Transparency and Taxation: Consequences for International Entertainers

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>> Introduction

Transparency is developing in tax law, especially after the turmoil about multinationals such as Google, Apple, Starbucks and Fiat avoiding taxation with their structures via tax havens and after scandals such as Lux Leaks and Panama Papers. This has led to the OECD[1] project "Base Erosion and Tax Evasion" (BEPS) with far reaching measures, which many states will implement multilaterally in their tax treaties. Also, tax havens are put under pressure and have started concluding (automatic) information exchange treaties with high-tax states, so that they are not put on black list by the OECD, EU and others. As a result, the bank secrecy of states such as Switzerland and anonymous holding structures in tax havens are disappearing because of the improved cooperation between tax authorities and changes in legislation. Aim is that tax payers, both companies and individuals, will pay their fair share of taxation.

This may also affect entertainers and others working in the entertainment industry. This chapter will study whether the implementation of the BEPS Action Plans via the Multilateral Instruments (MLI) and the exchange of information treaties will realize that states become so transparent with each other, that royalty structures with tax havens are not possible anymore, Article 17 OECD Model for performing entertainers as anti-avoidance measure is not needed anymore and it becomes harder for top entertainers to have no residence and avoid taxation.

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>> Royalties and the Use of Tax Havens

1) National Source Taxation

Most states have a national source withholding tax (WHT) on royalties for income from copyrights being paid to non-residents. This may vary from 10% to 30% from gross income. Reason for this is that states want (1) a share of the money earned in their country, and (2) be sure that the income is taxed in at least one country, because they don't know whether the owner of the copyright reports the income in another country. This source WHT very often also applies to other income for non-residents. Entertainers may experience this source WHT for record sales royalties, author's copyright income, merchandise royalties and other sales related income.

2) Art. 12 OECD Model Tax Convention and the Practical Use in Tax Treaties

But royalty income is also taxable in the residence state of the owner of the copyright, which means that double taxation would occur when no measures would have been taken. Then international trade and use of copyright would not be profitable. Therefore, states have started to conclude tax treaties with each other, in which in general the taxing right is allocated solely to the residence state of the owner of the copyright. This is mentioned in Article 12 of both the OECD, US and UN Model Tax Conventions. Then the source state needs to allow a tax exemption.

Most states follow this recommendation, but some want to keep a percentage from the royalties as contribution to their state's budget and negotiate in their bilateral tax treaties a low WHT rate, between 5% and 20%. If so, then the residence state should allow a foreign tax credit to eliminate double taxation, which is normally mentioned in Article 23 of the bilateral tax treaty. Exemption or the lower rate at source is only allowed under a bilateral tax treaty. Where tax havens do not have tax treaties, this measure should prevent owners of copyright from bringing over royalties to these low tax jurisdictions, because higher the national WHT still applies.

3) Structures With Tax Havens

But still royalty structures with havens have been possible, mainly because some states don't have a WHT on outgoing royalties. The best known example is the Netherlands, which believed that a WHT and exemption procedure would obstruct international trade. But the Netherlands also have 95 bilateral tax treaties with no or just a low WHT on incoming royalties, which means that a structure with a Dutch intermediate limited company licensing copyright to other states and collecting the royalties, paves the way to gross payments to the copyright owners in tax havens. And the Dutch tax authorities are willing to issue tax rulings on transfer pricing issues, especially about how much of the collected royalties should remain in the Dutch limited company and be taxed there. Publicly known examples of these structures via the Netherlands are the Rolling Stones and U2 with their Dutch BV's in an office in Amsterdam. But also other states have offered this service, such as Luxembourg, Hungary and Denmark.

These royalty structures are not only used by top entertainers but also by big international companies, such as Google, Apple, Starbucks, Fiat and many others. [2] Reason can be tax evasion but also to eliminate double taxation when a tax treaty is missing between states. Especially US companies very often use these structures because the US only has around 50 bilateral tax treaties with other states. Using an intermediate company in a state with many more treaties, such as the UK or the Netherlands with around 100 bilateral tax treaties, takes away double taxation.[3] Another reason is the reduction of the total tax burden by transferring a part of the profit from a high-tax state to a state with much lower tax rates, which was used by e.g. Google, Starbucks and Apple.

4) BEPS Action Plans

Treaty-shopping for the reduction of the tax burden and for tax evasion has brought the international world to action. The G20 has taken the initiative in 2012 and asked the OECD to start the program "Base Erosion Profit Shifting (BEPS)", which has led to an impressive set of Action Plans, being accepted by not only the 30 OECD Member States but also many others. Aim is that these states will implement the BEPS

measures with a multilateral instrument (MLI), which will change the bilateral tax treaties of a state all at once and do not need bilateral negotiations and protocols.

More specifically, BEPS Action Plan 6 discusses treaty shopping. It gives options for restricting abuse of tax treaties with the choice between a Principal Purpose Test (PPT) or the Limitation on Benefits (LOB) rule. With a PPT, companies need to show what the main benefit of their international structure is. When this is purely tax savings without any normal business reason, the structure can be neglected by one or both states. With a LOB, a taxpayer needs to prove that he has enough connection with the state to make use of the tax treaty advantages. After the choice for either of these two, also other anti-conduit rules can be implemented, such as substance requirements.

In addition, transfer pricing (TP) rules are specified more extensively by the OECD. With better TP rules, it can be avoided that the source state should allow a higher deduction from the taxable base than it wants. For example, Starbucks coffee is protected by copyright, for which Starbucks branches everywhere have to pay a royalty per cup of coffee to an intermediate company in the Netherlands. In most states, no source withholding tax is due because of the well-developed Dutch tax treaty network. But the Dutch company only has a license and will pay almost the whole royalty revenue through to the company of the licensor in a state with a lower tax rate, such as Ireland (or perhaps even no taxation, such as the Channel islands or one of the Caribbean islands). The measures from BEPS Action Plan 6 should prevent that this structure can still be used in the future.

5) Exchange of Information

An element of the BEPS program is the exchange of information between states. The OECD already had Art. 26 in its Model Income Tax Convention, which was followed by the UN and the US in their Model Tax Conventions, which has been taken over in almost every bilateral tax treaty. But in addition, the OECD has come up with a Model Tax Information Exchange Agreement (TIEA) for tax havens. They normally do not conclude bilateral tax treaties, because they don’t have income taxation and other

states do not want to allocate taxing rights with them. But with the BEPS program tax havens are threatened to be put on a black list of "non-cooperative states", which they can avoid with TIEAs with high-tax states. Therefore, many tax havens have concluded TIEAs and have started to exchange financial information with treaty partners, using the Model template created by the OECD,[4] available in many languages.

There are three types of exchange of information:

- AEOI: Automatic Exchange of Information
- EOIR: Exchange of Information on request
- SEOI: Spontaneous Exchange of Information

The OECD standards have become fully ingrained and widely used and the OECD Report 2018[5] about AEOI shows that 86 states are already exchanging financial account information automatically, marking a major shift in international tax transparency and the ability of states to ensure tax compliance.[6] The quality of the information is important and therefore all states are using the Common Transmission System (CTS) and the Common Reporting Standard (CRS) for their exchanges.

The OECD does not include the USA, because they use their own FATCA from 2015 with intergovernmental agreements (IGAs), based on reciprocity, to exchange financial information.

The EU has agreed on the Directive Administrative Cooperation (DAC) for automatic exchange of information.[7] There are several DACs implemented since then:

- DAC 1: Employment income, life insurance, pensions and real estate
- DAC 2: Financial account information[8]
- DAC 3: Rulings
- DAC 6: Mandatory disclosure rules for (aggressive) cross-border tax advice by tax advisers and other intermediaries.[9]

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6) EU Black and Grey Lists
The EU Council has decided to publish a black list of non-cooperative states for exchange of information and removal of harmful tax practices. The latest update of the black list is from 12 March 2019[10] and includes 15 states.[11] At the same date the EU Council also published an update of the grey list with states to be monitored further in 2019, which this includes 34 states.[12]

Interesting is that the OECD has renewed its partnership with the United Arab Emirates (UAE) to strengthen tax co-operation. This is an example that the 30 Member States of the OECD are not giving up that states on the black list can improve in order to be cleared from the list in the future. The EU has criticized the UAE for facilitating offshore structures and arrangements aimed at attracting profits without real economic substance, but this can change in the future.[13]

7) The Netherlands: Withholding Tax on Payments to Non-Compliant States
At the other end, the Netherlands have decided to introduce per 2020 a source withholding tax on outgoing royalties, interesting and dividends to companies in non-cooperative states. They use the EU black and grey list as reference for this conditional withholding tax. This a major turnaround in the Dutch tax policy.

>> Performance Income of Entertainers and Excessive Taxation

1) Allocation of Taxing Right With Art. 17 OECD Model Tax Convention
Most states also apply a national source withholding tax (WHT) on performance income for entertainers, same as for royalties and other sources of income. Some states just simply tax every source of income leaving the country, for the same two reasons as mentioned in paragraph 2.1 of this chapter.

But for performance income this is confirmed by Article 17 of the OECD Model Tax Convention, which allocates the taxing right to the state of the performance. This deviating article has been taken over in almost every bilateral tax treaty. Sometimes

with restrictions, such as exemptions for subsidized artists[14] and for income under a specific threshold,[15] but most often to the full amount to catch all income at source.

2) Problems With Tax Credits in Residence State

Unfortunately, this very often leads to excessive or even double taxation, because the taxable base is (much) higher in the performance state than in the residence state or tax certificates are missing or cannot be used. And both the source taxation and the tax credits lead to high administrative expenses for both the promoters, entertainers and tax authorities.[16] Entertainers are losing a part of their income from these inefficiencies and are worse off than when they would only perform in their residence state.

3) OECD Reports in 1987 and 2014

The OECD already mentioned Article 17 in its first Model Tax Convention in 1963 and extended the article with a second paragraph in 1977. In those days it did not give much reasoning for this deviating tax rule with which the normal allocation rules for companies and self-employed (Article 7) and for employees (Article 15) are set aside, but this changed in 1987 with a special OECD Report.[17] This showed that the OECD Member States did not trust entertainers but believed most of them were not reporting foreign income in the residence state and top stars were using tax structures for tax evasion. And even though the main principle underlining the report was that income from entertainment and sports should be taxed in the same way as income from other activities, it still came to the conclusion that the deviating Article 17 was necessary. This could be different when exchange of information between states would be possible, but that was not the case back in 1987.

A new OECD Report was published in 2014, after an internet consultation which started in 2010. This report started with a discussion on whether Article 17 perhaps could be removed from the Model Tax Convention, but came with three reasons to why the conclusion of the article should remain:[18]

a) Residence taxation could not be assumed, giving the difficulties of obtaining the relevant information

"Both the source taxation and the tax credits lead to high administrative expenses for both the promoters, entertainers and tax authorities."

b) Article 17 of the OECD Model permits the taxation of a number of high-income earners who could otherwise easily move their residence to low-tax jurisdictions
c) Source taxation of the income covered by Article 17 of the OECD Model can administered relatively easily.

Unfortunately, these reasons are erroneous and still result in the same misconception that has been the case over many years.[19] But for this chapter, the first reason for keeping Article 17 is interesting, because it suggests that the exchange of information is still not working for entertainers.

4) Entertainers and the (Automatic) Exchange of Information
In paragraph 2.5 of this chapter was discussed that the exchange of information between states has grown rapidly to a promising level. But the details also show that especially financial account information (OECD) and employment income, pensions, financial account information and EU rulings were automatically exchanged. It seems that performance income from entertainment is too miscellaneous to be included in this AEOI. Then it is still possible to ask for the information (EOIR) or to provide the information spontaneously (SEOI), but that will be by chance and not be convincing for the OECD to remove Article 17. It depends on the developments of the AEOI whether this can help performing entertainers with their problems of excessive or double taxation.

>> Conclusions
There is an impressive trend towards more transparency in taxation. States are cooperating with each other to exchange information, both at the OECD, EU and US level. Not only high-tax states but also (former) tax havens, because they want to avoid being mentioned on the black (or grey) list and excluded from the international economy. Figures from 2018 show that the automatic exchange of information is already impressive and that the information is also matching with the details in the other state.

This transparency will be an effective measure against tax avoidance structures for royalty income, but more seems to be needed for removing the excessive or

even double international taxation on performance income. The opening of tax havens and exchange of information about bank accounts and rulings will help against royalty structures but is not reaching far enough to give the residence state the information about the foreign performance income. This means that Article 17 OECD Model will not lose its ground reasons at short notice.

The transparency may also help to identify entertainers when they move their residency to a tax haven and with the bank information the (former) residence state has more evidence for compliance by these entertainers. This will lead to second thoughts by top stars when they consider a tax haven as their future home. With the improved transparency it will become much harder to hide income or residence.

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[1] *Organisation for Economic Cooperation and Development, based in Paris, France.*

[2] *Include figures from CBS 2019.*

[3] *Until 2018 an extra reason was that structuring via the Netherlands to a tax haven in e.g. the Caribbean (with no taxation), would avoid the high US corporation tax rate. But with the considerable reduction in tax rates by the Trump administration per 2018, this seems not necessary anymore.*

[4] *This Model template is not only available in English but also in many other languages.*

[5] *Figures were collected and published by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.*

[6] *This includes e.g. the Bahamas with exchanges to 36 states, Bermuda (52), British Virgin islands (50), Cyprus (59), Monaco (34) and Switzerland (36).*

[7] *Council Directive 15 February 2011, nr. 2011/16/EU.*

[8] *In 2018 there was a matching of 86% of the exchanged information, including 8.7 million accounts with account balances of EUR 2,919 billion in total. The information mostly came from Luxembourg, which has sent e.g. information about EUR 607 billion to Belgium and EUR 400 billion to the UK.*

[9] *DAC 6 starts per 2020. Disclosure is only mandatory when tax savings are the main purpose for the transaction and not when sound business reasons prevail.*

[10] *Council of the EU 12 March 2019, nr. 7441/19.*

[11] *The black list includes American Samoa, Aruba, Barbados, Belize, Bermuda, Dominica, Fiji, Guam, Marshall Islands, Oman, Samoa, Trinidad and Tobago, United Arab Emirates, US Virgin Islands and Vanuatu.*

[12] *The grey list includes Albania, Anguilla, Antigua and Barbuda, Armenia, Australia, Bahamas, Bosnia and Herzegovina, Botswana, British Virgin Islands, Cabo Verde, Costa Rica, Curacao, Cayman Islands, Cook Islands, Eswatini (former: Swaziland), Jordan, Maldives, Mauritius, Morocco, Mongolia, Montenegro, Namibia, North Macedonia, Nauru, Niue, Palau, Saint Kitts and Nevis, Saint Lucia, Serbia, Seychelles, Switzerland, Thailand, Turkey, and Vietnam.*

[13] *Council of the EU 12 March 2019, nr. 7441/19.*

[14] *This is an option from §14 of the Commentary on Article 17 OECD Model and included in around 67% of the bilateral tax treaties. See Dick Molenaar, "Article 17(3) for Artistes and Sportsmen: Much More than an Exception", 40(4) Intertax 270 (2012).*

[15] *The US has a minimum threshold in all of its bilateral tax treaties, although set at different amounts. The current policy is to include a $30,000 threshold per entertainer per state per year, as mentioned in Article 16 of the 2016 US Model Tax Convention. More can be found in Dick Molenaar, "Minimum Threshold for Entertainers and Sportspersons in Article 17 OECD Model", 70 Bulletin for International Taxation 4 (2016).*

[16] *More explanation can be found in Daniel Sandler, The Taxation of International Entertainers and Athletes – All the World's a Stage (Kluwer Law International 1995), Harald Grams, "Artist Taxation: Article 17 of the OECD Model Treaty – A Relic of Primeval Tax Times?", 27 Intertax 5 and Dick Molenaar, Taxation of International Performing Artistes (IBFD 2006).*

[17] *Taxation of Entertainers, Artistes and Sportsmen, OECD 1987.*

[18] *Issues Related to Article 17 of the OECD Model Tax Convention, OECD 2014.*

[19] *See for more discussion, Dick Molenaar, "Entertainers and Sportspersons Following the Updated OECD Model (2014)', Bulletin for International Taxation 1 (2015), and Dick Molenaar, "Touring and Taxation Domestically and Internationally", in The Monetization of the Global Music Business – from Creators to Major Industry, IAEL 2016.*