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TAX MANAGEMENT INC.
WASHINGTON, D.C.

How to Modernize Income Taxation of International Artistes and Sportsmen

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ART. 17 IS IN NEED OF RADICAL CHANGE

SUMMARY AND CONCLUSIONS

BACKGROUND

Treaty Provisions

Generally, performance fees earned by (or as a result of the activities of) an artiste or sportsman are sourced to the country of performance. Either earned by a nonresident self-employed individual (or by a company) or by an employee, the country of performance often taxes such fees on a gross basis. The Organization for Economic Cooperation and Development ("OECD") generally supports the application of such internal (or "national") law in Art. 17 of its Model Income Tax Convention ("OECD Model") and the United States supports such application in Art. 17 of its 1996 U.S. Model Income Tax Convention.

According to a 1987 OECD Report,[1] Art. 17 is viewed as an anti-avoidance measure to prevent highly mobile artistes and sportsmen, who pretend to live in tax havens, from taking gross self-employed income with them without paying tax in any country. The 1987 OECD Report suggested that artistes and sportsmen are not trustworthy. It stated that "sophisticated tax avoidance schemes, many involving the use of tax havens, are frequently employed by top-ranking artistes and athletes" and "there is a tendency to be represented by adventurous but not very good accountants." The report concluded that "there is a general agreement that where a category of — usually well-known — taxpayers can avoid paying taxes, this is harmful to the general tax climate." This picture of artistes and sportsmen trying to escape normal taxation has been reinforced, for example, by artistes such as Luciano Pavarotti, the famous Italian opera singer, who pretended to live in Monte Carlo but ended up paying ITL 25 billion in Italy after court cases,[2] and Sting, who performed in Canada and used a personal holding company called Roxanne Inc. to try to bring offshore a part of his Canadian performance income.[3]

This picture might be true for a small portion of top artistes and sportsmen, but not for the vast majority beneath the top of the pyramid. Most artistes and sportsmen are just normal people who report their foreign income in their home-country income tax returns at the end of the year. However, because of the lack of trust that government officials have in them, they often suffer excess taxation. This article will demonstrate that excessive taxation does in fact occur and will argue for a modernization of the current regime.[4]

History of Artiste and Sportsman Taxation

Special tax rules for international artistes and sportsmen first appeared in the 1963 Draft OECD Model Tax Convention. The Draft provided in Art. 17 that the primary right to tax the performance income of artistes and sportsmen was allocated to the country

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

[2] Rotondaro, "The *Pavarotti* Case," 40 *Eur. Tax'n* 8 (2000), pp. 385-391.

[3] *Sumner v. R.*, 7 Dec. 1999, 2000 *D.T.C.* 1667, [2000] 2 *C.T.C.* 2359.

[4] For other discussions of the problem of excessive taxation under the current regime, see Grams, "Artist Taxation: Art. 17 of the OECD Model Treaty — A Relic of Primeval Tax Times?" 27 *Intertax* (1999), pp. 188-193; Nitikman, "Article 17 of the OECD Model Treaty — An Anachronism?" 29 *Intertax* (2001), pp. 268-274; and Molenaar and Grams, "Rent-A-Star — The Purpose of Article 17(2) of the OECD Model," 56 *Bull. for Int'l Fiscal Documentation* 10 (2002), pp. 500-509.

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of performance, setting aside the normal rules of Arts. 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services).[5]

Art. 17 was expanded in 1977 to include a second paragraph, stating 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" or "star" companies, most often owned by themselves, which contracted for the performance of the artiste or sportsman. Such star companies provided the services of the artiste or sportsman and were established in tax havens. 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 companies that could receive fees for artistic and sports performances. This was later reflected in a 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 company 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 of escaping from source taxation of performance income.

Three countries, Canada, the United States, and Switzerland, made reservations with respect to this reversal. In the 1987 OECD Report [6] and the 1992-2003 Commentary,[7] 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 Income Tax Convention with a provision that Art. 17(2) does not apply when the artiste or sportsman does not have access to the profits of the company 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 (assuming the company does not have a permanent establishment in the source country).[8] This treaty practice is also followed by Canada and a few other countries.

However, most countries have inserted in their bilateral income tax treaties the unlimited anti-avoidance rule of Art. 17(2) of the OECD Model. Thus, there is a difference in tax treaty practice between those who follow the *limited* approach of the 1996 U.S. Model/old 1977 OECD Model and those who follow the *unlimited* approach of the 1987 OECD Report/new 1992-2003 OECD Model.[9]

NATIONAL TAX RULES

National tax rules for taxing nonresident artistes and sportsmen are often very onerous. Three principles are followed by many countries:

- Production expenses are not deductible (even though payments made to others are often taxable to such persons);
- The tax rate (normally applied as a withholding tax) is often higher than the average income tax rate for residents; and
- No normal income tax return is allowed at the end of the year.

As illustrated by the example in the next part of this article, this leads to excessive taxation because a part of the withholding tax in the country of performance cannot be credited against income tax in the home country. In some countries the artiste and sportsman withholding tax is so high that nonresident artistes and sportsmen decide not to perform there. For example, U.S. artistes and sportsmen consider the harsh tax measures as an obstacle to entering the European market. In Germany, the Minister of Culture stated in a press release in 2001 that, after the tax increase for nonresident artistes in 1996, the number of performances went down by 33%. In Germany the artiste and sportsman withholding tax was working as protection for resident artistes and sportsmen and kept foreigners from the local market. In the case of artistes and sportsmen who are residents of the European Union, such an obstacle violates the fundamental freedoms protected by the EC Treaty.

Set forth below for various countries are the key features of their tax systems for taxing nonresident artistes and sportsmen on income derived in the country (and assuming, where relevant, that the person is considered engaged in a trade or business in the country but does not have some type of "permanent establish-

[5] Since the removal of Art. 14 (Independent Personal Services) in 2001, only Art. 7 is mentioned in Art. 17 with respect to self-employed artistes and sportsmen.

[6] Para. 90 of the 1987 OECD Report.

[7] Para. 16 of the 1992-2003 OECD Commentary on Art. 17.

[8] Technical Explanation to the 1996 U.S. Model Income Tax Convention, Art. 17.

[9] For arguments against the unlimited approach, see Molenaar and Grams, "Rent-A-Star — The Purpose of Article 17(2) of the OECD Model," 56 *Bull. for Int'l Fiscal Documentation* 10 (2002), pp. 500-509.

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ment" in the country):

	Tax at source	*Deduction of expenses*	*Tax rate*	*Normal tax return allowed*
Australia	Yes	Yes	29-47%	Yes
Austria	Yes	No	20%	Yes
Belgium	Yes	No	18%	No
Brazil	Yes	No	25%	No
Canada	Yes	Yes	15%	Yes
Czech Republic	Yes	No	25%	No
Denmark	No			
Estonia	Yes	No	15%	No
Finland	Yes	No	15%	No
France	Yes	No	15%	Yes
Germany	Yes	No	21%	No
Greece	Yes	No	15-20%	No
Hungary	Yes	Yes	40%	Yes
Iceland	Yes	No	12.7%	No
Ireland	Yes	Yes	20%	No
Italy	Yes	No	30%	No
Japan	Yes	No	20%	No
Korea	Yes	No	20%	No
Lithuania	Yes	No	15%	No
Luxembourg	Yes	No	10%	No
Mexico	Yes	No	25%	No
Netherlands	Yes	Yes	1-20%	Yes
New Zealand	Yes	Yes	20%	Yes
Norway	Yes	Yes	15%	No
Portugal	Yes	No	25%	No
Russia	Yes	No	30%	No
Slovak Republic	Yes	No	25%	No
Slovenia	Yes	No	15%	No
South Africa	Yes	No	18-40%	No
Spain	Yes	No	25%	Yes
Sweden	Yes	No	15%	No
Switzerland	Yes	No	7-32%	No
United Kingdom	Yes	Yes	23-40%	Yes
United States	Yes	Yes	10-35%	Yes

This overview shows that many countries, especially European countries, are reluctant to allow the deduction of expenses and normal income tax settlements, although the Netherlands and the United Kingdom are positive exceptions. Unfortunately, the European Union has chosen not to harmonize the direct tax rules of its member countries,[10] so an initiative from the legislators in Brussels or Straatsburg cannot be expected.

However, drawing the conclusion that EU countries remain solely responsible for their direct taxation would not be correct. The freedom principles of the EC Treaty, such as the freedom of establishment, ser-

[10] However, the indirect Value Added Tax ("VAT") has been harmonized with EU Directives; individual EU Member States have very little room for variations in the VAT.

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vices, and work, which are intended to lead to equal treatment for citizens of EU countries when they are in equal positions, need to be secured in any Member country. The European Court of Justice ("ECJ") has played a vital role over the last years in judging whether national direct tax rules conflict with these freedom principles of the EC Treaty. With a stream of decisions, the ECJ is showing that it does not accept unjustifiable obstacles to the single market of the European Union. A subsequent section of this article will discuss a recent decision by the ECJ about artiste and sportsman taxation in Germany.

Example of Excessive Taxation; Tax Credit Problems

The following example will clarify the problem that international artistes and sportsmen are very often facing:

A U.S. artiste is performing in an overseas country and earns $25,000. The foreign withholding tax is 20% (from gross) and the touring expenses are 60% ($15,000). The U.S. artiste is a high earner, so his average federal income tax rate reaches the top rate of 35%.

Foreign withholding tax (in country of performance):	
20% × $25,000 = $5,000	
U.S. income tax (prior to foreign tax credit):	
Gross income – expenses = $10,000 taxable income	
35% × $10,000	$3,500
International excessive taxation	$1,500 (excess tax credits)

In this example, the U.S. artiste experiences an effective tax rate of 50% on his foreign-source income ($5,000 (tax)/$10,000 (taxable income)). This tax rate is much higher than the average tax rate in most countries of the world, even for multimillionaires. Is the assumption of 60% in expenses realistic? The next section of this article presents the results of a study on the expenses of international performing artistes, showing that 95% of this population has expenses of 50% or more.

In addition to this example, the unlimited approach of Art. 17(2) of the OECD Model, as discussed above, causes more tax credit problems. An artiste or sportsman company, such as a football club, theatre group, or classical orchestra, with its members as employees on the regular payroll, has problems with Art. 17(2) of the OECD Model. The company will normally pay fixed monthly salaries to the employees [11] and incur other expenses. The unlimited approach of Art. 17(2) is taxation overkill because it taxes the company on its full gross fee, with no deductions for expenses. Commercial companies normally receive in their home country only a partial, and not a full, tax credit for such taxes.[12]

In the Commentary to Art. 17, the OECD recognizes that excessive taxation can occur when artistes or sportsmen work for a company and gives OECD Member countries in their treaty negotiations the possibility of an exemption in normal employer-employee situations (paragraph 11(b)):

> 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.

Unfortunately, this exception is not used very often in tax treaties. Some countries have an exception in their national legislation for artiste or sportsman companies, but most do not go as far as the Commentary suggests.[13] Many countries are using another possible exception to Art. 17, mainly for cultural exchanges

[11] An artiste or sportsman company experiences a large administrative burden when its group travels abroad because it must deduct both home-country tax and source-country tax from the salaries. The taxation of salaries by the country of performance under Art. 17(1) should lead to a tax credit in the home country, but unfortunately, in practice, this is very difficult to implement. Very often the tax credit remains unused because of practical administrative problems. In the Technical Explanation of the new Netherlands-Belgium income tax treaty, concluded on June 5, 2001, this problem was recognized by both contracting states.

[12] Nonprofit institutions, which are very common in the art world, such as theatre groups and classical orchestras, often are subject to tax in the country of performance. Obviously, they do not obtain a tax credit in their home country because normally they are not required to pay the income or corporation tax of their home country.

[13] For example, nonresident classical orchestras and other music groups can be exempted from the nonresident artiste tax rules

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and subsidized companies or institutions. This so-called "Art. 17(3)" clause will be discussed in a subsequent section.

Deduction of Expenses at Source

Examples of Expenses — Results of Netherlands Study

Almost any performing artiste or sportsman incurs considerable expenses for foreign appearances. These expenses can be incurred for:

- Travel and accommodation: buses, trucks, sometimes air travel, hotels, food and drink;
- Equipment: sound, light, stage set-up, instruments, clothing, and in bigger venues even video and laser;
- Accompanying persons: sound and light technicians, "roadies," tour managers, tour accountants, drivers, and security;
- Agents and managers, who plan the performances and fit them into the career development of the artiste or sportsman; and
- Miscellaneous: administration, legal advice, insurance, rehearsals, and pre-production costs.

The conclusion that these expenses are normally quite high can be drawn from the authors' study of 150 nonresident artistes and groups that performed in the Netherlands in the period January-August 2001:

Number of Performances	150		
Gross Fees		EUR 7.3 million	
Production Expenses		- 5.6 million	(76% of gross fees)
Artiste Profit		EUR 1.7 million	(24% of gross fees)

Figure 1 shows the percentage that expenses are of gross fees, for a range of gross fees. Figure 2 breaks the range of percentages into sub-ranges of 10 percentage points each and shows the number of artistes having expenses within each sub-range.

The population in the study was a mixed group of small, medium-sized, and some major performing artistes, covering theatre, dance, classical, and popular music. On average, expenses were 76% of performance fees.[14] This is a weighted average, with the bigger artistes having more effect on the outcome than the smaller. It is interesting to note that even the big names had expenses between 60% and 80% of performance fees. The variations were considerable, but the conclusion is justified that 95% of the artistes had expenses that constituted 50% or more of performance fees.[15]

Figure 1

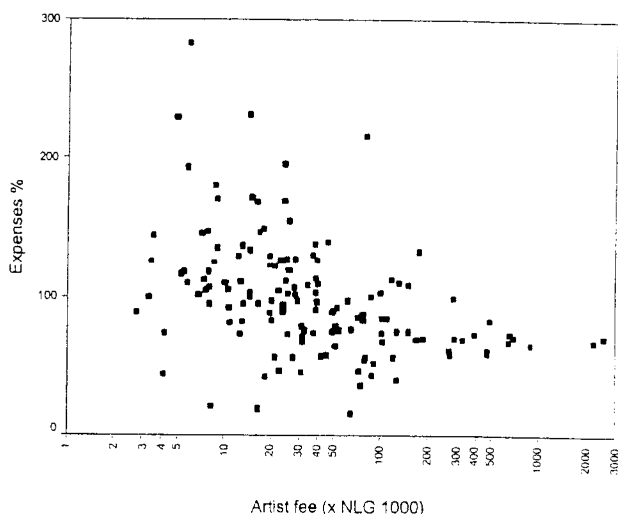
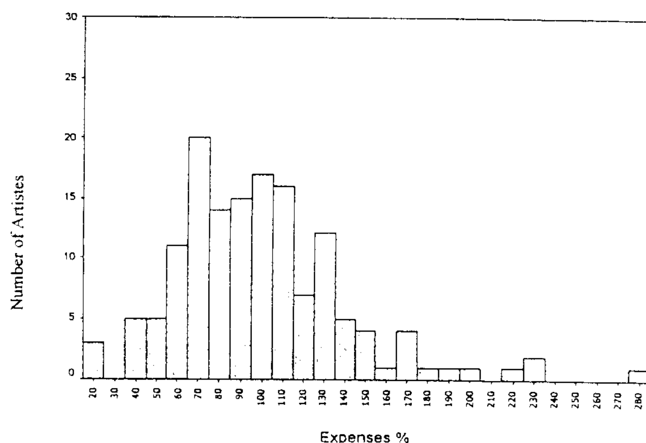


Figure 2



These figures are confirmed by an extension of the study to the three-year period 2001-2003, including 1600 artistes and groups with a total of 2500 shows.

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under the *Orchesterlass* in Germany and Austria.

[14] This result is consistent with the figures in the Sting case. *Sumner v. R.*, above. The expenses (excluding Sting's salary) for the six performances in Canada amounted to 79% of the gross fees.

[15] The results of this study were published earlier in Molenaar, "Obstacles for International Performing Artists," 42 *Eur. Tax'n* 4 (2002), pp. 149-154; and Molenaar and Grams, "The *Arnoud Gerritse* Case of the European Court of Justice," 31 *Intertax* 5 (2003), pp. 198-204.

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Figures were very often taken from U.S. artistes on tour in Europe, who stopped in the Netherlands for one or more shows. Total tour expenses were broken down per show, and the results of the Dutch study can be considered representative of what the results would be for other European countries.

Position of the OECD Regarding Expenses

In subparagraph 10 of the official 1992-2003 Commentary on Art. 17 of the OECD Model, the deduction of expenses for performances is discussed:

> The Article says nothing about how the income in question is to be computed. It is for a Contracting State's domestic law to determine the extent of any deductions for expenses. Domestic laws differ in this area, and some provide for taxation at source, at a low rate based on the gross amount paid to artistes and sportsmen.

The OECD does not want to provide rules for the deduction of expenses, although in practice the amount of expenses significantly influences the effective tax rate at source, as has been shown in the example, above. Many countries impose a final withholding tax on the gross amount, but keep the withholding tax rate high so that artistes or sportsmen with negligible expenses do not get away with low taxation.

At the IFA Congress in Cannes in 1995 Prof. Daniel Sandler [16] expressed in his overview of Seminar D that it can be problematic to compute the expenses for performances, but also admitted that the manner in which source countries deal with expenses can lead to excessive taxation of the foreign income. This conclusion was also brought forward by Paul A. Sczudlo [17] at the Seventh Annual IBA/ABA Conference in London in 2001.

National Provisions Regarding Expenses

In Europe, the United Kingdom and the Netherlands have introduced a system whereby a deduction for expenses at source is allowed. The United Kingdom set up the Foreign Entertainer's Unit ("FEU") in 1986; a nonresident artiste or his representative can send a budget of production expenses for approval to the FEU prior to a performance or tour. The Netherlands changed their artiste taxation rules effective January 2001; the new rules allow nonresident artistes to apply for a tax ruling on expenses from a special tax unit for foreigners. Both countries make it possible within a maximum period of four weeks to have a decision in advance on the amount of expenses to be deducted. This leaves only the artiste's net income subject to withholding tax. Both the United Kingdom and the Netherlands have positive experiences with their more detailed artiste and sportsman tax system, although discussions very often arise over the deductibility of some expenses and the apportionment of tour expenses to an individual show in a specific country.

Outside Europe, countries such as the United States,[18] Australia, and Canada allow nonresident artistes and sportsmen to apply for a deduction of expenses before the withholding tax is calculated.

Some countries have created a minimum threshold for artiste and sportsman fees, under which no withholding tax needs to be deducted:

- In the United Kingdom, the amount is GBP 1,000 (EUR 1,400) per group per show.
- In the Netherlands, the amount is EUR 136 per person per show for which no budget has to be submitted; up to this amount the fee is considered to be for production expenses.
- Germany has had a bracket system (*Staffelbesteuerung*) since 2002, with 0% tax for fees under EUR 250 and low rates for fees under EUR 1,000.
- Belgium introduced in October 2001 a threshold of EUR 400 for the first day in the country and EUR 100 for each following day, with a maximum of EUR 1,300 after 10 days.

De Minimis Rule in U.S. Tax Treaties

The 1996 U.S. Model Income Tax Convention has a threshold for artiste and sportsman fees.[19] In Art. 17(1) of this Model, the taxing right is allocated to the country of performance unless the gross income in the taxable year does not exceed $20,000 or its equivalent in the local currency. Most U.S. treaties have been drawn up according to this, although the de minimis rule in many treaties is set at a lower amount. Examples are:

[16] Seminar D of the 49th IFA Congress in Cannes, *Cahiers de droit fiscal international*, Vol. 20d (The Hague: Kluwer Law International, 1995).

[17] Partner with Loeb & Loeb LLP in Los Angeles, CA, USA.

[18] *See* IRS Publication 515 (Rev. November 2002), pages 23-24.

[19] Prof. Daniel Sandler supported this exception in the U.S. Model in his overview of Seminar D during the IFA Congress in 1995.

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Australia	$10,000	Belgium	$3,000	Canada	$15,000
France	$10,000	Italy	$12,000	Japan	$3,000
The Netherlands	$10,000	New Zealand	$10,000	Norway	$10,000
South Africa	$7,500	Spain	$15,000	Sweden	$6,000
Switzerland	$10,000				

THE EUROPEAN COURT OF JUSTICE DECISION IN *ARNOUD GERRITSE*

In an artiste (and sportsman) tax case (C-234/01), the European Court of Justice ("ECJ") answered questions from the Tax Court *(Finanzgericht)* Berlin about the taxation of the Dutch jazz drummer, Arnoud Gerritse, who performed in 1996 for a few days for a radio station in Berlin, Germany. His performance fee was €3,000 gross, on which 25% tax (€750) was levied. He was not allowed to deduct his expenses for travel and accommodation of €500 and he could not file a normal German income tax return *(Einkommensteuererklärung)* after the year. Gerritse believed he was not treated equally with German residents because he was paying more tax than under the normal income tax scheme, especially when the free taxable amount *(Grundfreibetrag)* was considered. Gerritse was also not happy with the situation because he received an insufficient foreign tax credit in the Netherlands, a mere €196. (For Dutch purposes, he was allowed deductions for his business expenses and personal allowances, and was subject to the low starting rates of the Dutch income tax.)

The case was to be decided by the Tax Court *(Finanzgericht)* Berlin. The court considered the possible breach of the freedom principles of the EC Treaty and therefore presented questions to the ECJ in Luxembourg in 2001.[20] On June 12, 2003, the ECJ announced a decision with the following two answers, based on the freedom and equal treatment principles of the EC Treaty:

- Expenses need to be deductible before income tax is calculated; and
- A normal income tax settlement needs to be allowed when the income tax rates are lower than the (fixed) withholding rate and a tax refund would be likely.[21]

Germany is now in the process of implementing the ECJ decision in its legislation. In November 2003 Germany approved a refund procedure, giving nonresident artistes and sportsmen the right to reclaim withholding tax to the extent it exceeds the normal income tax. Unfortunately, there is no initiative yet for allowing the deduction of production expenses prior to performance, which would bring down the withholding tax to a fair share of the performance fee. A change of this kind only seems to be a matter of time.

Arnoud Gerritse also has major consequences for other EU countries, both the old members, such as France, Spain, Portugal, Italy, Sweden, and Greece, and the new members, such as Estonia, Lithuania, Latvia, Czech Republic, Slovak Republic, Slovenia, and Poland.[22] Although most EU countries seem reluctant to take action, a citizen of an EU country can make direct use of the ECJ decision when a comparable case comes before a national tax court of another EU country and force the country to change its artiste and sportsman tax legislation.

The "Article 17(3) Clause"

An optional exception to the general rules of Art. 17 was given by the OECD in paragraph 14 of the 1992-2003 Commentary. This gives OECD countries the opportunity to exempt performances that are substantially supported by public funds:

> 14. Some countries may consider it appropriate to exclude from the scope of the Article events supported from public funds. Such countries are free to include a provision to achieve this but the exemptions should be based on clearly definable and objective criteria to ensure that they are given only where intended. Such a provision might read as follows:
>
> > The provisions of paragraphs 1 and 2 shall not apply to income derived from activities performed in a Contracting State by artistes or sportsmen if the visit to that State is wholly or mainly supported by public funds of one or both of the Contracting States or political subdivisions or local authorities thereof. In such a case, the income is taxable only in the Contracting State in which the artiste or the sportsman is a resident.

[20] Tax Court Berlin May 28, 2001, *Internationales Steuerrecht* 14/2001, pp. 443-446.

[21] In line with its earlier decisions, the ECJ reserved the free taxable amount to the country of residence.

[22] These former Eastern European countries will enter the European Union on May 1, 2004.

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This can be called the "Art. 17(3) clause." Some countries seem to use this opportunity in their treaty negotiations to take away (partially at least) a major obstacle to international cultural exchanges.[23] 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 and its Member countries are aware of the excessive taxation resulting from Art. 17, which, evidently, would lead to an extra need for subsidies for cultural and sports organizations (and raises the question of whether the countries are trying to protect their own interests with the "Art. 17(3) clause").

Distortion of Competition; Equal Treatment

The excessive taxation that follows from Art. 17 leads to a distortion of international competition because domestic artistes and sportsmen, who do not experience this excessive taxation, are better off than nonresident artistes and sportsmen. Interestingly enough, the OECD acknowledged already years ago that the special tax treatment of artistes and sportsmen causes difficulties. The 1987 OECD Report came to two conclusions on this matter:

> 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.
>
> 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.

This was an interesting objective 17 years ago, but unfortunately no realistic follow-up has occurred. After 1987, the OECD gave preference to the strict anti-avoidance rules of the two paragraphs of Art. 17, with just some minor adjustments, and most OECD Member countries are following this approach.

However, nondiscrimination is now an important issue within the European Union. Generally speaking, there is no harmonization of direct taxation among the Member States, and every country seems to be allowed to set up its income tax law according to its own wishes. However, this flexibility is limited by the EC Treaty, which upholds the fundamental freedoms, i.e., the free movement of persons, capital, and services, and the freedom of establishment. The EC Treaty obliges domestic tax authorities not to discriminate against residents of other EU countries in comparison to domestic taxable persons when they are in equal positions. It is entirely legitimate for a Member State to protect itself against possible loss of tax revenue, e.g., by levying a withholding tax. According to the proportionality principle, however, the withholding tax can only be charged to the foreigner based on an estimate of the extent of his likely tax liability and on equal terms with residents.[24]

Arnoud Gerritse, as explained above, is an interesting example of how to address the distortion of competition that results from onerous artiste and sportsman tax rules for nonresidents. With this decision, the ECJ interfered in both the national tax laws of EU Member countries and their bilateral tax treaties. This also happened in earlier decisions, such as *Avoir fiscal* [25] (tax refunds for foreigners), *Baxter et al.*[26] (deductions for expenses), *Biehl* [27] (normal income tax settlement), and *Asscher* [28] (no higher tax rate for foreigners), all upholding nondiscrimination.

The principle of equal treatment in equal situations also influences the discussion of Art. 17 outside the European Union. The nondiscrimination articles of both the OECD Model Convention and the 1996 U.S. Model Income Tax Convention (Art. 24 in each case) require equal treatment in a bilateral tax treaty context. It is unclear how far-reaching Art. 24 is when it comes to artiste and sportsman taxation, but conceivably it could be read to require most-favored-nation treatment, under which citizens of one country would be granted treaty benefits enjoyed by citizens of another country when they are in a comparable situation. For artistes and sportsmen, this could be the case with respect to the deduction of expenses, the de minimis

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[23] For example, the Netherlands included the "Art. 17(3) clause" in its latest tax treaties with Belgium and Austria, which came into effect in 2003. The ASEAN Model Treaty has standardized the "Art. 17(3) clause." Some countries have inserted the "Art. 17(3) clause" in more than 50% of their tax treaties.

[24] *See* Werlauff, "Remedies Available to Individuals under EC Law Against Discriminatory National Laws," 39 *Eur. Tax'n* 12 (1999), pp. 475-483.

[25] ECJ, 28 January 1986, Case 270/83, *Commission v. French Republic (Avoir fiscal)* [1986] ECR 273.

[26] ECJ, 8 July 1999, Case C-254/97, *Baxter et al.* [1999] ECR I-4809.

[27] ECJ, 8 May 1990, Case C-175/88, *Biehl-I* [1990] ECR I-1779, and ECJ, 26 October 1995, Case C-151/94, *Biehl-II* [1995] ECR I-3685.

[28] ECJ, 27 June 1996, Case C-107/94, *Asscher v. Staatssecretaris van Financiën* [1996] ECR I-3089.

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rule in U.S. tax treaties, the use of the "Art. 17(3) clause," and other exceptions to the basic Art. 17 approach. With these opportunities, more attacks on Art. 17 can be expected in the near future.

Tax Revenue and Administration Costs

Is the need for tax revenue in countries of performance so high that it justifies source taxation of nonresident artistes and sportsmen? As we have shown, the expenses of nonresident artistes can be quite high, equalling or exceeding 50% of gross fees in 95% of the cases, but also will vary considerably among the performers. A withholding tax on net income, i.e., the real income of the artistes and sportsmen from their performances, seems to be the correct way to achieve fair taxation; a withholding tax on gross income, even at a low rate, is too rough a measure.

We also explained above that we have extended the research on expenses in the Netherlands to a period of three consecutive years (2001-2003), including 1600 artistes and groups with a total of 2500 shows. According to the Dutch tax authorities, this covers around 60% of the performances of nonresident artistes in the Netherlands. With these figures and an estimate that nonresident sportsmen are earning an equal amount in the country, an estimate of the annual tax revenue generated by the Netherlands from nonresident artistes and sportsmen is as follows:

Net artiste fees (after expenses) per year:		EUR 3.9 million
Tax on artiste fees (20%) per year:		EUR 0.78 million
Percentage of market in study:	60%	
Total tax revenue from artistes:		EUR 1.3 million
Addition — tax revenue from sportsmen:		EUR 1.3 million
Total tax revenue — artistes + sportsmen		EUR 2.6 million (per year)

Although the Netherlands is a small country geographically, it does have around 16 million citizens. Tax revenue generated by other countries can be estimated as follows, based on the number of their citizens:

	Citizens	*Multiplier*	*Tax Revenue per Year*
Germany	80 million	5	EUR 13 million
United Kingdom	70 million	4.4	EUR 11.4 million
France	60 million	3.8	EUR 9.9 million
Belgium	9 million	0.6	EUR 1.6 million
Spain	60 million	3.8	EUR 9.9 million
United States	290 million	18.1	EUR 47.1 million
Australia	20 million	1.3	EUR 3.4 million

This revenue can only be generated with great administrative expense. At least four types of parties are involved in the process of complying with and applying the withholding tax in the country of performance and the foreign tax credit in the country of residence: (1) tax advisers in the country of residence, delivering the information about the production expenses, as well as tax advisers in the country of performance, for the correct application of the deduction of expenses; (2) the tax administration in the country of performance, that needs to set up a special tax department for nonresident artistes and sportsmen with knowledge about this special group of taxpayers; (3) the promoters of the concerts, theatre plays, and sports tournaments, who need to withhold the tax and declare it to the tax authorities, together with the proper information about the artistes and sportsmen, as well as provide to the nonresident artiste or sportsman a correct and reliable tax certificate; and (4) the tax authorities in the country of residence, who need to check whether the foreign tax credit is based on correct information about the foreign (withholding) tax.

Figures for these administrative expenses are not available, but it is likely these administrative expenses are relatively high compared to the amount of tax collected. The conclusion is that the collection of tax from artistes and sportsmen in the country of performance is not very cost effective.

ART. 17 IS IN NEED OF RADICAL CHANGE

As noted at the outset, some authors have questioned whether the international artiste and sportsman tax system is appropriate in modern times. The authors believe that this article has shown that Art. 17 causes international excessive taxation because the withholding tax in the country of performance is ordinarily much higher than the maximum foreign tax credit allowed in the country of residence. The OECD has already acknowledged the problems of Art. 17, but tries to take away the sharp edges of the article with vague exceptions and does not commit itself to a fair tax system for artistes and sportsmen. The OECD seems to believe that the avoidance behavior of international artistes and sportsmen still justifies a strict and onerous system.

The authors do not agree with this approach and believe that it is time for radical change. Art. 17 can be

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changed to a provision that is comparable to Art. 12 for royalties. This would mean that the OECD would recommend that bilateral tax treaties exempt international artistes and sportsmen from source-state taxation unless the performer has a permanent establishment in the source state. Thus, in most cases, no withholding tax would be levied and an artiste or sportsman would simply pay tax in his home country.

The authors of this article would like to make three observations about this radical change to Art. 17:

- *Anti-avoidance mechanism:* After this radical change, tax avoidance behavior of international performing artistes can be counteracted, perhaps even better than under the current rule. A country's national law is now available to impose a high withholding rate and disallow the deduction of production expenses, as well as exclude nonresident artistes and sportsmen from a normal income tax settlement after the year. When an artiste or sportsman is living in a regular treaty country, this will not cause any negative effect because the bilateral tax treaty will transfer taxation to the country of residence. When a top artiste or sportsman decides to have his residence in a tax haven, no tax treaty will be applicable and the tough withholding system will stay in place.

- *Compliance through exemption procedure:* Exemption in the source state can be allowed during the year of performance, but an exemption procedure is needed to assure that the tax authorities in the country of residence are aware of the foreign earnings. A simple procedure seems to be possible, equivalent to the procedure for royalties (Art. 12).

- *Minimal withholding tax:* When source countries do not want to give away completely their right to tax performance fees of artistes and sportsmen (despite the low revenue figures set forth above), they can insert a low withholding tax of five to 10% in their bilateral tax treaties, as is also the case with royalties. Variations would be possible when some countries just simply want a "piece of the money" that top artistes and sportsmen earn in their country, but it is good to realize that this can bring up the same discussion of the deductibility of considerable production expenses, the obstruction of cultural exchange, and the distortion of competition, all as noted above.

Making Art. 17 of the OECD Model Treaty similar to the royalty provision of Art. 12 seems to be achievable at very low expense. The "exporting" countries of arts and sports may receive higher tax revenue because their residents will be claiming fewer foreign tax credits. Moreover, even though the "importing" countries will experience an initial loss of tax revenue, they will also experience more economic activity when a major obstacle to nonresident artistes and sportsmen entering their market has been removed, leading indirectly to more tax revenue. Thus, both exporting and importing countries might profit from this radical change to Art. 17.

SUMMARY AND CONCLUSIONS

Most countries in the world impose a withholding tax on the performance fees of nonresident artistes and sportsmen, and residence countries allow a foreign tax credit to avoid double taxation. This system deviates from the normal tax rules for employees and self-employed/companies, but seems acceptable at first glance. It takes away the risks of tax avoidance and noncompliance, which is the reason for inserting Art. 17 as a special provision in the OECD Model Convention (since 1963) and in the U.S. Model Convention.

Unfortunately, examples show that excessive international taxation occurs very often in practice, and sometimes even the foreign tax credit is unobtainable because of incompatible subjects or exemptions. The national tax rules in many countries seem too strict, not allowing the deduction of production expenses or normal income tax settlements, and finalizing the taxation with a gross withholding tax. The existing tax systems create an obstacle for the free circulation of international artistes and sportsmen. The OECD acknowledges the negative effects of Art. 17, but only allows minor exceptions to its general rules and gives higher priority to anti-avoidance measures than to the equal treatment of nonresidents.

Within the European Union, the unequal treatment of nonresident artistes and sportsmen violates the basic freedom principles of the EC Treaty, as indicated by the European Court of Justice in *Arnoud Gerritse*. After this decision, not only Germany but also many other EU countries, including the new Member States, need to change their legislation drastically.

Art. 17 of the OECD Model Convention should also be changed drastically, following the system of Art. 12 for royalties. This would lead to home-state taxation in normal treaty situations, but leave the withholding tax regime in place for artistes and sportsmen who choose to reside in tax havens. With this change, tax avoidance schemes would still be counteracted, but excessive taxation would become

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very unlikely for treaty residents. An official exemption procedure, involving certification by the tax administration in the country of residence, would assure compliance with the tax laws of the country of residence. The authors believe that none of the countries involved need be worse off after this radical change. Both sides can profit from the increase in economic circulation, either through direct or indirect tax revenue. Most importantly, international artistes and sportsmen who are residents of treaty countries and performing in other treaty countries would no longer suffer from harsh and anti-competitive source-country taxation.

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