Sportspersons, entertainers and taxing the digital economy

BY MICHELLE KLOOTWIJK[1] AND DICK MOLENAAR[2]

Introduction

The trending topic in the international tax world, at the moment, is the taxation of the digital economy. The allocation rules of profits are until now based on the physical presence of companies in states, but digital companies do not need to have such permanent establishments ("PEs") to sell their products to customers.

Most often these products are digital services (such as for *Netflix*, *Google* and *Facebook*), but it can also be real goods (such as for *Amazon* and *Alibaba*). Without a PE in the state of the consumers, no corporate taxation is possible under the current art. 7 OECD Model Tax Convention, which is included in almost every bilateral tax treaty. But with new rules, states want these tech companies to pay tax where they earn their income.

This development has very much the likes of the taxation of the sports and entertainment businesses under art. 17 OECD Model, which is also included in almost every bilateral tax treaty. This art. 17 gives the performance state the right to tax the income, regardless of whether a PE of the sportsperson or entertainer is present. This means that taxation of these performers is allocated to where the consumers are using these performances and that is the same as the new direction for the taxation of the digital economy.

Our article will show the similarities between these two worlds and will explain the problems which sportspersons and entertainers experience, as a warning for the taxation of the digital economy. Also, it will outline the Unified Approach of the OECD and show that this can be helpful for sportspersons and entertainers to overcome their tax problems. How can two businesses, who seem to be worlds apart, come together and learn from each other?

Digital service taxes

There are two reasons for changing the international rules for taxing the digital economy:

- big tech companies should pay tax in the states where they are selling their products, *i.e.* where the consumers are; and
- tax avoidance with the use of low tax jurisdictions should be counteracted.

This was already mentioned in the BEPS[3] program, but the first element did not really take off, because other topics were attracting more attention then. However, with the rapid growth of the digital economy over the past years, some states got more focus on the possible tax revenue and they started to announce unilateral source taxes for digital sales and also some other consumer facing businesses on their territory.

Examples of these Digital Service Taxes ("DSTs") are the UK with 2%; France with 3%; Spain with 3%; Italy with 3%; and Turkey with 7.5%. These DSTs are taken from the gross turnover of specific tech companies selling digital streams, advertisement and other services to consumers in the state[4], without any deduction for expenses. But every state only wants to levy its DSTs above a relatively high threshold of turnover, so that the big companies are included and the smaller and medium-sized can stay out. The reason for this is the administrative work following from this new taxation.

And as these DSTs are unilateral and not based on tax treaty allocation rules, a tech company is not entitled to a tax credit or exemption in its residence state. This means that the DSTs act as a sort of extra turnover tax, in addition to the already existing VATs[5]. But DSTs can also be considered as a tax on deemed profits and then turn into double taxation. Anyhow, it is an extra layer of tax, which may raise prices and obstruct economic activities.

Taxation of sportspersons and entertainers

Already for many years, sportspersons and entertainers are being taxed in the state of their work, such as sports

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3 Base Erosion and Profit Shifting.

4 Although the taxable base may vary per state.

5 Most often the normal VAT rate applies to electronic services. Within the EU this is around 20%.

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matches or artistic performances. Since 1963, the OECD Model has a special art. 17 for them, which sets aside the normal art. 7 for Business Profits and art.15 for Dependent Personal Services. This means that no PE is required for taxation in the source state, as would be for art. 7, and no exception is applicable when a sports team or entertainment company travels with its employees to the other state, as would follow from art. 15(2). An important reason for art. 17 is that sportspersons and entertainers are so mobile that they can easily move their residence to tax havens and then would not pay any tax anymore. Not officially mentioned is that states also want to tax the source income from famous foreign celebrities to avoid the thought of the public that they could get away without paying tax.[6]

Because it is hard to calculate the profits of sportspersons and entertainers from short-term visits, states have asked the OECD to allow them to tax the gross performance income without the deduction of expenses. The OECD has allowed this, but has added that this should then be a lower rate than normal,[7] which is followed as the basic rule by most states.[8] Gross withholding rates vary from 15% in France, 15,825% in Germany, 18% in Belgium, 19% in Spain, 20% in the UK to 30% in Italy and the USA.

Art. 23 of the OECD Model specifies a foreign tax credit or exemption in the residence state for the foreign performance income. But this very often goes wrong because of missing tax certificates, net contracts, unreadable languages, certificates in the name of the group while the taxable income goes to the individual performers, differences in taxable income because of expenses, and high administrative expenses. In practice, very often double or excessive taxation results from art. 17, especially for small and medium sized sportspersons and entertainers, because the article applies to every payment without any threshold. And it leads to high administrative expenses, also for the tax authorities.

Similarities and differences

There are striking similarities between the taxation of sportspersons and entertainers and the new DSTs:

- measure against the move to low tax jurisdictions;
- need to tax the income in the state of the consumers;
- gross taxation at source because calculation of the profit is not easy;
- impossible or very problematic tax credit or exemption in the residence state; and
- high administrative expenses.

But there also differences:

- much higher source tax rates for sportspersons and entertainers (15-30%) than for digital companies (2-7,5%);
- high threshold directly available for digital companies, while sportspersons and entertainers don't have this, besides the US performers, because there is no active use of the possible threshold from the OECD Commentary yet; and
- no tax credit or exemption for digital companies, while sportspersons and entertainers have this in the tax treaties, although with problems.

Esports

An area which is perhaps the best example of combining both worlds is esports. Many say it is sports, although the viewers also consider it as entertainment and it has developed with the availability of the digital logistics. Players, promoters and viewers can easily reside in different states, with money streams going across the globe via the most modern bank accounts. Under the current taxing rules of art. 17, the esports players would only be taxable for their online games and tournaments in the state where they are doing their work, most often their residence state, and the states of the viewers and the organizers would not have a taxing right. But theses state might find this strange, because the esports earnings are generated on their territory and esports players can move their residence to low tax jurisdictions. In practice, some states want to withhold source tax from payments to foreign esports players, unless the player can show that he is registered as taxable person in his residence state.

But in esports also live events have been developed, because the viewers want a real experience, as with normal sports and entertainment. These events, for example Dota2, League of Legends and Fortnite, take place in and fill big arenas and also stadiums with spectators who want to see their heroes in combat during real, offline events. It is clear that the states of these performances want to tax the income from these esports players under art. 17 of their tax treaties.[9]

The new tax rules for the digital economy give source states the chance to also tax the online earnings of both the esports players and the promoters. This gives an extra dimension to the taxation of esports, which is already complicated under the existing rules.

6 See Savvas Kostikidis, "Influencer Income and Tax Treaties", in: *Bulletin for International Taxation* 74(6) (2020) for his view on the benefit principle behind art. 17. And also Dick Molenaar and Harald Grams, "Influencer Income and Tax Treaties: A Response", in: *Bulletin for International Taxation* 74(9) (2020).

7 This is mentioned in para. 10 of the Commentary on Article 17 OECD Model.

8 Many states also allow the deduction of expenses, but then raise that tax rate to the normal level. In the EU this was discussed at the Gerritse (ECJ 12 June 2003, C-234/01), Scorpio (ECJ 3 October 2006, C-290/04) and Centro Equestre (ECJ 15 February 2007, C-345/04) cases. The OECD has taken this over as an option in para. 10 of the Commentary in 2008.

9 See Sebastiaan van Overbeek and Dick Molenaar, "Esports and taxation", Global Sports Law and Taxation Reports (GSLT) 2018/35, Robert Esau, "International tax aspects of esports", Sports Law and Taxation 2020/03 and 2020/14, and Alara Efsun Yazicioglu, "Esports gamers cannot be considered as sportspersons for income tax purposes according to the Turkish tax administration" Sports Law and Taxation 2020/04.

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How to overcome the taxation problems

Digital economy – inclusive framework

For the taxation of the digital economy, the OECD has reacted swiftly in 2019 on the announcement of the DSTs and brought together the 130 states of the BEPS program, the so-called Inclusive Framework ("IF"). This has come with a proposal for a proper taxation, the Unified Approach, and has led to the delay of most of the unilateral DSTs. The Unified Approach fits within the tax treaties and, therefore, also eliminates double taxation. The proposal consists of:

- Pillar One, with which the taxable profit of a multinational is determined and allocated to the various states of the digital sales; and
- Pillar Two, which sets a minimum tax rate for all states involved.

The plan is that the tax authorities of the states, in which the tech companies are active, should come together, led by the residence state, to decide how much profit the multinational has made and who gets which share of this profit for taxation. This will also give the residence state the information about the total worldwide profit and how much foreign tax credit should be given. The IF advises not to apply the tax exemption method to eliminate double taxation, which is different from what many states allow for business profits under the current art. 7 OECD Model. The reason is that, under Pillar Two, the residence state should get an optional additional taxing right when the source taxes are lower than the taxation in the residence state, which can be realised with the tax credit method.

Also, the Unified Approach sets a minimum threshold for this taxation, which should be 750 million turnover worldwide and 50 million per state. Under this threshold, the new taxation should not be applied, but normal rules based on the PEs should prevail.

The blueprints of Pillar One and Two of the Unified Approach are very much under discussion within the IF and OECD and results are expected in the summer of 2021. On the other hand, states and also the EU are pushing that they do not want to wait with their unilateral DSTs if a comprehensive agreement would stay out.

Entertainment companies, such as Netflix and Spotify, and sales companies, such as Amazon, have reacted on the discussion drafts of the Unified Approach by the IF/OECD. They have explained that they are supporting the principle that normal tax should be paid by every multinational company and that they do not have a problem with another division of the taxable profits over states, as long as it will be kept simple and not increase the administrative work too much. And that seems to be a problem with both the DSTs and the Unified Approach/Pillar One and Two, although the minimum threshold is specifically meant to leave out smaller and medium sized companies because of the administrative burden.

Sportspersons and entertainers

For sportspersons and entertainers some solutions are available to take away parts of their problems:[10]

- minimum threshold;
- exception for payments to others than the sportspersons and entertainers themselves (limited approach of art. 17(2));
- deduction for expenses and normal tax settlements;
- exception for employees; and
- exception for publicly funded performances.

The 2016 US Model Tax Convention mentions a threshold of US$ 30,000 per person per year,[11] while the Commentary on the OECD Model has 15,000 IMF Special Drawing Rights (equivalent to € 18,000 or US$ 20,000 per person per year)[12].

The 2016 US Model also mentions the limited approach of art. 17(2) in the text,[13] but the Commentary on the OECD Model only has a note that Switzerland, Canada and the USA have made this reservation with art. 17.[14]

The deduction for expenses and normal tax settlements are not mentioned in the US Model, but are part of the US national legislation, while the Commentary on the OECD Model has the option in para. 10. The exception for employees and publicly funded performances are only mentioned in para. 2 resp. para. 14 of the Commentary on the OECD Model.

The USA has implemented art. 16 of its Model Tax Convention in most of its bilateral tax treaties, although often with lower thresholds, such as US$ 20,000 or US$ 10,000 per person per year, because those were the amounts from previous Models.[15]

OECD member states have hardly ever included a minimum threshold in their treaties, although the treaty between Chile and The Netherlands from January 2021 might be a sign for a new trend.[16] Also, the deduction for expenses and normal tax settlements and the exception for employees are hardly ever included, whilst the exception for publicly funded performances is taken over

10 The best option would be that art. 17 would be removed from the OECD Model, as advocated by many authors. It has also been discussed by the OECD member states, but they decided in 2014 to keep the article in the Model Tax Convention.

11 See art. 16(1) of the 2016 US Model Tax Convention.

12 See para. 10.1-10.3 of the Commentary on Article 17 OECD Model.

13 See art. 16(2) of the 2016 US Model Tax Convention.

14 See para. 16 of the Commentary on Article 17 OECD Model.

15 See Dick Molenaar, "Minimum threshold in tax treaties", in: *GSLTR* 2016/1, p. 16.

16 Art. 17 of this new tax treaty between Chile and The Netherlands has a threshold of € 5,000 per person per year, which is relatively low, but Chile has agreed almost the same in 2010 with the USA, *i.e.* US$ 5,000.

in almost 70% of the bilateral tax treaties in the world.[17]

Opportunities

Unilateral DSTs are dangerous for the digital economy, as can be learned from the taxation of sportspersons and entertainers. Gross taxation without the deduction of expenses very often leads to excessive or double taxation, which obstructs international economic activity. And it leads to high administrative expenses, both for the taxpayers and the tax authorities. This has already been recognized for the taxation of the digital economy, because a high minimum threshold is set for the unilateral DSTs and in the Unified Approach of the IF/OECD. It would also be fair if such a minimum threshold could be inserted in the text of art. 17 OECD Model and made available for sportspersons and entertainers across the globe, because that would take out the small and medium sized, who suffer the most from double or excessive taxation and the administrative burden.

Pillar One and Two offer a good balance of taxation in the source state and elimination of double taxation in the residence state. Also sportspersons and entertainers should get the option of such comprehensive international taxation and cooperation between tax authorities. Major sports events and tours of top entertainers are very well organized, also financially, and the managements can work together with the various tax authorities to come to proper taxation, the same as with Pillar One and Two.

Conclusions

There are surprising similarities between the taxation of the digital economy and the taxation of sportspersons and entertainers. The first is new and still developing; the second already has much experience with international tax problems. The IF/OECD can learn from these problems for the taxation of the digital economy, whilst sportspersons and entertainers may follow in the slipstream of these developments and come to comparable solutions for their problems.

The aim of the IF/OECD is to implement the final agreement about the Unified Approach with a Multilateral Instrument (MLI) at once in all the tax treaties of the participating states. It would be good also to include the improvements for art. 17 in this MLI package, so that sportspersons and entertainers at the same time can have a fairer taxation and better elimination of double taxation.

17 See Dick Molenaar and Harald Grams, "Article 17(3) for Artistes and Sportsmen: Much More than an Exception", in: Intertax 40(4) (2012).

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