GSLTR

Global Sports Law and Taxation Reports

Contents

CAS mediation conference Lausanne 16 May 2014

The 2014 update to art. 17 of the OECD Model Tax Convention

The jurisdictional problems hampering the fight against corruption in sport

McLaren Racing Ltd: tax deduction for penalties

Dahmane case: does Belgium have a trademark on landmark football cases?

The legal status of the International Olympic Committee

Sports arbitration in Trinidad and Tobago

Foreign tax credit or tax exemption for Dutch kick boxer

The taxation of profits from poker games in The Netherlands: latest developments

3

Sept '14

Foreign tax credit or tax exemption for Dutch kick boxer

by Dr. Dick Molenaar[1]

The Dutch Appeal Court of Arnhem-Leeuwarden has decided on 4 March 2014[2] in a case of a kick boxer, whether the tax credit or tax exemption method would apply for foreign performance income. The appeal court decided that, for the matches in Japan, the exemption method could be used, while, for the matches in Korea, the tax credit method had to be applied.

This decision was based on the differences in the bilateral tax treaties between the Netherlands and these two states.

Facts of the case

The kick boxer had performed in boxing matches in 2009 in Japan and Korea, from which he earned € 438,311 (Japan) and € 112,468 (South Korea), in total € 550,779, on which tax was withheld: € 60,756 (Japan, 14%) and € 16,677 (Korea, 15%), in total € 77,433.

After the deduction of expenses and personal allowances, the Dutch income tax was € 269,399. With the exemption method, the complete income tax would have been exempted, so the Dutch tax obligation would be zero; while with the credit method, the kick boxer would have to pay € 269,399 – 77,433 foreign tax credit = € 191,966 Dutch income tax.

Enough reason for an interesting tax fight before the Court of First Instance and the Appeal Court[3].

Tax treaties with Japan and South Korea

Decisive are the bilateral tax treaties between The Netherlands and Japan and South Korea.

- For Japan, the 1970 treaty was still applicable in 2009. This treaty specifies in art. 18 that artistes and sportsmen are taxable in the state of their performance, while in art. 24 the tax exemption method is included to eliminate double taxation for active income, such as for artistes and sportsmen[4].
- For Korea, the 1978 treaty was applicable in 2009, in which also art. 18 allocates the taxing right for artistes and sportsmen to the performance state; while art. 23 provides the tax credit method for this performance income[5].

The Netherlands and Japan have signed a new tax treaty in 2010, which became effective in 2012, in which art. 16 allocates – as art. 18 in the old treaty – the taxing right for artistes and sportsmen to the performance state, but art. 22 – different from art. 24 in the old treaty – allows the tax credit method to eliminate double taxation.

Recommendations in the OECD Model Tax Treaty

With the taxing right for artistes and sportsmen, both the 1978 Korea and 2010 Japan tax treaty are in line with the OECD recommendations, because also art. 17 of the Model Treaty allocates the taxing right to the performance state. For the elimination of double taxation, art. 23 of the OECD Model Treaty gives the choice between the tax exemption and credit method, but § 12 of the Commentary on art. 17 recommends to choose for the tax credit method for the performance income of artistes and sportsmen. This recommendation was inserted in the Commentary with the 1977 update of the OECD Model Treaty and the text has remained almost unchanged since then:

> *"12. [5] Where, in the cases dealt with in paragraphs 1 and 2, the exemption method for relieving double taxation is used by the State of residence of the person receiving the income, that State would be precluded from taxing such income even if the State where the activities were performed could not make use of its right to tax.* ***It is therefore understood that the credit method should be used in such cases.*** [Emphasis added by D.M.] *The same result could be achieved by stipulating a subsidiary right to tax for the State of residence of the person receiving the income, if the State where the activities are performed cannot make use of the right conferred on it by paragraphs 1 and 2. Contracting States are free to choose any of these methods in order to ensure that the income does not escape taxation."*

The difference between the 1970 Japan and 1978 Korea treaties makes clear that The Netherlands have actively taken over this 1977 OECD recommendation in their tax treaty policy.

Tax exemption and tax credit countries

When the first tax treaties were concluded 100 years ago by the continental European states, it was logical for two states to distribute the taxable earnings between themselves by allocating the taxing right to one state, making these earnings exempt in the other. Until World War II, this was the method unanimously applied by all double taxation conventions between continental European states.

---

[1] Dr. Dick Molenaar is partner with All Arts Tax Advisers in Rotterdam and researcher with the Tax Law Depart-ment of the Erasmus University, Rotterdam.

[2] Gerechtshof Arnhem-Leeuwarden, 4 March 2014, nr. 13/1032, NTFR 2014/1151.

[3] Rechtbank Gelderland. 3 September 2013, nr. AWB 12/3332.

[4] The tax credit method was in art. 23 only reserved for passive income, such as dividend, interest, royalties and capital gains, on which a low or no source tax was levied.

[5] The tax exemption applies to other active income, such as company profits, self-employed, employment income and pensions.

 © Nolot

The credit method, in contrast, was originally introduced in 1894 by the United Kingdom for relief from double imposition of estate duty within the British Empire. On the other side of the ocean, the United States first announced a credit for foreign taxes in 1918, as a unilateral measure in favour of US citizens. Both the USA and the UK initially inserted the tax credit only in their own tax legislation to compensate their citizens for the taxes they had paid in other (colonial) countries. An important step forward for the USA and the UK was their bilateral double tax convention of 1945, in which the tax credit was mentioned as the relief method for avoiding double taxation.

After the Second World War, the credit method gradually became more popular with some states of the European continent, although many continental European countries still use the exemption method as the preferred way to divide international taxation.

Whether the exemption method is better than the credit method has led to much discussion over the years. Not only tax experts, but also economists, have contributed to this discussion about the preferable neutrality of international taxation to support their preference for "capital import neutrality" or "capital export neutrality".

Both methods can have their restrictions. With the exemption method, the country of residence most often reserves the right to apply the progression, which means that the exemption is only given against the average tax rate. And the tax credit method is most often an ordinary credit (and not a full credit), which means that the foreign tax credit will not be more than an equivalent part of the tax, i.e. the tax that was levied on the foreign income and not the tax on the domestic income.

Countries using the exemption method apply this mainly for "active income" such as business profits (through permanent establishments) and employment income, while they use the credit method for "passive income", such as interest, dividends and royalties. This distinction has been taken over in the official recommendation of the exemption method in art. 23A OECD Model Tax Convention. The recommendation in § 12 of the Commentary to use the tax credit method for income from art. 17 is an exception to this common practice.

Decision of the Court of Appeal

For the Court of Appeal of Arnhem-Leeuwarden, it was clear that the kick boxer had to be allowed to use the exemption method for his Japanese income and the tax credit method for his Korean income. This led to the following result:

- tax exemption: € 438,311 / € 550,779 = 79,8% × € 269,399 = € 214,289;
- tax credit: € 16,677 (if not more than € 112,468 / € 550,779 = 20,5% × € 269,399 = € 55,010);
- remaining Dutch tax obligation: € 269,399 – € 214,289 exemption – € 16,677 exemption = € 38,433

This means that the kick boxer was € 191,966 – € 38,433 = € 153,533 better off than when the tax credit method would also have had to be applied for the Japanese income.

With the new 2010 tax treaty between the Netherlands and Japan, this tax profit cannot be obtained anymore from 2012 onwards, because of the change to the tax credit method for performance income of artistes and sportsmen.

Tax exemption method profitable for high earners

The conclusion from this case is that the exemption method is most often very profitable for high earners, especially when the withholding tax in the country of performance is relatively low and there are not many expenses to be deducted in the country of residence.

Problems with the tax credit method

On the other hand, the tax credit method very often causes problems for artistes and sportsmen.[6] In practice the following problems are recognized:

- tax certificates are missing;
- the name on the tax certificate is different from the person who needs to use the tax credit: this happens with e.g. natural persons vs. legal bodies and groups vs. individuals;
- withholding vs. final tax: some countries want their artistes and sportsmen to file income tax returns abroad before the foreign tax credit in the residence country is granted;
- triangular situations: performance in one country, organizer in the other country;
- net deals: the tax burden has been transferred to the organizer.

It is clear that the exemption method is easier to apply, because it does not have these problems.

Problems with both the exemption and credit method

Many artistes and sportsmen experience excessive taxation, which means that the withholding tax in the country of performance is higher than the income tax in the country of residence. This happens when the expenses are relatively high and cannot (completely) be deducted in the country of performance. With, for example, 70% expenses, a low withholding tax rate of 15% turns into an effective tax rate of 50% (of the profit) and can most often not be offset against the average tax rate in the country of residence.[7] This excessive international taxation happens both with the exemption and credit methods.

Epilogue

International performing artistes and sportsmen are caught by special tax rules. The tax treaties allocate the taxing right to the country of performance and the country of residence has to eliminate double taxation. With the exemption method, the higher earnings can obtain an unreasonable tax profit, while with the credit method various problems arise that can obstruct the foreign tax credit. It makes the taxation of international artistes and sportsmen more complicated than necessary.

Art. 17 exists because of the anti-avoidance behaviour of top stars, who travel so often around the world that they can move their residency to a tax haven or become a tax nomad without a home anywhere. But to counteract this abusive behaviour,

---

6 See Dick Molenaar, "Taxation of International Performing Artistes: The Problems with Article 17 OECD and How to Correct Them", in: IBFD (2006), p. 187, and Dick Molenaar, "Problems with tax credits", in: Xavier Oberson (éd.), *International Taxation of artistes & sportsmen*, Droit fiscal suisse et international (Schulthess, Bruylant 2009), p. 231.

7 See Dick Molenaar (2006) and (2009).

art. 17 in tax treaties is not needed, a withholding tax in performance countries for non-resident artistes and sportsmen is sufficient. When the artiste or sportsmen can prove that he lives in a treaty country, there is no need for a different tax treatment from normal self-employed or employees. The unreasonable tax profit resulting from the exemption method and the problems with the credit method can be taken away if art. 17 would be removed from the OECD Model Treaty.[8]

---

[8] The discussion regarding the legitimacy of art. 17 started with Daniel Sandler, *The Taxation of International Entertainers and Athletes: All the World's a Stage* (Kluwer Law International 1995), p. 344. A radical change was proposed by Harald Grams, "Artist Taxation: Article 17 of the OECD Model Treaty – a Relic of Primeval Tax Times?", in: *Intertax* Vol. 27 (1999), p. 188; Joel A. Nitikman, "Article 17 of the OECD Model Treaty – An Anachronism?", in: Intertax, Vol. 29, Issue 8/9 (2001), p. 268; Dick Molenaar and Harald Grams, "Rent-A-Star – The Purpose of Article 17(2) of the OECD Model", in: *Bulletin for International Fiscal Documentation* 56-10 (2002), p. 500 and Dick Molenaar, "Taxation of International Performing Artistes: The Problems with Article 17 OECD and How to Correct Them", in: IBFD (2006), p. 353. Other authors have supported this radical change.

© Nolot