The Monetization of the Global Music Business – from Creators to Major Industry

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Touring and Taxation Domestically and Internationally

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>> Introduction

The taxation of international performing artists (and sports figures) is special, because it is different from the normal tax rules. Most countries in the world levy a withholding tax on the performance fees of non-resident performers, even when they are self-employed, their fees are business income and they do not have a permanent establishment in the country of performance. This practice is confirmed in the OECD Model Tax Convention,[2] which devotes a special clause (Article 17) to performers. The OECD believes that taxation at source is a reasonable measure to ensure that every performer pays his or her share of earnings to the government, and almost every country follows this instruction, both in their bilateral tax treaties and in their national legislation.

Because the performers also have to report the foreign income in their residence country, double taxation may occur. But this should be eliminated in the country of residence by either exempting the foreign income or granting the artist or sports figure a foreign tax credit. The OECD Model Tax Convention advises to use the ordinary tax credit of Art. 23B,[3] but the tax exemption method is also still used, often in older tax treaties and by countries, which use a territorial basis for taxation.[4]

This suggests that the taxation of performance income of performers is balanced, allowing the country of performance the right to tax the income but reserving a secondary taxing right plus progression for the country of residence. It may seem that a reasonable allocation of income tax has been created, even though it deviates from the normal allocation rules of the Art. 7 (for self-employed and companies) and 15 (for employees) of the OECD Model Tax Convention, but the reality is that problems may arise.

>> History of Art. 17 for Performers

The special tax rules for international taxation of performers have existed since the first OECD Model Tax Convention of 1963 with the argument that there were "practical difficulties" when applying normal taxing rules to this specific group of taxpayers. Article 17 was extended in OECD Model 1977 with the addition of a second paragraph, stating that when another person (not the entertainer or sportsperson himself) receives remuneration for a performance, the country of performance still holds the right to tax the income. This gave countries an extra option to tax a "star company," which are usually set up by top performers in tax havens. The new paragraph was an additional measure to counter tax avoidance.

In 1992, the scope of the "star company" provision was extended to all legal entities receiving fees for artistic and sports performances. Accordingly, not only the income of the individual entertainer or sportsperson, but also the profits of every separate legal entity receiving income for the performance are taxable in the country of performance, regardless of whether the entertainer or sportsperson is the owner or a shareholder or otherwise has any profit-sharing in the company. Three countries, Canada, Switzerland and the United States, disagree with this reversal, have made a reservation at the OECD,[5] and still include a restricted Article 17(2) in their tax treaties. Most countries, however, follow the text of the OECD Model and its Commentary. The OECD also noted that Article 17 does not specify the method of taxation in the country of performance and indicated that countries can use gross taxation at a low tax rate.[6]

>> Problems Following from Article 17

Unfortunately, Article 17 increases the risk of practical problems, such as in the following example, which happens in practice very often:

Example
A German pop group performs in Portugal earning EUR 30,000. The Portuguese non-resident withholding tax is 25% from gross. The direct and indirect expenses are 50% of the costs, i.e. EUR 15,000. The average German income tax rate for the musicians is 35%. Accordingly:

	EUR
Portuguese Withholding Tax: 25% x EUR 30,000 German Foreign Tax Credit (Max)	7,500
Gross 30,000 – 50% Expenses = 15,000 Income x 35%	5,250
International Excessive Taxation	2,250

The foreign tax credit is lower than the foreign tax because the country of performance does not allow the deduction of expenses. The lower tax rate in the performance country does not compensate for that. In addition, the tax problem can be even bigger, because it may be difficult to obtain the tax credit in the residence country. This happens e.g. when the Portuguese tax certificate is missing or when the German tax authorities do not accept a certificate in the name of the group for individual tax credits. Then the result is double taxation, because there is full taxation in both the performance and the residence country.

>> Deductibility of Expenses

Within the European Union the problem of the non-deductibility of expenses has been taken away with court decisions. It started with the *Gerritse* case,[7] in which the European Court of Justice (ECJ) decided that expenses should be deductible and that after the year a difference between the fixed withholding tax rate and the normal rates should be refunded. But this decision did not make clear at which moment the expenses should be deductible, which was clarified in the decision in the *Scorpio* case,[8] where the ECJ decided that at least the direct expenses should be deductible already at source, leading to a lower withholding tax. After this, the decision in the *Centro Equestre* case[9] made clear that the indirect expenses can be deducted in a tax return after the taxable year.

Most European countries have changed their legislation after these decisions and allow the deduction of expenses and normal income tax returns now, although some are still reluctant and need to be forced to comply with these ECJ decisions.[10] It also has brought the OECD in 2008 to a change in Paragraph 10 of the Commentary on Art. 17, creating the choice between gross taxation at a low rate and net taxation after the deduction of expenses and normal tax settlement after the year.

But the ECJ did not want to go further and take away the withholding tax obligation for the organizer of the performance in the source country, with its decision in the X NV *(Football Club Feyenoord)* case.[11] This case did not question whether the country of the performance had the right to tax the performance fee under Art. 17, but only whether the organizer or the entertainer or sportsperson should file and pay the source tax. The ECJ decided that the withholding tax obligation of the organizer was justified by the need to ensure the effective collection of tax and that it would create even more administrative work if the non-resident performer had to file the income in the country of the performance.

In other countries non-resident performers also have the right to deduct their expenses and file normal income tax returns, such as in the UK, USA, Australia, New Zealand and Canada. But other countries still follow the OECD recommendation of gross taxation with a low tax rate, such as China, Japan, India, Brazil, South Africa, Mexico and Argentina.

"Over the last years the sports world has become active against the double taxation and administrative burden resulting from Article 17"

>> Extensive use of Art. 17(3) for Subsidized Performers

Over the years many countries have started to use an option from the OECD Commentary on Article 17 to exclude subsidized performances from Article 17(1) and (2).[12] Therefore, they added a third paragraph to Article 17 in their bilateral tax treaties, with which performers who are wholly or mainly supported from public funds are not taxed in the country of performance but in the residence country. This option was already inserted in 1977 in the Commentary on Article 17, with the argument that that cultural exchanges and subsidized performers could suffer from the far-reaching impact of the article. Worldwide the exception of Article 17(3) is now included in 2/3rd of the bilateral tax treaties and for some countries almost every tax treaty has an Article 17(3).[13] The exception is the recognition of the problems resulting from the broad effect of Article 17, but only gives relief to a restricted group. It seems as if countries are trying to protect their own interest with the Article 17(3) clause, because they are aware of the excessive or even double taxation resulting from the general rules of Article 17, which evidently would lead to the need for extra subsidies. With this exception the country of residence is defending its own national budget.

>> Unilateral Exemption in the Netherlands, Same Approach in Tax Treaty Policy

The Netherlands made a huge step forward in 2007 with the unilateral tax exemption for non-resident performers residing in a country with which the Netherlands has concluded a bilateral tax treaty. This covers many performers, because the Netherlands has 94 bilateral tax treaties. Interesting is that in almost all of these treaties a clause comparable to Article 17 OECD Model has been inserted, but the Netherlands has decided to make use of the wording "… may tax …", which does not make source taxation obligatory but optional.

Reasons for this radical change is that the government then had the policy to reduce the administrative burden in four years time by 25%, the tax revenue from non-resident performers was not more than 6,5 million euros and the government wanted to take away the risk of double taxation. With the unilateral exemption at source the performers only have to pay tax in their residence country, because the Dutch income has to be reported there in the worldwide income. With the credit method in most of the Dutch tax treaties, these countries do not have to allow a foreign tax credit and can tax the income with only their national tax.[14]

However, Dutch artists and sportspersons performing abroad cannot make use of this exemption, because of Article 17 is still in the Dutch bilateral tax treaties and is used by the treaty partners to the full extent. The Dutch performers therefore suffer from the problems described in paragraph 3 of this article. Nonetheless, the Dutch government gave the Dutch performers a glimpse of hope with the *Notitie Fiscaal Verdragsbeleid* (Dutch Tax Treaty Policy), which was published on 11 February 2011. This acknowledged the problems of performers and expressed the policy that the Netherlands does not want to include Article 17 in new tax treaties. The Netherlands has succeeded since then to keep Article 17 out of only one new treaty with Ethiopia, while it was unable to keep it out of the new tax treaty with Germany, a neighboring country very important for Dutch performers. The next test will come with the drafting of new tax treaties with Belgium and Spain, for which talks are taking place at the time of publishing.

>> Tax Exemptions for Major Sports Events

Over the last years the sports world has become active against the double taxation and administrative burden resulting from Article 17. At the 2000 Olympics in Sydney all participating athletes had to file Australian income tax returns, reporting the income connected with the Olympics, regardless of where it had been earned. The administrative work was enormous, both for the athletes and their advisers, for the tax authorities in Australia and countries of the athletes, and was too high compared with the tax revenue. That was enough for the IOC, and for the 2010 Winter Olympics in Vancouver it agreed with Canada to remove its non-resident taxation for the athletes participating in the event. Normally, Canada has a 15% withholding tax for non-resident performers, with the right to file a normal income tax return after the year, but these rules were set aside for the 2010 Winter Olympics.

The same happened with the 2012 Olympics in London, for which the UK removed its 20% source tax unilaterally, and the 2014 Winter Olympics in Sochi, Russia, and will be with the 2016 Olympics in Rio de Janeiro. There was also no source tax at the UEFA Champions League finals since 2011, the UEFA Europe League finals since 2011, EURO 2012 in Poland and Ukraine, the 2014 World Cup in Brazil, the 2011 World Cup Cricket in India, the 2011 World Cup Rugby in New Zealand, the 2013 Diamond League in London and the 2014 Commonwealth Games in Glasgow, and there will be no source tax with EURO 2016 in France.

This all demonstrates that the sports world is not waiting on changes in bilateral tax treaties, but is using the power of the major sports events to force the organizing countries to remove the source taxation for the sportspersons temporarily to avoid the problems resulting from Article 17 of the tax treaties. These major sports events follow the initiative of the Netherlands from 2007.[15]

>> OECD Discussion Draft and IFA Congress in 2010

In April 2010, the OECD published a Discussion Draft with proposed changes for the Commentary on Article 17 OECD Model Tax Convention. Strange enough none of the problems described in paragraph 3 above were discussed in this proposal, but only minor changes in the definition of who is an artist or sportsperson and what income falls under the article. In reaction, comments on the Discussion Draft criticized on a basic level how the article can lead to excessive or double taxation for performers and gave existing and new options as to how this could be taken away, including the recommendation to remove Article 17 from the OECD Model Tax Convention. At the 64th IFA Congress in Rome in 2010 the IFA/OECD seminar was devoted to taxation of performers under the title "Red Card Article 17?". The seminar made clear that the taxation of performers was a subject causing much discussion and was a priority at the OECD.[16]

>> The 2014 Update: OECD keeps Article 17, but Gives Options for Restrictions

1) No Removal of Article 17

On 25 June 2014, the OECD published the report *"Issues related to Article 17 of the OECD Model Tax Convention,"* in which the comments on the Discussion Draft from 2010 were considered. At first, the recommendation to remove Article 17 from the Model was discussed, which had been advocated by the representative of the Netherlands. But a vast majority of the OECD Member States wanted to keep the article. During the discussion, three reasons were noted:

- Residence taxation should not be assumed given the difficulties of obtaining the relevant information.
- Article 17 allows taxation of a number of high-income earners who can easily move their residence to low-tax jurisdictions.
- Source taxation of the income covered by the article can be administered relatively easily.

This author disagrees with the aforementioned rationales as they still lead to the same misconceptions that have existed over many years. The following are several arguments against the view of the OECD Member States:

- There is no need for Article 17, but it is enough when the country of the performance has a source taxation for non-resident performers in its national tax law, which shall only be given up when they file an application form which has been undersigned by the tax authorities of the residence country.
- With this involvement of the residence country the tax authorities there also have the information about the foreign income, which later has to be filed in the income tax return of the resident entertainer or sportsperson.
- There are no tax treaties with tax havens or low-tax jurisdictions, so the performer moving to such a jurisdiction cannot get tax exemption in the country of performance.

"Rather than simply take the decision to keep Article 17 with no further commentary, the OECD made some fundamental proposals to restrict the scope of Article 17"

- Article 17 is complicated and causes great administrative expenses both in the performance country with the deduction of expenses and normal tax returns, and in the residence country with the foreign tax credits. This is an obstacle for performers, organizers and tax authorities in both countries.
- Article 17 increases the risk of excessive or even double taxation, and the administrative work and expenses, creating an obstacle for international touring.

Therefore, the reasons for defending Article 17 are invalid, but the OECD Member States just did not want to remove the article. That is disappointing, because Article 17 in its current form is superfluous and counterproductive.

2) Options to Restrict the Scope of Article 17

Rather than simply take the decision to keep Article 17 with no further commentary, the OECD made some fundamental proposals to restrict the scope of Article 17. The following options are now mentioned in the Commentary which, if followed, will result in at least a part of the problems disappearing:

a) *Article 17 only for self-employed, normal rules from Art. 15 for employees:*[17] This option allows countries to restrict paragraph 1 of Article 17 to business activities. To achieve this it would be sufficient to insert the wording "subject to the provisions of Article 15" in Art. 17 of a bilateral; tax treaty. In such a case, employed performers would fall under Article 15, with the option to use the exemption following from Article 15(2).

b) *Deduction of expenses, normal tax settlements:*[18] This was already included in the 2008 Commentary, which is the choice between (1) taxation of the gross performance fee but at a low tax rate, or (2) the deduction of expenses and taxation under the normal rules. EU Member States do not have this choice after the decisions of the ECJ in the Gerritse, Scorpio and Centro Equestre cases and must follow the second route.

c) *De-minimis-rule of 15.000 IMF SDR:*[19] This third option is new in the Commentary. Under the minimum amount of 15.000 IMF Special Drawing Rights[20] per entertainer or sportsperson per year, the performance country does not have the right to tax the performance income. This has been taken over from Article 16 of the 2006 US Model Tax Convention, which mentions the amount of $20,000. This minimum works very well to keep small and medium-size performers outside the scope of the source taxation in the performance country and takes away the tax problems raised herein if they reside in a treaty country. The 15.000 IMF SDR is currently equivalent to € 20.000.

   A crucial element, however, is whether the minimum amount can be used directly at the performance or only after the taxable year. The Technical Explanation with Article 16 of the 2006 US Model discusses that problems may arise when an entertainer or sportsperson exceeds the minimum during the year. Therefore, it can be agreed that tax needs to be withheld during the year, which can be refunded after the year in which the minimum has not been exceeded. But the US has inserted this approach only in 1/4th of its bilateral tax treaties, while in 3/4th the direct method applies.[21] The new Commentary on Article 17 OECD Model also mentions this aspect. Unfortunately, a refund obligation after the year would make the de-minimis-rule less effective than the direct method, because refunds after the year are still an obstacle for cross-border work.

d) *Support from public funds:* As described in paragraph 5 of this article, already 2/3rd of the bilateral tax treaties have an Article 17(3) clause with this exemption, which means that this option from the Commentary on Article 17 is already a part of the tax treaty policy of many countries. Only subsidized performers can use this exemption, but still it is positive that at least some of the performers can avoid the problems resulting from Article 17.

e) *Limited use of Article 17(2):* Canada, Switzerland and the USA have expressed that Article 17(2) should only be used in abusive situations as mentioned in paragraph 11.2(c) of the Commentary, which is when the performer is the owner of the legal entity that receives the performance income. This means that payments to independent third parties, such as the orchestra, dance or theatre group or production group are not taxable in the country of the performance.

3) Other changes in the Commentary on Article 17

There are also other changes in the Commentary on Article 17, beyond proposed options to restrict the article. Some of these changes are:

a) Income which is directly connected with a performance but is earned outside the country may also be taxed in the performance country. This is a direct result of the Agassi case in the UK and the *Goosen*[26] and *Garcia*[27] cases in the USA, in which the sponsoring and endorsement income of this tennis player resp. these two golf players were taxed in the UK and the USA as far as they were directly connected to the performances in those countries. The fact that both the sportsperson and the sponsor had their residence abroad did not make a difference for this use of the territoriality principle.

b) Sale of merchandise around performances also falls under Article 17.[28] For many performers this is interesting extra income. The Commentary now states that only when there is no direct relationship between the performance and the sale of the merchandise, the income will fall outside the scope of the article.

c) Preparation, rehearsals and training also fall under the activities of the performers.[29] This means that income which can be allocated to these activities is also taxable in the country of the activities, even when no public performance has taken place there. Interesting is that most often the country in which these preparations, rehearsals or trainings sessions take place is not aware of this income, because no payments are made in that country, such as salaries of football players and orchestra musicians. This is no problem when the credit method is used to eliminate double taxation in the residence country, but it leads to double non-taxation when the exemption method applies.

d) Payments for the broadcast of a performance on radio, tv and other media also falls under Article 17.[30] However, when the payment is made to a third party and the entertainer or sportsperson does not receive a direct payment for his activities, the income does not fall under Article 17. An example is a football tournament, from which the organizer holds the rights and receives the income, after which payments are made to the football teams. This does not fall under Article 17, according to the new Commentary, which is interesting, because as there is a clear connection between the performances of the football teams and the income should normally be taxable under Article 17(2). But this seems too harsh for the OECD and the lobby of the UEFA and FIFA has worked very well to keep their finances outside the scope of Article 17. But it is unfair when compared with other sports teams, orchestras, music ensembles and theatre and dance groups, which are taxed on all income they receive from their performances, regardless to whom it is paid.

e) Image rights of entertainers and sportspersons also fall within the scope of Article 17 when there is a direct link to performances.[31]

f) Prize money for the owner of a racehorse or a race team falls outside the scope of Article 17.[32] The OECD believes that this prize money is used for the training and development of the horse or the design, manufacturing and preparation of the race car and not for the activities of the jockey or the race car driver. Only when the owner receives income specifically for the jockey or the race car driver, will this be taxable for the owner.

This is also unfair when compared to other payments to sports teams, orchestras, music ensembles and theatre and dance groups, because there also most of the performance income is not meant to be disbursed as payments to the performers, but rather stays with the team or group to pay for the creation and other direct and indirect expenses. But these other payments still fall under Article 17(2), even for their profit element.

>> Summary and Conclusions

The taxation of international touring is complicated, both in the country of performance and in the residence country. Article 17 of the OECD Model Convention has been taken over in most bilateral tax treaties to “avoid practical difficulties,” but in reality creates practical problems and can easily lead to double taxation.
A step forward is that EU court decisions have led to a change in the tax laws of many EU countries, with which deduction of expenses is accepted and performers can file normal tax returns. Other countries also have these possibilities in their national tax law, while many countries still follow the OECD recommendation of gross taxation at a low tax rate. But the fairness also leads to more administrative work and expenses. The best option would be to exclude Article 17 from all tax treaties. It is enough

when the country of performance would have a source tax, as provision against tax avoidance, which can only be taken away when the performer proves in the exemption procedure that he resides in a treaty country and the tax authorities of his residence country would confirm that. The OECD has considered the removal of Article 17, such removal proposed by the Netherlands, but the OECD Member States decided in June 2014 to keep it based upon flawed arguments. It appears that the Member States did not want to follow the example of the Netherlands and many major sports events and return to the normal allocation rules. This means that tax problems addressed herein will remain for performers, which leads to excessive or even double taxation and relatively high administrative expenses.

Nonetheless, the OECD also gives five options in its new Commentary to restrict the scope of Article 17 OECD Model. When these options are used to the full extent, many artists and sportspersons can apply for an exemption at source and avoid excessive or double taxation. Hopefully, countries will start to use these options actively in their tax treaty negotiations and support their performers with a modern and better-defined Article 17 in their tax treaties. This would take away tax obstacles for international touring.

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[2] *The Organisation of Economic Co-operation and Development (OECD) in Paris coordinates international taxation since 1963 with a Model Tax Convention for bilateral tax treaties.*

[3] *See § 12 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[4] *An example is Belgium, which is using the exemption still in most of its tax treaties. Also other continental European countries have the exemption method in their (older) tax treaties.*

[5] *§ 16 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[6] *§ 10 (old) of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[7] *ECJ 12 June 2003, C-234/01, Arnoud Gerritse*

[8] *ECJ 3 Oct. 2006, C-290/04, FKP Scorpio Konzertproduktionen GmbH*

[9] *ECJ 15 February 2007, C-345/04, Centro Equestre da Leziria Grande Lda*

[10] *An example is Italy.*

[11] *ECJ 18 October 2012, C-498/10, X NV (Football Club Feyenoord)*

[12] *§ 14 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[13] *Examples are Hungary, China, Slovenia, Indonesia and Turkey.*

[14] *The exemption method is still in the Dutch tax treaties with Ireland, Israel, Luxemburg, Morocco, Singapore, Spain and Thailand*

[15] *Also Denmark and Ireland do not have a source withholding tax from the income of visiting non-resident performers.*

[16] *See the article D. Molenaar, M. Tenore en R. Vann, Red Card Article 17?, 66 Bulletin for International Taxation 3 (2012)*

[17] *§ 2 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[18] *§ 10 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[19] *§ 10.1 – 10.4 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[20] *IMF Special Drawing Rights was created by the IMF in 1969 as a supplementary international reserve asset. It is neither a currency, nor a claim on the IMF, but is a potential claim on the freely usable currencies of the IMF members. A basket of currencies determines daily the value of the SDR.*

[21] *See Molenaar, supra n. 34.*

[22] *§ 14 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[23] *§ 16 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[24] *§ 9 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[25] *UK: HL, 17 May 2006, Agassi v. Robinson [2006] UKHL 23.*

[26] *US: TC, 9 June 2011, Goosen v. Commissioner, 136 T.C. No. 27.*

[27] *US: TC, 14 March 2013, Garcia v. Commissioner, 140 T.C. No. 6.*

[28] *§ 9 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[29] *§ 9.1 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[30] *§ 9.4 of the Commentary on Art. 17 of the OECD Model Tax Convention. It can also be found § 18 of the Commentary on Art. 12 of the OECD Model Tax Convention.*

[31] *§ 9.5 of the Commentary on Art. 17 of the OECD Model Tax Convention.*

[32] *§ 11.2 of the Commentary on Art. 17 of the OECD Model Tax Convention*