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Rent-A-Star – The Purpose of Article 17(2) of the OECD Model

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Rent-A-Star – The Purpose of Article 17(2) of the OECD Model

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1. INTRODUCTION

Most tax treaties have special rules for internationally performing artistes and sportsmen. This is coordinated by the OECD Model Tax Convention which, since the 1963 Draft, has stated in Art. 17 that the right to tax the performance income of artistes and sportsmen is allocated (although not exclusively) to the country of performance, setting aside the normal rules of Arts. 7 (Business profits) and 15 (Dependent personal services).[1] As stated in the 1987 OECD Report on artistes and sportsmen[2] (hereafter "1987 OECD Report") (Paras. 6 and 7), the reasons for this special treatment are the use of tax avoidance schemes by top artistes and sportsmen and their tendency to under-report foreign income in their home country.

Art. 17 was extended in 1977 by adding a second paragraph, saying that when another person (not the artiste or sportsman himself) receives the remuneration for the performance, the source country still holds the right to tax the income. Top artistes and sportsmen had started to use "loan-out" companies, most often owned by themselves, which contracted for the performances of the artistes or sportsmen. The star companies provided the services of the artistes or sportsmen and were established in tax havens. The new Art. 17(2) of the OECD Model was an extra measure in the battle against tax avoidance. Many countries could not "look through" a star company under their national legislation and lost the taxing right under the old Art. 17. With Art. 17(2), these countries obtained another means to levy tax on the income of top artistes and sportsmen.

More concerns were brought forward in the 1987 OECD Report, which recommended that the scope of Art. 17(2) be extended to all legal entities that could receive fees for artistic and sports performances. This was later added in the 1992 change to the Commentary on the OECD Model. Thus, not only the income of the individual artiste or sportsman but also the profits of the separate legal entity are taxable under Art. 17(2), regardless of whether the artiste is the owner or a shareholder or whether he has any profit-sharing in the company. This reversal in the Commentary took away any possibility to escape from source taxation on performance income.

Three countries, Canada, the United States and Switzerland, made observations on this reversal. In the 1987 OECD Report (Para. 90) and the 1992 Commentary (Para. 16 of the Commentary on Art. 17), they stated that they are of the opinion that Art. 17(2) should apply only in the cases of abuse mentioned in the 1977 Commentary. The United States has put this into practice in its 1996 Model Convention with the provision that Art. 17(2) does not apply when the artiste or sportsman does not have access to the profits of the other person that receives the performance fee. In that case, under Art. 17(1), only the salaries of the artistes or sportsmen are taxable in the source country. This treaty practice is also followed by Canada.

In recent years, the distinction between the limited and unlimited approaches again received attention in court decisions and in articles in tax journals. In December

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1. Since the removal of Art. 14 (Independent personal services) in 2001, only Art. 7 is mentioned for self-employed artistes and sportsmen in Art. 17 of the OECD Model.

2. OECD, *Taxation of Entertainers, Artistes and Sportsmen*, Issues in International Taxation No. 2 (Paris: OECD, 1987).

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1999, the Tax Court of Canada decided a rent-a-star company case (see 6.2.1.); in August 2001, Prof. Dr Klaus Vogel wrote about the new unlimited approach of the Central Economic and Administrative Court of Spain (see 6.2.2.); in September 2001, Risto Rytöhonka described the limited approach of the Supreme Court of Finland (see 6.2.3.); and at the 2001 IFA Congress in San Francisco, a portion of Seminar B (The OECD Model Convention – 2001 and beyond) focused on the different views on Art. 17(2) (see 6.2.4.).

The main question addressed in this article is: What is fair and necessary regarding Art. 17(2) – the *limited* approach of the 1977 Commentary or the *unlimited* taxing right of the 1987 OECD Report and the 1992 Commentary?

2. OBJECT AND PURPOSE OF ART. 17(2) IN 1977

Art. 17(2) was introduced in the 1974 Report of the OECD Committee on Fiscal Affairs updating the 1963 Draft and was included in the 1977 OECD Model. The 1974 Report added a new paragraph to Art. 17:

> 2. Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.

This change to the OECD Model was explained in Para. 4 of the 1977 Commentary on Art. 17. Para. 4. states:

> The purpose of paragraph 2 is to counteract tax avoidance devices in cases where remuneration for the performance of an entertainer or athlete is not paid to the entertainer or athlete himself but to another person, e.g. a so-called artiste-company, ... Paragraph 2 permits the State in which the performance is given to impose a tax on the profits diverted from the income of the entertainer or athlete to the enterprise where for instance the entertainer or athlete has control over or rights to the income thus diverted or has obtained, or will obtain, some benefit directly or indirectly from that income. ...

With Art. 17(2), star companies could be attacked. Some countries had reported to the OECD that top artistes and sportsmen were loaned out by companies more often, which gave the artistes and sportsmen a small salary and received the main part of the performance income as company profits. These companies were based mostly in tax havens, which do not have a normal income or corporation tax. It also appeared that the artistes or sportsmen were the actual shareholders of these offshore companies or received a large share of their profits. That was often combined with the change of residence of the artistes and sportsmen personally to tax havens.[3]

A few countries already had in their national legislation the ability to look through the set-ups with Art. 17 of the 1963 Draft, which became Art. 17(1) after the 1977 change. The legislation of many other countries, however, was not as flexible; it could not fight the tax avoidance schemes and required extra international ammunition. With Art. 17(2), the countries were able to widen the scope of performance income that was taxable in their country, although this did not mean that the extended rules were automatically effective in these countries.[4]

Para. 4 of the Commentary on Art. 17 shows that, in 1977, the OECD did not have its eye on normal employer-employee situations with Art. 17(2). There seemed to be no threat from artistes and sportsmen employed by companies or non-profit organizations, such as orchestras, theatre groups, dance companies, football clubs, baseball teams, etc., trying to escape from taxation. These employers were normally based in a treaty country and did not have the intention to relocate to a tax haven. For the artistes and sportsmen as employees, a move of residence was also not very likely because they were linked mainly to the central place of the organization and had to come to rehearsals, home matches, group travel, etc. The text of the 1977 Commentary made it clear that the new rule did not have these artistes or sportsmen and their employers as its focus; rather, the purpose was to counter the tax avoidance schemes of self-employed top artistes and sportsmen. According to Paras. 2 and 3 of the 1977 Commentary on Art. 17, cultural exchanges and artistes and sportsmen employed by a government could suffer especially:

> 2. This provision makes it possible to avoid the practical difficulties which often arise in taxing entertainers and athletes performing abroad. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of paragraph 1 to independent activities by adding its provisions to those of Article 14. In such a case, entertainers and athletes performing for a salary or wages would automatically come within Article 15 and thus be entitled to the exemptions provided for in paragraph 2 of that Article.
>
> 3. The provisions of the Article do not apply when the entertainer or athlete is employed by a Government and derives income from that Government. Such income is to be treated under the provisions of Article 19. Certain conventions contain provisions excluding entertainers and athletes employed in organisations which are subsidised out of public funds from the application of Article 17. The provisions of the Article shall not prevent Contracting States from agreeing bilaterally on particular provisions concerning such entertainers and athletes.

Strangely enough, however, the wording of Art. 17(2) itself was much broader than necessary for this object and purpose in 1977; there was more room in the text of the article than the limited explanation in the Commentary required.

Canada and the United States seemed to be suspicious, already in 1977, of the new provision in Art. 17. They registered their observation in Para. 6 of the 1977 Commentary on Art. 17:

3. For a recent example, see Rotondaro, Carmine, "The *Pavarotti* Case", 40 *European Taxation* 8 (2000), at 385.

4. The different approaches to the relationship between domestic law and treaty provisions are discussed in Sandler, Daniel, *The Taxation of International Entertainers and Athletes – All the World's a Stage* (The Hague: Kluwer Law International, 1995), at 204-229, with examples from the United Kingdom and France.

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> Canada and the United States are of the opinion that paragraph 2 of the Article applies only to cases mentioned in paragraph 4 above and these countries will propose an amendment to that effect when negotiating conventions with other Member countries.

The OECD Member countries appreciated the introduction of Art. 17(2) in 1977 because it took away an opportunity for tax avoidance. Other than Canada and the United States, no country seemed concerned that the actual text of Art. 17(2) added to Art. 17 more than what was needed.

3. REVERSAL IN THE 1987 OECD REPORT

The mistrust of artistes and sportsmen became quite evident in the 1987 OECD Report, which (in Paras. 6, 7 and 8) used phrases such as: "clear evidence of non-compliance", "rarely disclose casual earnings", "sophisticated tax avoidance schemes, many involving the use of tax havens, are frequently employed by top-ranking artistes and athletes", "relatively unsophisticated people – in the business sense – can be precipitated into great riches", and "travel, entertainment and various forms of ostentation are inherent in the business and there is a tendency to be represented by adventurous but not very good accountants".

The international world that gathered at the OECD believed in 1987 that especially the rich and famous artistes and sportsmen tried to escape from normal taxation via avoidance schemes and that small artistes did not report their foreign income in their home countries. The 1987 OECD Report mentioned that systematic audits in Canada and the Netherlands and studies in Canada had been undertaken, but figures were not published.

The suspicion became even clearer when the use of "slave agreements" with "slave companies" was explained (1987 OECD Report, Paras. 25 and 26). Rent-a-star companies, based in tax havens, were used to avoid source taxation in the country of performance. This was mentioned as if Art. 17(2) had not been introduced already ten years earlier. Resident countries had problems with gathering information about the foreign performance income of their taxpayers.

Because of the lack of trust and the absence of exchange of information, the OECD Committee on Fiscal Affairs, responsible for the 1987 OECD Report, concluded that Art. 17 was still the right way to tax artistes and sportsmen, although it was an exception to the normal international tax rules (1987 OECD Report, Paras. 14, 15 and 16). To fight non-compliance and the tendency to avoid tax, even a distortion of competition turned out to be acceptable (1987 OECD Report, Para. 61).

The Committee finally decided to make more use of the wording of Art. 17(2). Not only star companies but also incorporated teams, troupes, etc., should fall within the scope of Art. 17(2), which meant that, in addition to the artistes' and sportsmen's salaries for their personal performance, the profits of the (separate) legal entity were also taxable in the country of performance. Thus, even without having a permanent establishment in the country of performance, a separate production company or legal entity could be taxed in that country, although it was not an artiste or sportsman itself. The Committee realized that the original intention of Art. 17(2) in 1977 was different, but decided in favour of a reversal to the unlimited approach (1987 OECD Report, Para. 89). No further arguments were given to support this reversal.

The 1987 OECD Report also gave an opinion about the deduction of expenses from the performance income in the source country. Strangely enough, the 1987 OECD Report (Para. 94) allowed taxation based on the gross amount paid to artistes and sportsmen – also with respect to fees paid to third parties. This gross taxation often leads to excessive taxation internationally because the effective tax rate in the source country is too high for a full tax credit/exemption in the home country and because, with the flat and final source tax, foreign artistes and sportsmen are, in most cases, taxed more heavily in the source country than the normal residents of that country.[5] Furthermore, important for purposes of this article, it is unclear how this gross taxation at source relates to the earlier expression in the 1987 OECD Report that the *profit* of a legal entity can be taxed. Using the word "profit" assumes that expenses are deductible. Examples of the results of this unusual treatment are given in 7.

The Committee was honest in its conclusions in the 1987 OECD Report when it stated that the difficulties in effectively taxing artistes and sportsmen had led to tentative recommendations. It is beyond doubt that an unlimited taxable base without any exceptions for persons or deductions is without reference in the tax world. What did the artistes and sportsmen do wrong to deserve this suppressive treatment?

In its final paragraphs (Paras. 105 and 106), the 1987 OECD Report suggested improvements, especially in the exchange of information and assistance in collection. In 2002, it is unclear whether these improvements have been realized and whether the unusual exceptions for artistes and sportsmen from the normal international tax rules are still necessary.

4. IMPLEMENTATION IN THE COMMENTARY TO THE 1992 OECD MODEL

The 1987 OECD Report was implemented in the 1992 Commentary on Art. 17 of the OECD Model, and the Commentary was adjusted in length and content. The unlimited approach of Art. 17(2) was laid out in Para. 11 of the Commentary, most recently changed in 2000:

> Paragraph 1 of the Article deals with income derived by individual artistes and sportsmen from their personal activities. Paragraph 2 deals with situations where income from their activities accrues to another person. If the income of an entertainer or sportsman accrues to another person, and the State of source does not have the statutory right to look through the person receiving the income to tax it as income

5. See Molenaar, Dick, "Obstacles for International Performing Artists", 42 *European Taxation* 4 (2002), at 149.

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of the performer, paragraph 2 provides that the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration. If the person receiving the income carries on business activities, tax may be applied by the source country even if the income is not attributable to a permanent establishment there. But it will not always be so. There are three main situations of this kind.

a) The first is the management company which receives income for the appearance of e.g. a group of sportsmen (which is not itself constituted as a legal entity).
b) The second is the team, troupe, orchestra, etc. which is constituted as a legal entity. Income for performances may be paid to the entity. Individual members of the team, orchestra, etc. will be liable to tax under paragraph 1, in the State in which a performance is given, on any remuneration (or income accruing for their benefit) as a counterpart to the performance; however, if the members are paid a fixed periodic remuneration and it would be difficult to allocate a portion of that income to particular performances, Member countries may decide, unilaterally or bilaterally, not to tax it. The profit element accruing from a performance to the legal entity would be liable to tax under paragraph 2.
c) The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an artiste or sportsman is not paid to the artiste or sportsman himself but to another person, e.g. a so-called artiste company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the artiste or sportsman nor as profits of the enterprise, in the absence of a permanent establishment. Some countries "look through" such arrangements under their domestic law and deem the income to be derived by the artiste or sportsman; where this is so, paragraph 1 enables them to tax income resulting from activities in their territory. Other countries cannot do this. Where a performance takes place in such a country, paragraph 2 permits it to impose a tax on the profits diverted from the income of the artiste or sportsman to the enterprise. It may be, however, that the domestic laws of some States do not enable them to apply such a provision. Such States are free to agree to other solutions or to leave paragraph 2 out of their bilateral conventions.

The third illustration (Para. 11 c)) mentioned the original and limited purpose of Art. 17(2): tax avoidance schemes must be counteracted. In the first two illustrations, the unlimited approach was added, which made Art. 17(2) applicable to all third parties that received fees for artistes and sportsmen.

Canada, Switzerland and the United States registered their observation on the reversal (Para. 16 of the 2000 Commentary on Art. 17). Their opinion was that Art. 17(2) should apply only to the cases mentioned in Para. 11 c).

5. THE LIMITED APPROACH IN THE 1996 US MODEL

The United States issued a new Model Income Tax Convention in 1996, replacing the 1981 Model. The 1996 Model differs slightly from the OECD Model. In the Technical Explanation of the 1996 US Model (Para. 2), the United States makes it clear that the US Model often refers to the OECD Commentaries, but that the US Model is also based on existing US tax treaties, recent negotiating experience, current US tax laws and policies, and the opinion of tax practitioners and other interested parties.

One of the remarkable differences between the 1992-2000 OECD Model and the 1996 US Model is in Art. 17(2). Art. 17(2) of the 1996 US Model provides:

> Where income in respect of activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income, notwithstanding the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services), may be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised, unless it is established that neither the entertainer or sportsman nor persons related thereto participate directly or indirectly in the profits of that other person in any manner; including the receipt of deferred remuneration, bonuses, fees, dividends, partnership contributions, or other distributions.

With this change in the wording, the United States brings into practice its observation on Art. 17(2) of the OECD Model, as mentioned in the 1977 Commentary, the 1987 OECD Report and the 1992 Commentary. The United States has chosen to follow the limited approach to Art. 17(2), which means that only avoidance schemes are confronted. The United States is not impressed by the reversal in the Commentary to the unlimited approach. Separate legal entities with normal employer-employee relationships fall outside the scope of Art. 17(2) of the US Model, although the salaries of the artistes/employees remain taxable in the source country under Art. 17(1) of the US Model. Separate legal entities fall under Art. 7 and cannot be held taxable in the source country if they do not have a permanent establishment there (Technical Explanation of the 1996 US Model, Paras. 233-239).

The bilateral tax treaties concluded by the United States with various other countries usually include Art. 17(2) of the US Model. This might lead to the conclusion that the contracting partners of the United States seem to be more convinced by the arguments of the 1996 US Model than by the 1992-2000 OECD Model.[6]

6. DISCUSSION AFTER THE 1987-1992 REVERSAL

6.1. Publications in the early years after the 1992 implementation

The reversal of Art. 17(2) of the OECD Model did not cause much disturbance in the tax world in the early years after 1992. Short comments were written in 1992 by Lüthi, Kolb and Stiefel[7] and Long and Tyrrell,[8] but they only explained the change to the Commentary in a technical manner. More attention was paid to the subject in 1995 by

6. This could, however, also reflect the United States' negotiating position.
7. Lüthi, Daniel, Andreas Kolb and Christian Stiefel, "The Revision of the 1977 OECD Model Convention – an Overview", 19 *Intertax* 653 (1992).
8. Long, Yves and Patrick Tyrrell, "Taxation of Employees, Artistes and Sportsmen (Articles 15 and 17)", 19 *Intertax* 688 (1992).

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Sandler in his book on artistes and sportsmen[9] and at the 1995 IFA Congress in Cannes.[10] The interesting issue of triangular situations was discussed by Betten and Lombardi in 1997.[11] None of these authors criticized the reversal in the 1987 OECD Report and the 1992 Commentary on Art. 17(2).

6.2. Recent court cases and discussions

In recent years, the discussion of Art. 17(2) started again after a few court cases were decided and some articles were published in various tax journals. The discussion was based partly on the question whether the new Commentary could be used in connection with a tax treaty that had been concluded earlier, but the discussion also focused on the object and purpose of Art. 17(2).

6.2.1. Decision by the Tax Court of Canada

On 7 December 1999, the Tax Court of Canada decided the case of *Sumner (aka Sting) v. The Queen* (the Canadian tax administration).[12] The artiste performed in the United States and Canada in 1991, and his performance fee was paid partly via the Dutch company Wyneco BV to Roxanne Inc., a Delaware company. The artiste was entitled to 95% of the profits of the company. In Canada, he declared only his fixed salary for the performances, and he took the position that the profits of the company were not taxable in Canada. The Court referred to the 1984 Technical Explanation of Art. XVI(2) of the 1980 United States–Canada treaty and to the 1992 Commentary on Art. 17(2) of the OECD Model and ruled that Canada had the right to tax an appropriate part of the artiste's salary plus the company's profits from the tour.

This can be seen as a decision in a typical rent-a-star company case for which Art. 17(2) was inserted in 1977.

6.2.2. Taxation of payments to star companies in Spain

In 2001, Prof. Dr Vogel described the reversal of the taxation of artistes and sportsmen in the September 2000 decision of the Central Economic and Administrative Court of Spain.[13] In that case, a Dutch company loaned out an artiste for several concerts in Spain. The artiste earned a salary for his performances, and the company received compensation for the contractual rights to publish pictures and use the name of the artiste. The Court ruled that the latter part of the payments did not constitute royalties (as the organizer argued), but was an additional compensation for the personal activities of the artiste.

Art. 18 of the Spain–Netherlands tax treaty (which corresponds to Art. 17(1) of the OECD Model) does not have a second paragraph because the treaty was concluded in 1971, years before the introduction in 1977 of Art. 17(2) of the OECD Model. In earlier cases, the Spanish Court had decided not to look through the foreign entity, but to apply Art. 7, which meant that the profits of the foreign company were not taxable in Spain since the company did not have a permanent establishment there. With its September 2000 decision, the Court drastically reversed its earlier opinion and interpreted Art. 18 of the treaty as if it were identical to the entire Art. 17, i.e. including Art. 17(2), of the OECD Model. Prof. Vogel argued that this went beyond the ordinary rules of interpretation because the contracting states in 1971 could not have intended a rule identical to Art. 17(2) to apply. According to Prof. Vogel, the Court should have examined more closely who the owner of the Dutch company was and the business reasons for the transfer of the rights to the company. A tax avoidance scheme could have justified the Court's reversal.

6.2.3. Taxation of non-resident artistes' income in Finland

A short article in 2001 described the decision of the Supreme Administrative Court of Finland of 29 January 2001.[14] In that case, a Dutch production company was contracted by a Finnish promoter for a large-scale opera production in Helsinki. The Dutch company employed the performing artistes, who had no share in the profits of the Dutch company. The 1995 Finland–Netherlands tax treaty followed the OECD Model and contained the full text of Art. 17 (i.e. Arts. 17(1) and (2)). The Court ruled that only that part of the total fee that corresponded to the payments to the performing artistes for their personal activities was taxable in Finland. The rest of the performance fee, production expenses and profits of the Dutch company were taxable in the Netherlands, not in Finland. In this decision, the Court used the older limited approach to Art. 17(2) and did not follow the reversal in the 1992 Commentary on Art. 17 of the OECD Model.

6.2.4. 2001 IFA Congress in San Francisco

At the IFA Congress in San Francisco in October 2001, a joint IFA/OECD Seminar (Seminar B) was held on the effect on treaty interpretation of OECD Commentaries that are adopted after the conclusion of a treaty.[15] Four hypothetical cases were presented and discussed by five panel members. The third case was about entertainers and described the position of Armoury, a company resident in State R, that owned a professional football club. In 2001, Armoury entered into a contract by which its team would play two exhibition games in State S for a very large amount of money.

The dispute was whether Art. 7 of the State R–State S treaty prevented State S from taxing the performance

9. Daniel, supra note 4.

10. *Taxation of Non-Resident Entertainers* (Seminar D at the 49th IFA Congress in Cannes, France), *Cahiers de droit fiscal international*, IFA Congress Seminar Series, Vol. 20d (The Hague: Kluwer Law International, 1995).

11. Betten, Rijkele and Marco Lombardi, "Article 17(2) of the OECD Model in Triangular Situations", 51 *Bulletin for International Fiscal Documentation* 12 (1997), at 560.

12. *Gordon Sumner, Roxanne Inc. v. The Queen*, 7 December 1999, 2000 D.T.C. 1667, [2000] 2 C.T.C. 2359.

13. Vogel, Klaus, "Tax Treaty News", 55 *Bulletin for International Fiscal Documentation* 8 (2001), at 319 (Taxation of payments to "star companies" in Spain).

14. Rytöhonka, Risto, "Finland: Taxation of Non-Resident Artists' Income", 41 *European Taxation* 9 (2001), at 344.

15. Summarized in Avery Jones, John, "The Effect of Changes in the OECD Commentaries after a Treaty is Concluded", 56 *Bulletin for International Fiscal Documentation* 3 (2002), at 102.

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income or whether Art. 17(2) allowed State S to tax the full income. The treaty had been concluded in 1985 and followed the existing OECD Model. After the 1987 OECD Report, State S changed its domestic law in 1988, making it possible to tax all foreign companies deriving income from sports and artistic events taking place in State S. Before 1988, this would have been possible only for star companies; this did not apply to Armoury because the football players were not shareholders of the company.

State R was one of the three countries referred to in Para. 16 of the 1992 Commentary on Art. 17 of the OECD Model.

Of the panellists, Jacques Sasseville (OECD) took the position that the full performance fee was taxable in State S. He referred to the Canadian case *Sumner v. the Queen* (see 6.2.1.), in which the Tax Court of Canada accepted the 1992 reversal in the Commentary on Art. 17 (after the 1987 OECD Report) in connection with a 1980 treaty. The Court found that Art. 17(2) allowed taxation of both the artiste and the company.

Michael Lang (Vienna University of Economics and Business Administration) followed the wording of Art. 17(2) and concluded that there were no restrictions on specific activities or persons. He also concluded in favour of taxing the full performance fee in State S.

Philippe Martin (*Conseiller d'Etat*, France) thought that Armoury (the taxpayer) should win. The purpose and object are always useful in case of doubt and even when the words appear clear if the result is unreasonable or absurd. The 1977 Commentary on Art. 17 had a clear statement of the purpose of Art. 17(2), which excluded a company such as Armoury from taxation in the source state.

Richard Vann (University of Sydney) was of the opinion that the taxpayer should lose because of the clear wording of Art. 17(2). The 1992 Commentary may be used to show that the previous interpretation in the 1977 Commentary was incorrect.

Dr John Avery Jones finally concluded that the taxpayer should win because the older 1977 Commentary should apply to a treaty that was concluded in 1985.

The panellists did not discuss the effect of the observation on Art. 17(2) that State R had made in the 1992 Commentary.

The discussion led to a two-to-three result for the exhibition games in favour of the unlimited approach of Art. 17(2).

7. FOUR EXAMPLES

Is it possible for artiste and sportsman companies to be compensated for the source tax in the country of performance by a sufficient tax credit in their country of residence? How can the tax credit be divided between the individual income tax and the company's corporation tax? Is a normal income or corporation tax settlement possible in the country of performance? A football company like Armoury now faces a withholding tax on the gross fee in the country of performance and will need a tax adviser to reclaim tax in the source country, claim the tax credit in the home country and try to avoid excessive taxation. Unfortunately, the discussion on Art. 17 does not consider this important aspect; until now, only the arguments about the allocation of the taxing right have been considered. No one seems to be concerned with the financial outcome.

To make the discussion on the scope of Art. 17(2) more complete, four practical examples are given in which the difference between applying the older limited and the newer unlimited approach of Art. 17(2) is calculated. In practice, it occurs very often that there is excessive taxation internationally because the withholding tax in the source country cannot be fully credited against the income tax in the home country and because, with the flat and final source tax, foreign artistes and sportsmen are, in most cases, taxed more heavily in the source country than the normal residents of that country. It is felt that Art. 17(2) in particular is an overkill, obstructing artiste groups and sports clubs from going on the road internationally.

The discussion follows the three illustrations given in Para. 11 of the 2000 Commentary, as reproduced in 4. The second illustration, however, is divided into the two examples that normally occur in practice.

Example A involves a group of four artistes who are represented by a management company. The artistes are not shareholders of the company. The performance fee goes to the management company, which pays the direct production expenses for the shows and the indirect expenses during the year. The artistes receive monthly salaries from the management company, but the remaining balance before the management commission (percentage) will also accrue to the artistes. In Para. 11 a) of the Commentary, the profit/commission of the management company was not taxable under Art. 17(2).

Example B-1 calculates the result for Armoury, a commercial football company, which was the third case at the 2001 IFA Congress (see 6.2.4.). The company has direct production expenses and indirect overhead expenses and pays the salaries of the sportsmen. The profit is kept by the company, leading to a corporation tax liability.

Example B-2 involves a non-profit classical orchestra whose expenses exceed market earnings, but which receives a reasonable subsidy from the government to cover the difference.

Example C calculates the result of the structure of a top artiste that has a personal company, where both the artiste and company reside in a tax haven.

The artiste withholding tax in the country of performance is set at 20% of the gross performance fee,[16] and the average income tax rate and corporation tax rate in the home country are set at 35%. To simplify the calculations, no difference is made between the personal income tax of the artistes and sportsmen and the corporation tax of the third party/company. This division would make the examples

16. Many countries use this simple gross source taxation without a deduction for expenses. This is supported by Para. 10 of the 1992 Commentary on Art. 17.

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too complicated to understand, although in practice artiste/sportsman organizations experience these complications (see 8.3.).

Internationally performing artistes and sportsmen normally have considerable expenses. For high-profile or well-known artistes, the direct expenses can be as high as 70% of the performance income.[17] In the examples, these expenses are divided into:

(a) *agent fee/management commission:* artistes and sportsmen are normally represented by agents and managers. The agents are responsible for booking the performances with local promoters and receive 5% to 15% of the gross performance fee. The manager takes care of the career development of the artiste or sportsman and communicates with record companies, sponsors, the press, the media, the fans, the production staff, and others involved. The management can be divided in general management, business management and legal representation, receiving 10% to 25% from the gross performance fee;

(b) *production expenses:* to go on the road, artistes and sportsmen must pay the cost of flights, local travel, lodging, clothing, equipment, crew, personnel, insurance and many other necessities. These expenses can be immense, not only because a production can be huge, but also because the status of the star requires business class travel and the best hotels. In this regard, major artistes and sportsmen can be compared with captains of industry or important statesmen; and

(c) *indirect expenses:* some expenses are not directly related to touring, such as accounting fees, legal expenses, consultants, office rent, personnel and coaching. Although these expenses also relate to other sources of income, they pertain partly to touring income.

All the examples are in euro.

Example A: Management company receives performance fee for artistes (four persons)

The artistes and the management company are residents of a treaty country.

– performance fee	100,000	
– agent fee: 10%	(10,000)	
– production expenses	(30,000)	(directly related to performance)
– indirect expenses	(15,000)	(yearly expenses, divided over various earnings)
– salary for artistes	(20,000)	(monthly salary, divided over various earnings)
– balance to artistes	(10,000)	(bonus)
– profit/commission of management company: 15%	15,000	

Unlimited approach:

country of performance – source tax:	
20% x 100,000 =	20,000
home country – income tax:	
35% x (20,000 + 10,000) =	10,500
tax credit (maximum)	(10,500)
balance due in home country	0
excessive taxation: 10,500 – 20,000 =	(9,500)

Limited approach:

country of performance – source tax:	
20% x (20,000 + 10,000) =	6,000
home country – income tax:	
35% x (20,000 + 10,000) =	10,500
tax credit	(6,000)
income tax due	4,500
excessive taxation: 6,000 – 6,000 =	0

This is comparable to illustration a) in Para. 11 of the 2000 Commentary.

Example B-1: Football company receives fee for two exhibition games (16 sportsmen)

The sportsmen and the football company are residents of a treaty country.

– performance fee	130,000	
– direct expenses	(30,000)	(directly related to performance)
– indirect expenses	(40,000)	(yearly expenses, divided over various earnings)
– salary for sportsmen	(50,000)	(monthly salary, divided over various earnings)
– remaining profit for football company	10,000	

Unlimited approach:

country of performance – source tax:	
20% x 130,000 =	26,000
home country – income/corporation tax:	
35% x (50,000 + 10,000) =	21,000
tax credit (maximum)	(21,000)
balance due in home country	0
excessive taxation: 21,000 – 26,000 =	(5,000)

Limited approach:

country of performance – source tax:	
20% x 50,000 =	10,000
home country – income/corporation tax:	
35% x (50,000 + 10,000) =	21,000
tax credit	(10,000)
balance due in home country	11,000

17. Examples can be found Molenaar, supra note 5; Grams, Harald, *Besteuerung von beschränkt steuerpflichtigen Künstlern* (Herne/Berlin: Neue Wirtschaftsbriefe, 1999); *Sumner v. The Queen*, supra note 11; and *Hoge Raad* of 23 November 1983, *BNB* 1984/33 (Netherlands Supreme Court).

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excessive taxation: 10,000 – 10,000 =	0

This is comparable to illustration b) in Para. 11 of the 2000 Commentary.

Example B-2: Classical orchestra – non-profit, subsidized, 60 musicians

All the relevant parties are residents of a treaty country.

– performance fee	60,000	
– production expenses	(35,000)	(directly related to performance)
– indirect expenses	(20,000)	(yearly expenses, divided over various earnings)
– salaries for musicians	(27,000)	(monthly salary, divided over various earnings)
– remaining balance for orchestra	(22,000)	(to be subsidized)

Unlimited approach:

country of performance – source tax:	
20% x 60,000 =	12,000
home country – income/corporation tax:	
35% x 27,000 =	9,450
tax credit (maximum)	(9,450)
balance due in home country	0
excessive taxation: 9,450 – 12,000 =	(2,550)

Limited approach:

country of performance – source tax:	
20% x 27,000 =	5,400
home country – income/corporation tax:	
35% x 27,000 =	9,450
tax credit	(5,400)
balance due in home country	4,050
excessive taxation: 5,400 – 5,400 =	0

This is comparable to illustration b) in Para. 11 of the 2000 Commentary.

Example C: Top artiste – lives in tax haven and has his personal company in the same territory

– performance fee	150,000	
– direct expenses	(60,000)	(directly related to performance)
– indirect expenses	(30,000)	(yearly expenses, divided over various earnings)
– salary for artiste	(20,000)	(monthly salary, divided over various earnings)
– remaining profit for artiste	40,000	

Unlimited approach:

country of performance – source tax:	
20% x 150,000 =	30,000
home country – income/corporation tax:	
0% x (20,000 + 40,000) =	0
tax credit (maximum) =	0
balance due in home country	0
average tax rate on income:	
30,000 / (20,000 + 40,000) =	50%

Limited approach: same result.

This is comparable to illustration c) in Para. 11 of the 2000 Commentary.

8. THE UNLIMITED APPROACH IS UNFAIR

8.1. The reversal in the Commentary hits the wrong target

The figures in Examples A, B-1 and B-2 show that the unlimited approach of Art. 17(2) leads to excessive taxation internationally. The source country uses a flat withholding tax rate on all gross income, while the home country taxes the net foreign income at its normal progressive income tax rates. This unlimited approach does not meet the requirements of Art. 23 of the OECD Model.

It is interesting that the tax avoidance scheme in Example C is already countered by the withholding tax in the country of performance. The limited and unlimited approaches in this example lead to the same result. With the company and/or the artiste being resident in a tax haven, Art. 17(2) of the OECD and US Models does not apply because no tax treaties are concluded with these territories. In Example C, the result is a more than sufficient source tax at the rate 50% on the net amount. As an average, this can be seen as a heavy tax burden for star artistes and sportsmen who try to avoid tax.

The conclusion after these examples is that the reversal of Art. 17(2) of the OECD Model to the unlimited approach has been useless, even pernicious. In practice, the normal artiste/sportsman organizations, which are resident in a normal treaty country under normal employment circumstances together with their employees, suffer heavily from the eye-catching stars and their flashy advisers. The change from the limited approach in 1977 to the unlimited approach in 1987-1992 was not needed because, for the rent-a-star structure, the outcome of the limited and unlimited approaches is the same. Unfortunately, every normal artiste, sportsman, orchestra, dance company, theatre group and sports club now has to fight against this far-reaching and unfair international rule, which very often leads to excessive taxation. The older limited approach, which is also used in the US Model, seems to be more balanced.

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8.2. Distortion of international competition

It is clear that Art. 17(2) leads to a distortion of international competition because domestic artistes and sportsmen, who do not experience excessive taxation, are better off than foreign artistes and sportsmen. Interestingly enough, the OECD already acknowledged that the special tax treatment of artistes and sportsmen causes difficulties. The 1987 OECD Report concluded (Para. 61): "differences in treatment which exist in some countries distort competition and produce claims for a harmonized system whereby resident and non-resident artistes and athletes would be treated alike and pay the same tax."

Putting aside the threat of tax avoidance schemes by top artistes, the OECD argued (Para. 62): "There is a feeling, in these countries, that counteracting tax avoidance and evasion in this area should preferably use ways and means which would not divorce the artiste or athlete from the main categories of taxpayers to which they belong, i.e. providers of dependent and independent services."

The calculations in 7. show that, with the reversal of Art. 17(2), the OECD has unfortunately failed to fulfil the goals that it set in the 1987 OECD Report. The art and sports businesses cannot work properly under this treatment and lose tax money, the cost of advisers and much-needed energy because of this unbalanced treatment.

The attention at the OECD, in the Member countries and again during the seminar at the 2001 IFA Congress (see 6.2.4.) focused only on the allocation aspect. This one-sided approach does not meet the basic objective of tax treaties, namely, the avoidance of double taxation.

8.3. More tax credit problems in the home country

The normal artiste and sportsman companies, shown in Examples B-1 and B-2, have problems with the full Art. 17 of the OECD Model. They pay fixed monthly salaries to their employees. Income tax is deducted from the salaries and paid in the company's residence country, as is normal for employment contracts. These football companies, theatre groups, classical orchestras, etc., experience a large administrative burden when they travel abroad due to two problems. Both lead to higher excessive taxation internationally:

(1) the taxation of an appropriate part of the salaries in the country of performance under Art. 17(1) must lead to a tax credit in the home country. Unfortunately, in practice, this is very difficult to implement – first in the salary ledgers and later in the individual income tax returns.[18] Very often the tax credit remains unused because of the practical administrative problems; and

(2) the unlimited approach of Art. 17(2) is a taxation overkill because it not only taxes the profits of the company in the country of performance but also the full gross fee. Commercial companies still have a partial tax credit in their home country, but non-profit institutions, which are very common in the art world, normally do not fall under the income or corporation tax and cannot therefore obtain a tax credit.

Both problems were recognized by the OECD in the 1977 Commentary (as explained in 2.) by giving the OECD Member countries in their treaty negotiations the possibility for an exemption in normal employer-employee situations. Unfortunately, with the reversal in the 1987 OECD Report, this opportunity was pushed aside. But why do the average artistes and sportsmen have to suffer from the tendency to avoid tax of the small group of top stars?

8.4. The "Art. 17(3) clause"

Only one small possible exception remained in the 1987 OECD Report (Para. 98) and the 2000 Commentary (Para. 13 of the Commentary on Art. 17), giving the OECD countries the opportunity to exempt performances that are substantially supported by public funds. This can be called the "Art. 17(3) clause". Some countries seem to use this opportunity in their treaty negotiations to take away (partially) an obstacle for international cultural exchanges.[19] Unfortunately, this exception leads to unequal treatment of subsidized cultural and sports institutions, on the one hand, and commercial artistes and sports companies, on the other. The "Art. 17(3) clause" shows that the OECD, its Member countries and many others are aware of the overtaxation resulting from Art. 17. Evidently, this leads to an extra need for subsidies to the cultural and sports organizations. Do the countries want to protect their own interests with the "Art. 17(3) clause"?

9. DEVELOPMENTS IN THE EUROPEAN UNION

Especially the issue of equal treatment draws attention in the European Union. Direct taxation in the various Member States is not an object in the EC Treaty, but the principal freedoms and equal treatment are important in the effort to establish a common market. The European Court of Justice (ECJ) and the European Commission (EC) are striving to take away hurdles in the national laws that obstruct these principles.

For artistes and sportsmen, an interesting court case is presently pending before the ECJ. The *Finanzgericht Berlin*[20] has asked the ECJ for a preliminary ruling in the case of the Dutch drummer Arnoud Gerritse, who performed for a few days in Germany in 1996. He was taxed under § 50a(4) of the *Einkommensteuergesetz* (German Income Tax Law) on his gross performance fee at the rate of 25% (withholding tax), without the possibility of deducting his expenses. After the tax year, he was not entitled to a normal income tax settlement in Germany, i.e. to be treated as a normal German resident, while, in the Netherlands, his tax credit was insufficient to compensate for the German withholding tax. The EC has already indi-

18. In the discussion of the new Netherlands-Belgium tax treaty, concluded on 5 June 2001, this problem was recognized by both contracting states.

19. For example, the Netherlands included the "Art. 17(3) clause" in its new tax treaties with Belgium and Austria. The ASEAN Model Treaty has standardized the "Art. 17(3) clause".

20. *Finanzgericht Berlin* of 28 May 2001, 9 K 9312/99, *Internationales Steuerrecht* 14/2001, at 443, with a comment by Dr Harald Grams and Dick Molenaar.

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cated that it is ready to support the opinion that this treatment is in breach of the fundamental freedoms in the European Union. The Member States have now been asked to give their opinion on the issue.[21]

The ECJ's decision will undoubtedly influence the systems for taxing artistes and sportsmen in the Member States and can also indirectly affect the approach taken by the OECD.

10. SUMMARY AND CONCLUSIONS

The introduction of Art. 17(2) in the 1977 OECD Model was understandable. The tendency to avoid tax by top stars using "slave agreements" with "loan-out companies" incorporated in tax havens needed to be countered. The Commentary on Art. 17(2) of the 1977 OECD Model made it perfectly clear what the problem was and also stated that normal employer-employee relationships were not the object and purpose of the extended and deviant article. The wording of Art. 17(2), however, was broader than was needed in 1977.

The reversal of Art. 17(2) in the 1987 OECD Report extended Art. 17 to all payments to third parties, including the normal employment situations. Strangely enough, no new arguments were given to support extending the scope of Art. 17(2), and nothing had changed since the introduction ten years earlier. Still, the reversal was implemented in the Commentary to the 1992 OECD Model and gave Art. 17 its unlimited approach. Switzerland, Canada and the United States registered an observation on the reversal.

In the 1996 US Model, in contrast, the limited approach of Art. 17(2) was encouraged. Art. 17(2) of the 1996 US Model states that it applies to payments of all performance fees to any person, unless it is confirmed that the artiste or sportsman does not participate in the profits of the third person receiving the performance fee. If the artiste or sportsman does not so participate, only his actual salary is to be taxed under Art. 17(1) of the US Model. This wording makes it clear that the tax administration needs to be involved to confirm whether the exception can be used.

For many years, there was no discussion in the relevant tax literature on the reversal in the Commentary, but this changed with recent court cases and the publication of comments. This article gives new food for thought by expressing the darker side of Art. 17(2) of the OECD Model. The allocation of the taxing right in Art. 17(2) seems to be very effective with the unlimited approach, but calculations clearly show that Art. 17(2) results in excessive taxation internationally. This leads to the conclusion that Art. 17(2) is an overkill; Art. 17(2) also leads to obstacles on the international market.

Changes to Art. 17(2) of the OECD Model would be very much welcomed by the art and sports world. The OECD and its Member countries need to take their own arguments in the 1987 OECD Report seriously and combine the taxation of artistes and sportsmen with equal treatment and removal of distortions in the market. The limited approach of Art. 17(2) is sufficient for controlling the top stars who try to evade tax. The different wording of Art. 17(2) of the 1996 US Model can be adopted by the OECD Model to make clear the object and wording of the paragraph. A return to the 1977 Commentary with the possibility of excluding normal employment situations from Art. 17(2) needs to be considered.

Going one step further, the OECD can also endeavour to support the calls for removing Art. 17 by various commentators, including Sandler,[22] Grams,[23] and Nitikman.[24] Even Julian Nida-Rümelin, the State Minister of Cultural Affairs in Germany, supports this idea for Europe.[25] Earlier (see Example C and 8.1.), it was shown that countering tax avoidance schemes can be done simply with a withholding tax in the country of performance. To help the normal artistes and sportsmen, Art. 17 of the OECD Model could be changed to a provision that allows countries to treat them according to the normal allocation rules for employees and the self-employed.

21. In the Netherlands, a similar case has already been decided: *Gerechtshof Amsterdam* of 25 April 2000, *Infobulletin* 2000/489, *BNB* 2000/369. The Dutch income tax legislation was amended afterwards. The case was translated into German and published in *Internationales Steuerrecht* 12/2002, at 420, with a comment by Dr Harald Gram and Dick Molenaar.

22. See Sandler, supra note 4, at 344.

23. Grams, Harald, "Artist Taxation: Art. 17 of the OECD Model Treaty – a Relic of Primeval Tax Times?", 27 *Intertax* 188 (1999).

24. Nitikman, Joel A., "Article 17 of the OECD Model Treaty – An Anachronism?", 29 *Intertax* 268 (2001).

25. At the conference "Musik als Wirtschaft" in Berlin, Germany on 22 April 2002.

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