CHAPTER 12

CONFLICTS BETWEEN OECD MODEL AND EC TREATY

12.1. Community law supersedes treaty law, unless it provides otherwise

Both the EC Treaty and bilateral tax treaties have the objective of abolishing double taxation.[1] But where bilateral tax treaties are the result of negotiations between two countries which divide the taxing rights between them (and grant tax exemptions or credits), but stay fully responsible for their own interests, the EC Treaty has created a European Community with a multilateral treaty, which results in substantial cooperation and binding rules with direct effect in all participating countries. The Community is a separate legal body,[2] having its own responsibilities and being able to enter into agreements with third parties.[3]

A major difference between the EC Treaty and bilateral tax treaties is that the EC Treaty is about much more than taxation and does not give any rules for the allocation of taxing rights for direct taxation. The EC Treaty orders the establishment of a common market,[4] for which equal treatment[5] and the free movement of persons, services and capital[6] are a few of the means to achieve market integration, but it does not specifically order the Community to harmonize direct taxation rules in the individual Member States.[7] Some authority to harmonize can be derived from the more general

1. The EC Treaty mentions this objective in the second part of Article 293, amongst many other objectives. A bilateral tax treaty mentions this objective in the title of the treaty.
2. Article 281 of the EC Treaty.
3. Article 300 of the EC Treaty.
4. Article 2 of the EC Treaty. This article also mentions other objectives, such as economic and monetary union, harmonious, balanced and sustainable development of economic activities, a high level of employment and social protection and equality between men and women.
5. Article 12 of the EC Treaty.
6. Articles 39-60 of the EC Treaty.
7. The ECJ has considered on several occasions that harmonization of direct taxation is not within the competence of the European Community but of the individual Member States. Examples are *Schumacker*, C-279/93, Paragraph 21, *Safir*, C-118/96, Paragraph 21, *Eurowings*, C-294/97, Paragraph 32 and *Hughes de Lasteyrie du Saillant*, C-9/02, Paragraph 44.

Article 94 of the EC Treaty, but this has not been used very often.[8] This article does not have a direct effect and cannot be used by taxpayers before national courts. And in Article 293 EC the EC Treaty orders the abolition of double taxation within the Community, although this provision does not have a direct binding effect either.[9]

It was one of the objectives after the establishment of the European Community in 1958 to negotiate a multilateral income tax treaty for Member States, but up to now this has not been achieved.[10] Within the Community a network of bilateral tax treaties exists, mainly following the OECD Model Tax Convention, but deviating from it in some respects.

The general opinion is that European Community law not only affects national law but also bilateral tax treaties. The provisions of the EC Treaty are binding and have direct effect, which means that Member States do not have discretion in applying the obligations, and they also have supremacy, which means that domestic legal provisions are overridden. The supremacy can be called absolute because Community law also takes precedence over incompatible provisions in treaties concluded by a Member State with another Member State. It is recognized by the ECJ that the Member States have the right to allocate their taxing rights amongst

8. To date the EC has enacted four direct tax directives, i.e. Parent-Subsidiary Directive (1990), Merger (1990), Interest and Royalty (2003) and Savings Income (2003). Also the Arbitration Convention (1990) affects direct taxes.

9. Article 293 of the EC Treaty: "Member States shall, so far as necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: ... (2) the abolition of double taxation within the Community". The ECJ concludes from this wording that Article 293 of the EC Treaty cannot be relied on by individuals before national courts (*Gilly*, 12 May 1998, C-336/96, Paragraph 16).

10. The first recommendation for a multilateral tax treaty within the EEC was made by the Neumark Committee in February 1963. This was followed by an initiative of the European Free Trade Association (EFTA), which led to the report of the Segré Committee in November 1966. The European Commission adopted the recommendations and published a Programme for harmonization of direct taxation in June 1967 and a Draft European Tax Convention in July 1968. But the EFTA Committee ended its activities in 1969 and the European Commission only achieved the establishment of some Directives regarding direct taxation, such as the Parent-Subsidiary (1990) and Merger (1990) directives. No agreement has been achieved up to now among the EU Member States for a multilateral tax treaty, although discussion has continued. See e.g. Michael Lang ed., *Multilateral tax treaties*, Series on international taxation No. 18, Kluwer Law International (1998), and Pasquale Pistone, *The Impact of Community Law on Tax Treaties: Issues and Solutions*, Kluwer Law International (2002). One of the obstacles to a multilateral tax treaty for the EU and for the harmonization of direct taxation in EU Member States is that Article 94 (or Article 308) requires unanimity in the decision process.

each other by means of bilateral tax treaties[11] (and with third countries), but the results still have to meet the principles of Community law, such as equal treatment (Article 12 of the EC Treaty) and free movement of persons, services and capital (Articles 39, 43, 49 and 56 of the EC Treaty).

The binding, direct effect and supremacy of these elements of Community law are confirmed in many decisions of the European Court of Justice.[12] An exception is made only when the EC Treaty expressly allows it.[13]

The discussion in this chapter will be about whether Article 17 of the OECD Model regarding the taxation of performing artistes in general, in its exceptions in Paragraph 2 and in the Commentary, is in accordance with the EC Treaty, and if not, what the consequences may be.

For the study of a possible non-conformity with the EC Treaty three questions need to be answered:[14] (1) is Community law applicable? (2) Is the contested income tax measure contrary to Community law? And if so, (3) are there any justifications for the contested measure?

12.2. The (non-)deductibility of expenses and the position of the Commentary

The first possible conflict between tax treaty provisions based on Article 17 of the OECD Model Tax Convention and the freedom principles of the EC Treaty is the incompatibility between Paragraph 10 of the Commentary on Article 17 of the OECD Model and the *Gerritse* decision of the European Court of Justice.[15] These two read as follows:

11. See e.g. ECJ in *Gilly*, 12 May 1998, C-336/96, Paragraph 30.
12. As well as in many general legal procedures, also in procedures regarding taxation, e.g. in *Commission v. French Republic ("Avoir fiscal")* 28 January 1986, C-270/83, Paragraphs 25-26. It also follows implicitly from § 2 of the Protocol (No. 30) on the application of the principles of subsidiarity and proportionality - annexed to the Treaty of the European Community, Official Journal 1997, C 340/105-107.
13. An example is Article 306 of the EC Treaty: "The provisions of this Treaty shall not preclude the existence or completion of regional unions between Belgium and Luxembourg, or Belgium, Luxembourg and the Netherlands, to the extent that the objectives of these regional unions are not attained by application of this Treaty", and Article 307 EC, regarding the acceptance of deviating agreements concluded before 1958 or a later date if a Member State acceded later to the EC.
14. These three questions are the same as in chapter 11.
15. ECJ in *Arnoud Gerritse*, 12 June 2003, C-234/01. See 11.4.

Paragraph 10 of the Commentary on Article 17 OECD Model[16]
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 provide for taxation at source, at a low rate based on the gross amount paid to artistes and sportsmen. Such rules may also apply to income paid to groups or incorporated teams, troupes, etc.

Answers by the European Court of Justice on the prejudicial questions in the Gerritse case
– 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 progressive table, in respect of net income increased by an amount corresponding to the tax-free allowance.

With Paragraph 10 of the Commentary, the OECD prefers to stay out of the discussion about the deductibility of expenses. It leaves the Member State in which the performance takes place to decide whether expenses are taken into consideration before applying the taxing right. The OECD only mentions – from its neutral position – that some countries have opted for gross taxation, but at a low rate. Many countries have interpreted this paragraph of the Commentary on Article 17 as a positive recommendation for gross taxation of non-resident artistes (and sportsmen).

By contrast, the ECJ clearly stated in the *Gerritse* decision that the non-deductibility of expenses for performing artistes violated the freedom of services within the Community, because resident artistes and other residents and non-residents have the right to deduct expenses. It has supported this answer in Paragraphs 25 to 29 of the decision and stated there that no precise argument was put forward to justify this difference in treatment (with other taxable persons).

16. 1992 addition to the Commentary.

In its second answer the ECJ seems to accept source taxation on a gross basis, but only if the tax rate is no higher that progressive tax rates on the net income (after the deduction of expenses). This means that in the second answer the deductibility of expenses is also acknowledged by the ECJ.[17]

As noted in 11.5., Germany is reluctant to change its legislation after *Gerritse* and seems to rely on the second answer by the ECJ, in which it was permissible to use a fixed tax rate if this did not exceed the normal progressive tax rates. But the gross tax rate of 21.1% in Germany does not seem low enough when the results from the study on the expenses incurred by international performing artistes set out in chapter 8 of this thesis are taken into consideration. The average expenses for the years 2001-2003 were 75% of earnings, which gives a gross tax rate of 21.1%, which is effectively a tax rate of 84.4% on the 25% average profit.

A gross tax rate of 21.1% also does not seem appropriate when the detailed graphs for the year 2003 are considered,[18] because these show a major variance in expenses between 40% (low) and 140% (high), while 54% of the artistes had more than the average of 75% expenses.[19]

The conclusion is warranted that after the clear decision of the ECJ in the *Arnoud Gerritse* case, the Member States of the European Union cannot in their mutual bilateral tax treaties make use of Paragraph 10 of the OECD Commentary on Article 17 to justify their national (gross) artiste tax rules and exclusion of income tax returns. And as the decision of the ECJ has direct effect in individual Member States, non-compatible national tax rules should no longer be applicable.

17. As discussed in the chapter 11, two more cases are pending before the ECJ regarding the (non-)deductibility of expenses, *FKP Scorpio Konzertproduktion* (C-290/04) and *Centro Equestre da Leziria Grande Lda* (C-345/04). However, these cases do not discuss the basic element of the deduction of expenses, but seek to determine at what time and to what extent the tax authorities need to allow the deduction of expenses.
18. See 8.3.4.
19. With these figures about expenses a low tax rate would have to be in the range of 5-10% of the gross earnings. This goes in the direction of the proposals put forward by Richard Doernberg to levy a 3% withholding tax from gross earnings from electronic commerce, for which he assumed deductible expenses of around 90% and a tax rate of 30% from the net profit. But it can also be argued that any gross taxation for artiste performance fees is in conflict with Community law, because the survey of expenses shows a big variance between 40% and 140% of the earnings.

12.3. Interpretation of Article 17(2): limited or unlimited approach

In 2.11. and following paragraphs the object and purpose of Article 17(2) of the OECD Model Tax Convention were discussed. Initially, in 1977 when the second paragraph was added to Article 17, the approach was limited to abusive situations, i.e. when top stars wanted to use their personal limited liability companies, mainly based in tax havens, to partially escape from taxation. The addition of Article 17(2) gave countries more scope to "look through" these tax avoidance structures in order to counteract such tax avoidance behaviour.[20] But later, in 1992, after the (very negative) 1987 OECD Report, the approach of Article 17(2) was made unlimited, making all payments to any third party for the performance of artistes (and sportsmen) taxable in the source country. To achieve this, the Commentary on Article 17 of the OECD Model was changed radically in 1992.

Only Switzerland, Canada and the United States have registered observations on the reversal from the limited into the unlimited approach. The United States has made this clear in the text of Article 17(2) in its 1996 US Model Income Tax Convention, which excludes the use of Article 17(2) when the artistes (or sportsmen) are not shareholders and do not receive bonus payments or profit shares from a "third" company.

Most OECD Member countries follow the recommendations of the OECD, add Article 17(2) in their tax treaties and apply the unlimited approach of the OECD Commentary, at least in post-1992 treaties. With the unlimited approach countries may draw up their national tax legislation so that they can levy a source tax from any performance fee of a non-resident artiste, regardless of the contracting partner and the country of residence of the artiste and their intermediary, if any. The examples in 9.2.2. show that this very often leads to excessive taxation.

This approach is very different from the tax rules for resident artistes in any EU Member State, because they are not taxed on their gross earnings but on the net profit resulting from their activities.

20. Some countries needed this special provision because they could not "look through" with only Article 17(1) in a bilateral tax treaty. See 2.11.

The question in this paragraph is whether the unlimited approach is in conflict with Community law. The problems that arise from the unlimited approach can be divided into three categories: (1) a major risk of excessive taxation, (2) risk of tax credit problems and (3) high administrative costs (when compared with the earnings). Both non-resident artistes and non-resident third parties can experience these problems. This is a disadvantage for a non-resident theatre company or orchestra entering the market of another EU Member State, because a resident theatre company or orchestra normally charges a gross fee to the organizer of the performance and arranges its tax matters without these three problems. This difference seems to be in conflict with Community law, especially with Articles 12 (equal treatment), 39 (freedom of movement for workers) and 49 (freedom to provide services).

Some of these problems would be significantly reduced if Article 17(2) were restricted to the limited approach. This would reduce the barriers to entering other markets in the Community considerably.

As explained above, the reason for the reversal to the unlimited approach was the tax avoidance behaviour of artistes and their companies. Can this be a sufficient justification for this contested tax measure? That is not very likely, because the ECJ has decided in several cases that tax avoidance issues can often be solved with other measures and are therefore not sufficient justification for a breach of the EC Treaty principles.[21] And this is the same with non-resident artistes, because the risk of tax avoidance is minimal when an artiste and his intermediary are resident in a treaty country. Abusive situations only occur when tax havens are involved, and EC Member States generally do not conclude tax treaties with tax havens.

Besides this the search for the lowest tax rates within the internal market is in conformity with the freedom principles of the EC Treaty and a good sign of internal competition.

Therefore the unlimited approach of Article 17(2) is not needed for the purpose of counteracting tax avoidance behaviour and, as explained in 9.3.2., it hits the wrong target. Other measures are possible within the European Community, such as the exchange of information about the earnings of the theatre and dance companies or orchestras under the EC

21. See ECJ in *ICI*, 16 July 1998, C-264/96, Paragraphs 25-30, *Lankhorst-Hohorst*, 12 December 2002, C-324/00, Paragraphs 34-38, and *Hughes Lasteyrie du Saillant*, 11 March 2004, C-9/02, Paragraphs 50-51.

Directive 77/799/EEC, to make sure that the residence country is aware of the income.

The examples in 9.2.3. show that the unlimited approach can very easily lead to excessive taxation. This can even turn into double taxation when one or more of the tax credit problems of 7.5. occur, such as difficulty in defining the "person of the artiste". When the country of performance taxes the total performance fee, without any division between the individual performing artistes and the company that puts on the performances and pays for the expenses, it can easily happen that the tax certificate will not be issued in the correct names and that therefore no foreign tax credit will be allowed in the country of residence.[22] The resulting double taxation constitutes an obstacle for entering other European markets and is in conflict with the freedom to provide services. And following the ECJ jurisprudence, the OECD defence of the unlimited approach of Article 17(2) will not be considered as a sufficient justification.[23] This means that the unlimited approach of Article 17(2) does not correspond with the principles of Community law and therefore cannot be followed by EC Member States in their mutual bilateral tax treaty relationships.

12.4. Exemptions from corporation tax (*Stauffe*r – C-386/04)

Very often classical orchestras and theatre and dance companies are exempt from corporation tax in their country of residence and would be exempt if they were resident in the performance country. But when they perform in another country, they will be taxed under the non-resident artist tax rules, both on the income of the individual artistes and the compensation for the expenses of the orchestra or company. This clearly causes problems for these orchestras or companies, as explained in example B-2 in 9.2.2.

A case currently pending before the ECJ discusses the issue of tax exemptions, the case *Centro di Musicologia Walter Stauffer* (C-386/04). And although it does not directly concern artistic performances, the outcome can affect non-resident artiste taxation in EU Member States. The

22. See 12.8.2. for further discussion.
23. See the preceding footnote for the strict approach of the ECJ with regard to justification and the risk of tax avoidance.

case is about the Italian music education institute *Fondazione Centro di Musicologia Walter Stauffer* in Cremona (hereinafter: *Stauffer*), which teaches talented young classical musicians and grants scholarships for study in other places. *Stauffer* is exempt from corporation tax in Italy, because of its cultural and educational purposes. In the year 1997 Stauffer owned a piece of land in Germany, which created rental earnings. These rental earnings were taxable in Germany under corporation tax. If *Stauffer* had been resident in Germany, it would qualify for an exemption from German corporation tax, but this exemption is not applicable to non-resident institutions.

The German *Bundesfinanzhof* (Federal Supreme Court) considered in its decision of 14 July 2004 that this treatment might be contrary to Community law and therefore raised the following preliminary question to the ECJ:

> Reference for a preliminary ruling by the *Bundesfinanzhof* by order of that court of 14 July 2004 in the case of *Centro di Musicologia Walter Stauffer* against *Finanzamt München für Körperschaften* (C-386/04)
>
> Is it contrary to Article 52 EC, in conjunction with Article 58 EC, Article 59 EC, in conjunction with Articles 66 EC and 58 EC, and Article 73b[24] EC for a charitable foundation established under private law in another Member State with limited liability to tax on its rental income in Germany, unlike a charitable foundation established in Germany with unlimited liability to tax and receiving similar income, not to be entitled to exemption from corporation tax?

Non-profit (classical) orchestras, theatre and dance companies seem to be in a comparable situation with *Stauffer*, qualifying for exemption from corporation tax not only in the country of residence but also in the country of performance if they are resident there, but not obtaining the corporation tax exemption in the country of performance because the exemption is limited to resident non-profit institutions. And as with *Stauffer*, it can be questioned whether the earnings of a tax-exempt orchestra or other company can be taxable in the country of performance.

A positive decision in *Stauffer* may lead to the conclusion that at least Article 17(2) does not correspond with Community law with regards to non-profit orchestras and other artistic companies that would be exempt from corporation tax if they had been resident in the performance country.

24. These are the old article numbers of the EC Treaty. After the renumbering following from the Treaty of Amsterdam in 1999, the corresponding articles of the EC Treaty are 43, 48, 49, 55 and 56.

But such a decision would not affect the taxability of the salary element in the performance fee, which can be allocated to the performing artistes (Article 17(1)). This element has no relationship to the tax exemption for corporation tax. The performing artistes can get relief for double taxation on their salaries in their country of residence (tax exemption or tax credit).

12.5. Unequal treatment following from Article 17(3)

Many countries have inserted an "Article 17(3)" clause in their bilateral tax treaties, granting an exemption in the performance country when a certain condition is met, such as being financed by public funds or performing on the basis of a cultural agreement or an exchange programme. In that situation only the residence country has the right to tax performance income. The survey in 5.1. shows that an average of 66% of the tax treaties of the 46 countries that were studied contained this clause. This is an extensive use of this optional paragraph, which is not mentioned in the text of Article 17 of the OECD Model Tax Convention, but only in Paragraph 14 of the Commentary on Article 17 of the OECD Model. The variations of Article 17(3) are discussed in 5.5. of this thesis.

Does the application of Article 17(3) lead to a conflict with Community law?[25] An artiste, orchestra, theatre or dance company not meeting the conditions for Article 17(3) will be taxed in the country of performance and has to apply for a tax credit in the country of residence. This creates the same three problems as mentioned in 12.3., i.e. (1) a major risk of excessive taxation, (2) risk of tax credit problems (and double taxation) and (3) high administrative costs (when compared with earnings). Those who can make use of Article 17(3) only suffer taxation in their country of residence. This is much simpler than the allocation to the country of residence and removes the risks.

The Netherlands and Belgium have, for example, inserted Article 17(3) in their bilateral tax treaty, which came into effect on 1 January 2003 and allows home state taxation to artistes who are subsidized for more than 30% of their budget for the specific performance. A subsidized Dutch theatre group will meet this condition when it performs in Belgium, but a commercial Dutch theatre company will not qualify for the exemption of Article 17(3). The performance fees of this company (and its artistes) will

25. Especially Article 12 (equal treatment) and Article 49 (freedom to provide services).

be taxed in Belgium at 18% *bedrijfsvoorheffing* (withholding tax), without the chance to deduct expenses or to file a normal income tax return after the year.[26] In addition, the company and its artistes may experience tax credit problems in the Netherlands, as explained in 7.5.

The conclusion from this example is that *the commercial Dutch theatre company* is in a negative competitive position compared with *the subsidized Dutch theatre company* when it comes to Belgian performances.[27]

It can be questioned whether the EC Treaty has priority in this situation. The ECJ has decided in several cases that EU Member States are free to negotiate with each other how to allocate the taxing rights of various (income) items in a bilateral tax treaty. The EC Treaty does not call for the harmonization of direct taxes, which leaves the composition of a bilateral tax treaty to the Member States' discretion.[28] But the ECJ has also ruled that the results have to meet the principles of Community law, such as equal treatment on grounds of nationality, freedom of establishment and the free movement of persons, services and capital.[29]

The example from Belgium and the Netherlands makes clear that Article 17(3) can create a disadvantage for those who do not meet the conditions. And there is no objective difference between subsidized and non-subsidized artistes; they are in the same position and in the same market. It is as though countries try to protect their state budgets by allowing home state taxation to subsidized companies and their artistes, removing the extra costs arising from the three problems that were mentioned earlier. This creates a conflict with Articles 12 (equal treatment), 39 (freedom of movement for workers) and 49 (freedom to provide services) of the EC Treaty.

26. Belgium has not changed its tax legislation after the *Gerritse* decision of the ECJ. It applies an 18% gross withholding tax and does not allow an income tax settlement after the year-end.
27. This negative tax position makes it especially difficult for *the commercial theatre company*, because it also needs to be more profitable to compensate for the absence of subsidies.
28. See e.g. ECJ in *Gilly*, 12 May 1998, C-336/96, Paragraph 30; and *D*, 5 July 2005, C-376/03, Paragraph 52.
29. See e.g. ECJ in *Commission v. French Republic ("Avoir fiscal")*, 28 January 1986, C-270/83, Paragraphs 25-26.

Altogether this can lead to the conclusion that an "Article 17(3)" clause in a bilateral tax treaty between EC Member States does not correspond to the principles of Community law. If so, the non-subsidized artistes or companies from the two countries ought to have the same rights when performing in another country as subsidized artistes, with residence state taxation for everyone. This would make non-resident artiste taxation non-existent for two countries which have agreed an "Article 17(3)" clause in their bilateral tax treaty.

The following table shows the use of Article 17(3) by 16 of the 25 EU Member States:

Use of Article 17(3) by EU Member States (selected 16 countries, included in survey of 5.1.)

	AUS	BEL	CZE	DEN	EST	FIN	FRA	GER	GRE	ITA	NET	POL	POR	SPA	SWE
Austria															
Belgium															
Czech Republic															
Denmark			Yes												
Estonia	Yes	Yes	Yes	Yes											
Finland			Yes	Yes	Yes										
France	Yes			*	Yes										
Germany	Yes		Yes	Yes	Yes										
Greece			Yes		*										
Italy			Yes	Yes	Yes		Yes	Yes	Yes						
Netherlands	Yes	Yes			Yes										
Poland		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes				
Portugal			Yes	Yes	Yes						Yes	Yes			
Spain		Yes					Yes		Yes				Yes		
Sweden			Yes	Yes	Yes	Yes	Yes	Yes				Yes			
United Kingdom	Yes	Yes			Yes		Yes					Yes			

* France and Denmark, and Greece and Estonia have not (yet) concluded bilateral tax treaties with each other.

12.6. Deviating treaty provisions and most-favoured-nation treatment

Interesting discussions have developed over the last few years about the subject of most-favoured-nation (MFN) treatment with regards to the principles of Community law. In particular, three cases before the ECJ have attracted much attention, i.e. the *D* case (C-376/03), *Bujura* (C-8/04) and *Test Claimants in Class IV of the ACT Group Litigation* (C-374/04).

MFN treatment deals with the differences in bilateral tax treaties. If MFN treatment applies, a resident of country A could make use, when working in country B, of the treaty provisions between e.g. countries B and C, B and D and others. But the question is whether the equal treatment (Article 12 of the EC Treaty) and freedom principles (Articles 39, 43, 49 and 56 of the EC Treaty) are strong enough to enforce such MFN treatment.

EC Member States generally follow the guidelines of the OECD Model Tax Convention as far as possible when they negotiate their bilateral tax treaties, but sometimes deviate from the Model for some reason. This can be the result of a "barter trade", in which both countries give and take until an acceptable balance of allocation rules results.

These differences in bilateral tax treaties can lead to advantages and disadvantages. When a person from country A works in country B and has different allocation rights under the tax treaty A–B from a person from country C under the tax treaty B–C, one of the two, A or C, will be at an advantage and the other will be at a disadvantage. It can be questioned whether this distinction is in accordance with Community law, under the principles of equal treatment and free movement.[30] When direct or covert discrimination is found, there may be reasons to justify the discriminatory measure. The principle of balance and reciprocity of a bilateral tax treaty can be an objective justification,[31] but this will not apply in all situations, especially when the disadvantage is considerable and causes an obstacle within the internal market of the European Community.

The way in which MFN treatment can affect the taxation of non-resident artistes can be illustrated with six examples. It can be questioned whether artistes from treaty countries with a stricter Article 17 can refer to other tax treaties with a more limited (or even absent) Article 17:

(a) Many tax treaties have included Article 17(2), while other tax treaties, especially older ones, do not have this second paragraph.

(b) Some tax treaties have limited the scope of Article 17(2) in the text.[32]

30. The ECJ has found discrimination in two cases, *Saint Gobain*, 21 September 1998, C-307/97, and *Gottardo*, 15 January 2002, C-55/00.
31. See also the ECJ in *Gilly*, 12 May 1998, C-336/96, Paragraph 30.
32. Examples are: most tax treaties of Canada and the United States, and some tax treaties of the Netherlands (with France, Germany, Switzerland, Canada and the United States) and France (with Australia, Finland, the Netherlands, Quebec, Romania and the United States).

(c) Almost all tax treaties with the United States have a *de minimis* rule in Article 17(1). Some contain the maximum threshold of USD 20,000, while others have a lower maximum.[33]

(d) Many tax treaties have included an "Article 17(3)" clause, with exemptions in the country of performance when the conditions (being financed by public funds or cultural exchange or agreement) are met.

(e) Some tax treaties do not contain a special artiste provision at all.[34]

(f) Some tax treaties use the tax credit method for the elimination of double taxation, while other tax treaties use the tax exemption method.

These differences lead to disadvantages for artistes in countries with stricter treaty allocation rules than in other countries. When e.g. part d. (about Article 17(3)) is considered and the table at the end of 12.5. is reviewed, a subsidized artiste from e.g. Spain, who is performing in e.g. the Netherlands, cannot claim an exemption because the tax treaty between Spain and the Netherlands does not contain an Article 17(3). But if most-favoured-nation treatment applied, he could claim an exemption for the Dutch income tax, because the Netherlands has agreed Article 17(3) with other countries, such as the EU Member States Austria, Belgium and Estonia.[35] The Spanish artiste can justify his claim with the argument that he is at a disadvantage on the Dutch market when compared with subsidized artistes from Austria, Belgium, Estonia and other countries.

While this disadvantage has been recognized, there may be justifications for these incompatible (artiste) tax measures. The balance and reciprocity of bilateral tax treaties can constitute an objective justification for refusal of MFN treatment. Countries negotiate for a tax treaty and give and take before coming to a final agreement. It is recognized under European law that treaty partners need to have the freedom to negotiate.

But does this also apply to the taxation of international performing artistes? Article 17 has been inserted in the OECD Model Tax Convention

33. See 5.6.2 for a detailed overview of the bilateral tax treaties concluded by the United States.
34. See 5.2 for more information about the tax treaties that do not contain an allocation rule comparable to Article 17.
35. But the Netherlands also agreed Article 17(3) with e.g. Argentina, Armenia, Bangladesh, Bosnia-Herzegovina, Bulgaria, China (and others). But as discussed earlier in 5.5 the text of Article 17(3) can vary.

as an anti-avoidance measure and the tax revenue from this measure is relatively small. It is therefore not realistic to believe that Article 17 plays a role in the "barter trade" which takes place during treaty negotiations. This will be even more so with the exceptions to Article 17, such as the limited approach of Article 17(2), the special exemption of Article 17(3) and the *de minimis* rule of Article 17(1) of the tax treaties with the United States. Why can e.g. a US artiste have residence state taxation when his performance fee in e.g. Italy stays under USD 20,000 per year, while an artiste from e.g. Spain falls under the Italian artiste source tax and experiences the very real risk of excessive (or even double) taxation?

The mere existence of these exceptions confirms that Article 17 can easily lead to obstacles. This disadvantage is mitigated for specific groups of artistes with these exceptions, but why only for them? Under Community law these positive measures should be applicable to any artiste from any EU Member State.[36]

The tax avoidance element in Article 17 could also be brought forward as a justification for non-conformity with the EC Treaty. But this argument does not seem very realistic, because the ECJ has decided in several cases that tax avoidance behaviour can often be solved by other specific, proportional measures and is therefore not sufficient justification.[37] This also applies to non-resident artistes coming from a treaty country. The risk of tax avoidance does not even exist then, because abusive situations occur only when tax havens are involved and tax treaties are rarely concluded with tax havens.

The discussion about MFN treatment and European law has been strongly influenced by the decision of the ECJ in the *D* case.[38] The ECJ has

36. One of these exceptions has already been put to the test. After the answers by the ECJ in the *Gerritse* case, the case has been referred for a final decision to the German *Bundesfinanzhof*. Gerritse has brought an extra argument forward as to why he should not pay German tax, i.e. the tax-free allowance of USD 20,000 for US artistes who are performing in Germany. He considers this an obstacle for him (and other non-resident artistes) for performing in Germany and has asked to be entitled to the same allowance. This so-called *Arnoud Gerritse (2)* case is still pending before the *Bundesfinanzhof*.
37. See ECJ in *ICI*, 16 July 1998, C-264/96, Paragraphs 25-30, *Lankhorst-Hohorst*, 12 December 2002, Paragraphs 34-38, and *Hughes Lasteyrie du Saillant*, 11 March 2004, C-9/02, Paragraphs 50-51.
38. *D*, 5 July 2005, C-376/03. In this case a German resident was not permitted a tax-free allowance in the Netherlands, which was permitted to a Belgian resident in the Netherlands under the tax treaty between Belgium and the Netherlands. The German resident asked for the same treatment in the Netherlands as the Belgian resident.

discussed the allocation of the taxing powers in bilateral tax treaties and has decided, that "a difference in treatment between nationals of the two Contracting States that results from that allocation cannot constitute discrimination contrary to Article 39 EC".[39] And it also stated that "the fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions".[40] Therefore the individual articles of a bilateral tax treaty "cannot be regarded as a benefit separable from the remainder of the Convention, but is an integral part thereof and contributes to its overall balance".[41]

The conclusion is that with the ECJ decision in the *D* case no MFN treatment is possible under the EC Treaty. But this does not mean that the discussion about the *D* case has ended, on the contrary. Some authors believe that the ECJ was wrong with its decision, although these authors are also paying much more attention to the position of bilateral tax treaties than they did before. In the discussion in the literature the MFN aspect has vanished and the (more or less) regular discussion about equal treatment and the scope of the freedom principles has taken its place.[42]

This will be the same for the MFN discussion in this chapter about the variations in Article 17 of the OECD Model. The ECJ has confirmed the exclusivity of treaty partners to allocate the taxing rights in a bilateral double tax treaty and therefore tax treaties cannot be compared to look for the best provision.

The discussion in 12.2. to 12.5. about the possible collision between the variations in Article 17 of the OECD Model and the non-discrimination and freedom principles of the EC Treaty are more in line with the direction chosen by the ECJ in the *D* case.

39. See Paragraph 52 of the ECJ decision in the *D* case.
40. See Paragraph 61 of the ECJ decision in the *D* case.
41. See Paragraph 62 of the ECJ decision in the *D* case.
42. See e.g. Pasquale Pistone, "National Treatment for All Non-Resident EU Nationals: Looking Beyond the D Decision", 33 *Intertax* 10 (2005), at 412; Servaas van Thiel, "A Slip of the European Court in the D Case (C-376/03); Denial of the Most-Favoured-Nation Treatment because of Absence of Similarity?", 33 *Intertax* 10 (2005), at 454.

12.7. Is Article 17 of the OECD Model permissible under Community law?

It may be asked whether Article 17 of the OECD Model Tax Convention in general, as an exception to the Articles 7[43] and 15 of the OECD Model Tax Convention, is permissible under Community law. It was argued in the preceding paragraphs that the special allocation rule of Article 17 leads to a disadvantage for performing artistes, for whom three problems were recognized, i.e. (1) a major risk of excessive taxation, (2) risk of tax credit problems and (3) high administrative costs (when compared with the earnings). This leads to a conflict with the principles of the EC Treaty.

A central question is whether non-resident artistes are in a comparable situation with other non-resident self-employed persons, companies or employees. This seems to be the case when artistes are compared with models, film directors, cameramen, architects, lawyers, composers, authors and many others who also live from the exploitation of their personal skills.[44] Very often these self-employed people are even more mobile than artistes, especially when big orchestras and theatre and dance companies are taken into consideration.

The EC Treaty does not specify a division between categories of service providers, but makes a distinction between “workers”, “services” and “capital”. It does not therefore seem consistent to select only artistes (and sportsmen) as a group of persons for special tax treatment with Article 17 and to treat others under the general allocation rules of Article 7 or Article 15 of the OECD Model Tax Convention. It can be questioned whether this special allocation rule with its disadvantages is permissible under the EC Treaty.

Here is a clear conflict between the freedom of countries to divide taxing rights in their bilateral tax treaties and the non-discrimination and freedom principles of the EC Treaty. As discussed in the previous paragraph, it cannot be considered that Article 17 plays a significant role in the “barter trade” during the negotiations for a tax treaty, especially when the tax revenue from performances by non-resident artistes is taken into consideration.[45] It should therefore not be an element in the balance and

43. But also to Article 14, which has been deleted from the OECD Model in 2000, but is still in use in many bilateral tax treaties.
44. See for the comparison between artistes and other individual service providers, Sandler (1995).
45. See Chapter 9.

reciprocity that could be recognized as a justification for a conflict with Community law.

But it can currently be expected, shortly after the ECJ decision in the *D* case and the clear choice in favour of the position of bilateral tax treaties, that the ECJ will leave it to treaty partners' discretion whether they want to follow the recommendations by the OECD to insert a special provision for performing artistes in their bilateral tax treaty. The ECJ clearly gives priority to bilateral tax treaties in the *D* case, which means that the balance with the freedom principles of the EC Treaty needs to be redefined.

And it can be expected that the ECJ will add, in line with the decision in *Gerritse* and with the cases of *Scorpio* and *Centro Equestre* pending, that the Member States have to remove any tax obstacle for international performing artistes, both in the country of performance and the country of residence.

The conclusion from this paragraph is that there are strong arguments supporting a conflict between the EC Treaty and Article 17 of the OECD Model, but that it is not realistic at this moment to expect that the ECJ, after its decision in the *D* case with the priority rule in favour of bilateral tax treaties, will follow these arguments. But the ECJ will continue to remove obstacles for artistes in the European Union.

12.8. European law and the tax credit problems in the country of residence

12.8.1. The limitation of the ordinary tax credit

The previous paragraphs focused mainly on the country of performance, the source state. But a comparable discussion can also be held for the other party involved, the country of residence. This country has agreed in its bilateral tax treaties to eliminate double taxation; but is the compensation that is offered in line with the requirements following from European law? Bilateral tax treaties provide for a tax credit (for the foreign tax) or tax exemption (for the foreign income). Most countries also have a unilateral measure for the elimination of double taxation, in case of the absence of a tax treaty. See chapter 7 of this thesis for an in-depth discussion of this subject.

The OECD Model recommends the tax credit method as the preferred method for performing artistes.[46] This may lead to a possible conflict because it is questioned within the European Community whether the tax credit method in general is in accordance with European law. The argument is that the tax credit method may not fully compensate for the foreign tax; there may be excessive taxation because the usual tax credit method has its limitations. The OECD Model Tax Convention recommends the ordinary tax credit in Article 23B, which means that the tax credit will be limited to the amount of tax that is due in the residence country on the foreign income. This can lead to a disadvantage when the source country has higher tax rates than the residence country.

Under European law this may be justified when it is caused by differences between the tax systems of the two countries involved. These differences are called disparities. The ECJ has decided in the *Gilly* case[47] that disparities are not in conflict with the principles of the EC Treaty. As explained in 11.1., the European Community has decided not to harmonize direct taxation, which means that every country has retained the right to pass its national direct tax legislation and set tax rates at the desired level, as long as this is in conformity with EC law. In the *Gilly* case, the French tax credit was not sufficient to compensate for the higher German source tax and the French Mrs Gilly ended up with an excess tax credit because of this difference in tax rates. But this was not considered a breach of Treaty principles.

But when the situation is the opposite, i.e. when the income tax in the source country is lower than in the residence country, then the tax credit method leads to the result that the taxpayer needs to pay an additional amount of tax in his residence country.

The preceding leads to the conclusion that the ordinary tax credit method is inconsistent. A taxpayer residing in a high-tax country can never benefit from the differences in tax rates between countries. Within the European Community this seems to offend the principles of an internal market. The freedom principles of the EC Treaty prohibit restrictions on cross-border activities and aim to realize a “level playing field”. This does not correspond to the tax credit method, which allows residence countries to tax away tax advantages received in other countries.

46. See Paragraph 5 of the Commentary on Article 17 of the OECD Model.
47. *Gilly*, 12 May 1998, C-336/96.

The inconsistency of the tax credit method also goes against the obligation of Community loyalty for the Member States, as laid down in Article 10 of the EC Treaty, because it jeopardizes the EC objectives of the freedom principles (non-restriction) and the normal conditions of competition.[48]

The tax exemption method gives a better balance between the tax rates of two different countries. It can lead to either excessive taxation or undertaxation, because it does not have any link with the amount of tax levied in the source country, but is more appropriate for an internal market, because the differences in tax rates can stimulate competition.[49]

Within the European Community it can also be debated whether countries which allow the tax exemption method to resident self-employed persons (with a permanent establishment abroad) and employees having foreign income, can restrict the compensation for resident artistes with foreign income to the (ordinary) tax credit method. Both self-employed artistes and other self-employed persons and artistes/employees and other employees seem to be in an objective comparable situation, for which the European Treaty orders the same treatment. The risk of non-compliance is the same for both and the risk of insufficient taxation in the source country is also no different. This means that countries such as the Netherlands do not have the right to exclude resident artistes from the tax exemption method for foreign income, either in tax treaty situations or by a unilateral method to eliminate double taxation.

12.8.2. Tax credit problems

Paragraph 7.5. has explained that the international performing artiste may experience several tax credit problems in his home country. These tax credit problems do not arise from a special tax regime in the country of residence for foreign income of artistes, but occur under the normal national tax credit (or exemption) rules. Examples of tax credit problems are:

- absence of a tax certificate;
- qualification of the foreign-source tax;
- person of the artiste;
- triangular situations;
- net deals;

48. Terra and Wattel (2005), at 260.
49. Terra and Wattel (2005), at 259.

– differences in the taxable base;
– per country or overall (basket);
– year of the tax credit;
– creditable domestic income tax;
– difficulty of the tax credit system.

These tax credit problems can lead to considerable excessive taxation, even more than calculated in the examples in chapter 9. The worst outcome is that they can generate double taxation when no tax credit is granted in the country of residence. It is evident that this is a major obstacle to cross-border activity.

Given the complexity and the problems of the tax credit method, the conclusion of 12.8.1. can be supported: that – as in the previous paragraph – it would be better to use the tax exemption method to eliminate double taxation.

12.8.3. Mutual assistance, exchange of information

Until now it has seemed to be the responsibility (and the risk) of only the artiste/taxpayer to obtain the tax credit in the country of residence. But European law, the OECD Model Tax Convention and other bilateral treaties support the view that the source and the residence country involved also have an important responsibility in this respect. The following regulations can be especially referred to:

Article 26 of the 2005 OECD Model Tax Convention (Exchange of information)

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention …

(e.g.) Memorandum between the Netherlands and Sweden on mutual assistance[50]

Automatic exchange of information

Article III.2 The competent authorities shall exchange automatically information regarding the following earnings and/or data:

...

d. earnings of artistes and sportsmen as specified in Article 17 of the Treaty.

50. Memorandum of 3 September 2004, nr. DGB2004/4601M (NL).

> *Article 293 of the EC Treaty*[51]
> Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals
> – the abolition of double taxation within the Community
>
> *Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (77/799/EEC)*[52]
> Art. 1. In accordance with the provisions of this Directive the competent authorities of the Member States shall exchange any information that may enable them to effect a correct assessment of taxes on income and on capital.
> …
> Art. 4 (Spontaneous exchange of information)
> 1. The competent authority of a Member State shall without prior request forward the information referred to in Article 1(1), of which it has knowledge, to the competent authority of any other Member State concerned, in the following circumstances:
>   (a) the competent authority of the one Member State has grounds for supposing that there may be a loss of tax in the other Member State;
>   (b) a person liable to tax obtains a reduction in or an exemption from tax in the one Member State which would give rise to an increase in tax or to liability to tax in the other Member State;
> …
> 3. The competent authorities of the Member States may forward to each other in any other case, without prior request, the information referred to in Article 1(1) of which they have knowledge.

With these bilateral agreements, the EC Treaty and the EU Council Directive, the countries concerned cannot lean back and observe the artiste/taxpayer struggling to obtain his foreign tax credit. First, the country of performance should take action and automatically or spontaneously inform the residence country of the artiste about the performance income and the amount of tax that has been levied. Second, the country of residence needs to be ready to integrate the information received into the income tax assessment procedure and allow the foreign tax credit, even when the artiste is not able to specify this in his tax return. Both countries need to take the appropriate administrative measures to meet the obligations which follow from their international agreements and directives.

51. This article of the EC Treaty does not (unfortunately) have a direct effect for taxpayers in the EC. See *Gilly*, 12 May 1998, C-336/96, Paragraph 16.
52. This Council Directive does not (unfortunately) have direct effect and can therefore not be relied on by taxpayers in the European Community.

The ECJ has set a low threshold for the (spontaneous) exchange of information. In the case *W.N.*[53] it was interpreted that not only the risk of tax avoidance or evasion, but also the need for a correct assessment of income taxes in the country of residence, should lead to action by the source state. This country has to send information about the income earned in its territory to the residence country when it has grounds for supposing that, without that information, an unjustified saving in tax might exist in the residence country. This can also be the case, according to the ECJ, when only a small amount of tax is involved.

Bearing in mind the mistrust of the OECD Member countries of international performing artistes, partly because of their non-compliance behaviour, i.e. fear that they will fail to declare foreign performance income in their total worldwide income in their home country,[54] the (spontaneous) exchange of information by the country of performance with the country of residence should be carried out on a regular basis. This would not only help the country of residence to come to the right assessment, but also help artistes who want to comply in a normal way and enter their foreign performance income on their tax returns, because it would become easier for them to obtain a foreign tax credit.

It is even possible for artistes/taxpayers to ask the tax authorities of the residence country to take action towards the country of performance and obtain the information that is needed for the correct foreign tax credit. This has also been specified in the OECD Model Tax Convention:

> *Article 25 of the OECD Model Tax Convention (Mutual agreement procedure)*
> 1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of one of those States, present his case to the competent authority of the Contracting State of which he is a resident (…). The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of this Convention.
> 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be

53. *W.N.*, 13 April 2000, C-420/98).
54. See 2.12. about the 1987 OECD Report.

implemented notwithstanding any time limits in the domestic law of the Contracting States.

The conclusion from these measures needs to be that the tax credit problems of international performing artistes are a combined responsibility of the artiste/taxpayer and the tax authorities in both the country of performance and the residence country. The tax authorities in the source country need to exchange information automatically and spontaneously about performance income, while the tax authorities in the residence country need to ask for information from the source country if tax credit problems occur. But unfortunately the conclusion is warranted that this has not yet been recognized in practice.

12.8.4. Developments towards a full tax credit in the European Union

The latest developments in the European Union seem to go even further than the approach of the previous paragraph. A discussion has started about whether the residence country needs to allow a full credit for the foreign-source tax instead of a (limited) ordinary tax credit.

The ECJ has gone in the direction of a full tax credit in the cases of *Lenz*[55] and *Manninen*.[56] Although it is as well to realize that these cases concern the free movement of capital (Article 56 of the EC Treaty) and not the freedom to provide services (Article 49 of the EC Treaty) and can therefore not be directly transferred to international performing artistes, the direction of the ECJ still seems irreversible. In both cases the ECJ decided that foreign source dividends have to be treated in the same manner as domestic source dividends. In the *Lenz* case it was found unacceptable that a reduced tax rate could be used for dividends from a domestic source, where the full amount of tax had to be paid on foreign dividends. In the *Manninen* case a Finnish taxpayer could get a full tax credit for Finnish dividends but no tax credit for Swedish dividends. Both provisions were found to be in breach of the free movement of capital.

These decisions go much further than the ECJ decision in *Gilly*,[57] where the ordinary tax credit was still clearly accepted, leading to the

55. *Anneliese Lenz*, 15 July 2004, C-315/02.
56. *Petri Manninen*, 7 September 2004, C-319/02.
57. *Gilly*, ECJ 12 May 1998, C-336/96.

consequence that the foreign tax exceeded the tax in the residence country, and in *De Groot*,[58] where an extra compensation was allowed in the residence country, but still without taking the real amount of foreign-source tax into consideration. But it seems as if the ECJ is changing its interpretation fundamentally with the latest decisions in the *Lenz* and *Manninen* cases.

Another sign of the movement towards a full foreign tax credit comes from the Council of the European Union. The Council concluded on 3 June 2003 the Council Directive on taxation of savings income in the form of interest payments (2003/48/EC). For this Directive the European Council has reached agreement with not only its Member States but also with Switzerland, Andorra, Liechtenstein, Monaco, San Marino and other countries, that they will either automatically exchange information about interest payments with the country of residence of the recipients or will levy a withholding tax on the interest payments. The flat withholding tax rate starts at 15% (for three years), will be raised during a transitional period to 20% (for three years) and will then be set at 35% of the interest payment. With this agreement the European Union respects banking secrecy, but also improves tax compliance in respect of interest earnings.

The interest is also taxable in the country of residence of the recipient when a withholding tax has been levied in the source country. In the latter situation the country of residence has to allow a tax credit as relief for double taxation. It is very interesting that the Savings Income Directive provides for a *full* tax credit, i.e. not only a tax credit up to the amount of tax due in the country of residence, but also a reimbursement of any excess amount of tax withheld.[59] This goes beyond the existing tax credit systems in residence countries.

It is important to note is that the Directive also requires the transfer of tax revenue from the source country to the residence country. This will give compensation for the full foreign tax credits.

Although the Savings Income Directive can be seen in isolation, it can also be argued that this is an official step further in the direction of full tax credits within the European Union. But the gap between this full tax credit

58. *De Groot*, ECJ 12 December 2002, C-385/00.
59. Council Directive of 3 June 2003 on taxation of savings income in the form of interest payments (2003/48/EC), Paragraph 21 and Article 9. Alternatively, the country of residence can also grant a refund of the foreign withholding tax.

and the ordinary tax credit for EU performing artistes is still wide. First, interest is passive, capital income and therefore very different from the active income of performing artistes; secondly, this full tax credit system is embedded in the controlled environment of the Savings Income Directive; and thirdly, the residence countries are financially compensated for their full foreign tax credit. But it adds to the movement towards a full tax credit system within the European Union. At the same time it acknowledges the responsibilities of both the residence country and the source country to avoid excessive taxation, especially within the European Union, as discussed at the end of the previous paragraph.

The full foreign tax credit has the positive effect of removing the inconsistency of the ordinary tax credit system, as discussed in 12.8.1., and creating more home neutrality within the internal market of the European Community. If the new approach became available to international performing artistes, the excess taxation explained in the examples in chapter 9 would disappear.[60]

12.9. General discussion and conclusions

Both the OECD Model Tax Convention and the EC Treaty have the objective of removing double taxation. But while bilateral tax treaties fully focus on this issue, the EC Treaty has many more provisions and does not even wish to interfere directly in the direct tax rules within the Community. However, the EC Treaty has a great influence on direct tax rules, through its equal treatment and freedom principles. It is not surprising that with these very different approaches conflicts of competence can easily arise.

The first conflict regarding artiste taxation is about the deductibility of expenses. The OECD Model Tax Convention tries to stay neutral in its comments in Paragraph 10 of the Commentary on Article 17, although many countries have used this position as a recommendation for the gross taxation of performance fees; but the European Court of Justice has been very clear in its *Arnoud Gerritse* decision and stated that the non-deductibility of expenses is in conflict with the freedom to provide services of the EC Treaty. This means that EU Member States, which are

60. Besides the tax credit problems described in 7.5.

members of both the European Union and the OECD, can no longer rely on Paragraph 10 of the Commentary on Article 17 of the OECD Model.

Furthermore, the interpretation of Article 17(2) about whether the limited or unlimited approach should be used for payments to people other than the artistes personally leads to a clash between the OECD Model and the EC Treaty. The unlimited approach causes disadvantages for international performing artistes, because it increases the risks of excessive taxation and tax credit problems considerably, and extra administrative expenses need to be incurred. And there seems to be no need for the unlimited approach within the European Community, because the risk of tax avoidance is nil. There are no tax havens and the exchange of information to the country of residence is possible with the EC Directives. Therefore the unlimited approach of Article 17(2) does not seem to correspond with the principles of Community law.

The pending *Stauffer* case also puts pressure on Article 17(2). The question in this case is whether an exemption for corporation tax can be allowed only to residents, while non-residents cannot make use of this exemption, even if they would have qualified for the same exemption had they been residents. Non-conformity with the freedom principles seems very likely.

The optional and extensively used Article 17(3) clause in tax treaties can also lead to a conflict with the principles of the EC Treaty. The exemptions for source taxation for either subsidized artistes or exchange programmes cause disadvantages for those artistes who do not meet the conditions. There is no justification for this unequal treatment, which would give scope for an extension of the Article 17(3) clause to every performing artiste from the same two treaty countries and the virtual removal of artiste taxation in the country of performance.

MFN treatment would make it possible to choose the most profitable provisions from other bilateral tax treaties. An example is the absence of Article 17(2) in tax treaties between EU Member States: with MFN treatment it would be possible for artistes from other countries to take over this restriction, even though it is not specified in their tax treaty.

MFN treatment has initiated a lively discussion in the European Community, but this has radically changed direction after the ECJ decision in the *D* case, which strengthened the position of bilateral tax treaties and the exclusive rights of countries to allocate taxing powers amongst themselves.

The disadvantages of the system of artiste taxation, i.e. risk of excessive taxation, tax credit problems and high administrative expenses, lead to a discussion of whether Article 17 of the OECD Model in general is compatible with the principles of the EC Treaty. There seems to be no valid justification for the hindrances to the freedom provisions. But after the decision in the *D* case, it can be doubted whether the ECJ is willing to prioritize equal treatment of non-resident artistes under Community law over the special position of artistes in bilateral tax treaties.

Possible conflicts can also arise in the country of residence of the international performing artiste. The recommended ordinary tax credit method can very easily lead to excessive taxation, while the artiste cannot profit from an advantage in the opposite situation. This makes the tax credit method inconsistent and not useful for the internal market of the European Community. The tax exemption seems to be more suitable, because it stimulates competition.

The tax credit problems which international performing artistes can experience in their residence country can even turn excessive taxation into double taxation. This issue also indicates the need for a change to the tax exemption method.

Tax credit problems are now only the risk for the performing artiste/taxpayer. But there are very clear provisions in bilateral tax treaties, the EC Treaty and EC Directives that give both the country of performance and the country of residence the responsibility to exchange information and to take action to prevent double taxation. The ECJ has acknowledged this in the *W.N.* case and decreed that this responsibility exists even when only a small amount of tax is involved. Therefore the mitigation of tax credit problems for international performing artistes is the combined responsibility of both the artiste/taxpayer and the tax authorities in the two countries. Unfortunately this has not been recognized up to now.

The limitation of the ordinary tax credit would be less restrictive if the *De Groot* decision of the ECJ also applied to the differences in taxable income for non-resident artistes in the source and the residence country. An example shows the positive effect.

New developments before the ECJ may lead to the conclusion that it is changing its approach towards the tax credit system. While it accepted the limitations of the ordinary tax credit in *Gilly* and in *De Groot*, although moderated, it ordered a full tax credit in the more recent *Lenz* and *Manninen* decisions, although under specific circumstances.

This development has gone further with the allowance of a full tax credit in the 2003 Savings Income Directive of the Council of the European Union. If a source country is allowed to levy a withholding tax on interest payments, the residence country needs to grant a full foreign tax credit. This Directive also obliges source countries to transfer a part of the withholding tax to residence countries, to compensate them for the full tax credit.

Altogether, there a signs of a development towards a full tax credit system within the European Union, although this is not yet sufficiently marked to bring about a tax credit for international performing artistes. But such a credit would help to do away with the excess taxation which was calculated in chapter 9.