranteed for the computation of taxable profit.

86. See 12.7. for further discussion about this issue.

These problems would disappear if the artiste created a permanent establishment in the country of performance. In that situation the problems would evaporate and the normal situation for other businesses would prevail. The non-discrimination rules of Article 24(1) of the OECD Model would also be applicable to these artistes.

This different treatment is unacceptable under the EC Treaty, especially under freedom of establishment, but also under the freedom to provide services. Therefore, the ECJ will not accept the limitations on the deduction of expenses of both *Scorpio* and *Centro Equestre*.

An intriguing discussion can be held about the question whether a gross artiste taxation system can be seen as a forbidden VAT under European law. But the discussion leads to the conclusion that there are clear similarities but also major differences, and that the similarities will not be enough for the ECJ to conclude that there is a conflict with Article 33(1) of the Sixth VAT Directive.

The cultural authorities in the European Community take the tax obstacles for performing artistes seriously. Not only the representatives of cultural institutions and artistes but also the national authorities and even the European Commission and the Council of the European Union have started action to find solutions.

