Star Companies in International Tax Law

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I. Introduction

1. Overview

The use of an enterprise such as a **service company personally owned** by **the artiste or sportsman** (a "Star" company; sometimes also called a "Rent-A-Star company") is a well-known phenomenon with regard to the aim to lower the tax burden of, in particular, artistes and sportsman who are active internationally. Ever since such companies have been being used for tax planning schemes, their abusive intention has been obvious[1]. However, not all structures are to be characterized as tax evasion; some of them having objective business reasons that could be regarded as legal tax avoidance[2].

The latest judgment by the **England and Wales House of Lords (judgment re** Andre **Agassi** v Robinson[3]) applied the British "look through" approach and decided: *"The British tax liability has never been exclusively limited to British subjects and foreigners resident within the jurisdiction*, according to Lord Scott of Foscote. *(All) Payments made to Agassi Enterprises Inc., a non British ("=Rent-A-Star") service company, shall therefore be characterized as if such payments shall be made to the individual Agassi, performing in the UK*[4] *"*. No

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1 **Johansson v. United States**, 14 American Federal Tax Reports 2d, (AFTR 2d) 5605 (1964): Johansson, a boxer, thought to claim exemption from US taxation under Art. X(1) (dependant personal services) of the 1951 DTC US-CH. This provision allowed an exemption from US taxation for Swiss residents who were present in the US for 183 days or less during the taxable year and who performed services as employees of Swiss corporations. Therefore, Mr. Johansson entered an employment contract with Scanart SA in the same month that a title fight was to be held in the USA. The Court decided that the exemption was not available to Mr. Johansson, because, although a Swiss citizen, he was actually resident in Sweden, where his social and economic relations were. In addition, the Court determined that Scanart SA was merely a device to escape US taxation and imposed income tax directly on Mr. Johansson.

2 Tax avoidance means behaviour that is legal and that results in tax savings. Tax avoidance is the use of legal methods to pay the smallest amount of taxes necessary. It is thus a form of legitimate tax reduction. This is in accordance with the principle of legality of taxation. The Swiss Supreme Court has always held that a taxpayer may arrange its business in order to pay less tax, as long as such arrangements are not abusive. BGE 102 Ib 151, http://www.bger.ch/index/juridiction/jurisdiction-inherit-template/jurisdiction-recht/jurisdiction-recht-leitentscheide1954-direct.htm; **98 Ib 314**.

3 **England and Wales House of Lords judgment re Andre Agassi v Robinson** (HlMT) [2006] UKHL 23 [2006] STC 1056; the Crown won;
In this case, Andre Agassi, an international tennis player ordinarily resident and domiciled in the USA, set up a company (Agassi Enterprises Inc., AE Ltd.) controlled by himself. Through the company he entered into endorsement contracts with two manufacturers of sports clothing (N. Inc. and H SPORTS AG), neither of which was resident in or had a tax presence in the UK. During the tennis tournament Agassi played in London each year. AE Ltd. received payments from N Inc. and H Sports AG, which derived at least in part, from Agassi's activities performed in those tournaments.

4 Lord Scott of Fuscote; N 15, *"It would mean that foreign entertainers and sportsmen, who earn money from commercial sponsorship contracts connected with their profes-*

reference to the OECD MC Art. 17 para. 1 was made in this judgment[5].

This judgment does not take into account the generally accepted principles of the OECD MC. By failing to respect the existing DTC UK – US, the House of Lords created a British "island" approach which will have to be scrutinized in future day-to-day application, especially considering the DTC's allocation rights.

2. Reasons for interposing an enterprise

According to the OECD's 1987 report, it is the rich and famous artistes and sportsmen in particular who try to escape normal taxation via avoidance schemes and slave arrangements[6]. Pursuant to the OECD, artistes and sportsmen try to **reduce their tax burden**, to **defer the tax** to be paid on earned income by interposing a legal entity with a seat in a no or low tax jurisdiction and routing their income through such an entity and finally to realize tax **optimal passing-through** of sheltered income to either a domestic holding company or to the company's "tax haven" residence state.

The **use** of such companies with regard to **structures** available under civil law results in a first **tax advantage** (shifting and sheltering the respective income by tax deferral), using low or no tax countries as their state of incorporation/state of statutory seat. The advantage of saving the income in the interposed company without distribution (tax-free sheltering) ends up in**tax deferral.**

The **privileged taxation** of **dividend income,** most likely paid out at a later time, **in the residence state** of the artiste/sportsman is a further advantage of such a strategy. This is because the **performance income** is **converted into dividend income,** which may be taxed more favorably (e.g. in countries with a dual income taxation system)

The artiste/sportsman may largely or entirely escape host-country tax by receiving only a small salary from his/her performance in the year the services are performed since Art. 17(1) only applies to salaries paid to the artiste/sportsman[7]. The artiste/sportsman may arrange to receive further payments in a later year,

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sional activities in this country, can avoid liability to tax on this money simply by ensuring that the money is paid by a foreign company with no trading presence or assets in this country";
http://www.internationaltaxreview.com/?Page=9&PUBID=210&SID=676911&ISS=23419.

5 Merchandising and endorsement income as well as prize money directly linked to the performance in UK will therefore be taxed, based on a unilateral, domestic look-through approach, as provided for the British income tax law, section 556 (2) ICTA 1988, replaced by Income Tax (Trading and other income) Act 2005, March 25, 2005, Section 13.

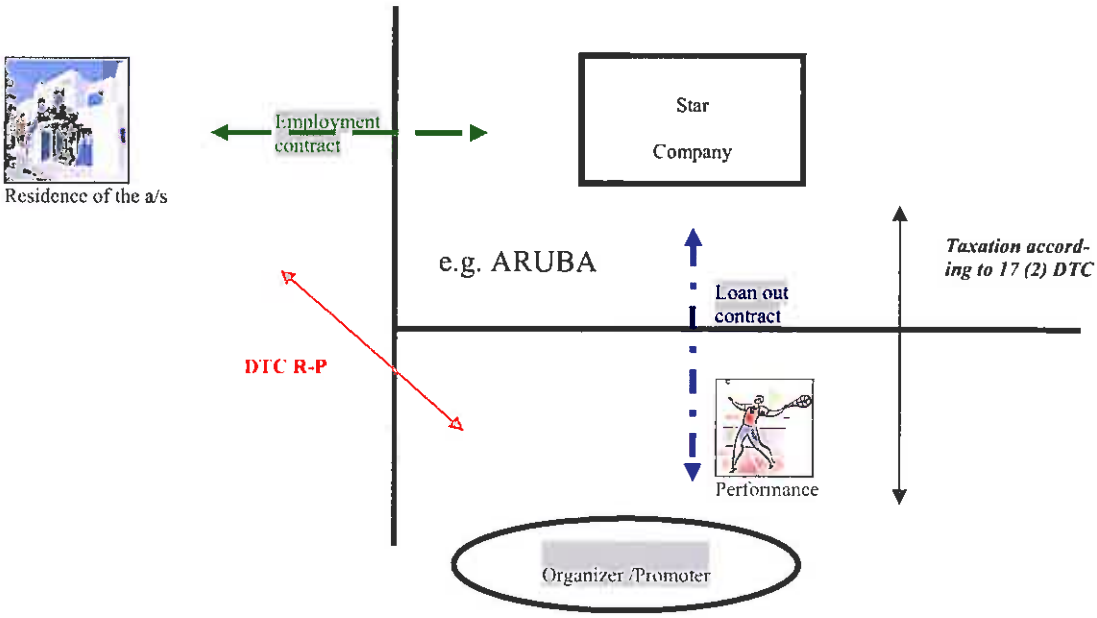
6 OECD, Taxation of Entertainers, Artistes and Sportsmen, *Issues in International Taxation No. 2, OECD, Paris 1987,* Paras. 6-8, 25-26.

7 Malin, Employed Artists and Sportsmen according to the OECD Model, in this book.

when he is not subject to host-country tax, perhaps as deferred salary payments, dividends or liquidation distributions. The benefits may also include deductible accident and medical insurance programs, group-term life insurance and qualified retirement plans, paid by the interposed entity on behalf of artiste/sportsman. Sometimes (or even often) the interposed company fulfills an economic role for the artiste/sportsman. The interposed company acts e.g. as an **organizer** of concerts, festivals and other entertaining events, **being responsible for all arrangements** other than strictly local ones, i.e. employment of staff, organizing traveling arrangements and accommodation, taking care of stage arrangements, and a diversification of risks. When all **business relations are concluded on an arm's length basis**, no abuse occurs and therefore no "look-through" approach should be taken. Also, the acceptance of such a construction should not depend on where the interposed entity is located and should rather be determined on the basis of the criteria mentioned earlier, i.e. the "business reason or substance over form doctrine".

3. Rent-A-Star structures found in practice

A basic case[8] illustrating the tax planning and tax avoidance possibilities is the following:



The artiste/sportsman sets up a corporation in a low-tax country. The artiste/sportsman enters into an employment contract with the corporation. The

[8] BFH decision of October 29, 1997, *IWB, Fach 3a, Gruppe I*, at 653 et. seq.

agreements with the promoters are concluded by the corporation rather than the artiste/sportsman. Whereas artistes/sportsmen are, in principle, subject to limited tax liability in the country in which they perform their activities, a corporation residing in a DTC country may be taxed in the source country only if it maintains a PE in the state of performance.

The developed states (especially OECD member countries) have mechanisms in their national laws that are designed to counteract such strategies. Many states provide for a look-through approach for taxing the income of the entity as income of the artiste or sportsman. Even without specific anti-abuse rules, general income attribution rules enable states to treat the income as being accrued to the artiste sportsman himself if the interposed entity turns out to be merely artificial. If there is no treaty, the state of performance is free to look through or to tax the Star Company according to its domestic tax rules of limited tax liability. A very broad survey of such domestic allocation rules is given in section II of the present contribution.

However, if a tax treaty is applicable, it restricts the taxing rights of the contracting states. Depending on whether the treaty contains only an Art. 17(1) or also an Art. 17(2), the range of the taxation rights in the state of performance for payments made to the interposed company in connection with sportive or artistic events is different. This will be illustrated in section III of the present contribution.

If we look for **court cases**, a number of cases have been decided[9] so far. Inter-

[9] **Gordon Sumner, Roxanne Inc. v. The Queen.**, *7 December 1999, 2000 D.T.C. 1667, [2000]2 C.T.C. 2359;* In this case, the North American tour took place under the aegis of Roxanne Music. Inc., incorporated under the laws of Delaware (USA). Roxanne Inc. was contractually obliged to pay Mr. Sumner 95% of its net profit before any deduction for amounts paid to him. It seems somewhat improbable that a company whose function is to handle Mr. Sumner's concert tours in Canada, the US, Japan, Australia and New Zealand and which is committed to paying him 95% of its profits can be considered to be at arm's length with him.
Supreme Administrative Court of Finland, *January 29, 2001, No. 139/2001*; *ET*, 2001, 344.
Supreme Administrative Court of Sweden, *ET*, 2003, 475: A company resident in the Netherlands presented the show "Holiday on Ice" in Sweden, where the artistes were taxed on their salary in accordance with **Art. 17 (1) of the DTC NL-SWE**. In addition, the Swedish authorities wanted to tax the entrance fees charged by the company. The Court rightfully decided, however, that this paragraph, as it intends to prevent tax avoidance by way of "artistes companies", referred only to compensation paid for the activity of the artiste/sportsman, not to additional income derived by their employer through making the activity public.
Court of Appeal of Amsterdam, *October 6, 2004, No. 01/04112*; *ET*, 2005, 259.
During 1999 a Dutch resident individual, a professional ice skater who participated in games at the highest international. level, signed a contract with the Dutch Royal Skating Association regarding membership on the team. Under this agreement, the athlete was entitled to financial remuneration which consisted of six parts: basic salary and another of which was apparently prize money. The main issue was whether or not in respect of the amount of basic salary attributable to the time spent in Austria, Germany and Spain

estingly enough, some of the Court decisions seem to be quite arbitrary[10], especially when it comes to the reasoning.

However, most of the decisions are based on domestic law and do not deal with treaty rules.. Therefore, the intentions in the OECD MC were not considered in the decisions[11]. Quite surprisingly, none of the Court cases dealt with a hybrid structure, which is quite usual when it comes to international tax planning and structuring (e.g. IP and merchandising structures). Of course, such structures have been implemented, otherwise famous tennis players or formula 1 drivers would spend a lot of their income in paying taxes.

Since Star Companies offer a wide array of avoidance possibilities, they are not

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the athlete was entitled to the application of the measure for the avoidance of double taxation provided for in the applicable DTC.
Supreme Court of Switzerland, *ET* 1990, 307: X AG, a Swiss resident loan-out corporation, administered the copyrights of several non-Swiss writers. The shares were owned by partners and employees of a local law firm! Later, the activities shifted to serve the interest of non-Swiss entertainers exercising personal services in countries outside Switzerland, mainly the UK and USA. X AG entered into contracts with foreign producers in the capacity of the employer of the individual entertainer. X AG managed to receive payments for the entertainer's performance and the receipts were passed over to the entertainer. X AG retained only a modest fee of 3% to 5%. The Supreme Court did not characterize the contracts as fiduciary but instead to be classified as employment contracts and concluded that these contracts were a mere **sham** aimed at avoiding foreign WHT. Therefore, the conduit of 95%-97% of X AG's receipt was viewed as foreign tax evasion. However, the Supreme Court indicated that such loan-out activities would be accepted if the commission retained by the loan-out company amounted to at least 10 %. This judgment indicates that a Rent-A-Star company bearing a true entrepreneurial risk will be recognized by the (Swiss) tax authorities.

10 **Central Economic and administrative Court of Spain**, Vogel, Tax Treaty News, *IBFD* 2001, 319: A Spanish organizer of entertainment events paid an artiste compensation for giving certain concerts in Spain. In addition, he paid a considerably higher sum – for showing the concerts in TV – to a Dutch company that held the contractual rights to publishing pictures of the artiste and using her name. The Court considered the latter payment not to be royalties, but additional compensation for the personal activities of the artiste. Art. 18 of the DTC E-NL corresponds to Art. 17(1) OECD MC, but does not contain a clause similar to Art. 17(2). The Court interpreted Art. 18 of the DTC E-NL as if it were identical to the OECD Model's full Art. 17, i.e. as if the DTC concluded Art. 17 (2). As a result, the Dutch company was held to be taxable in Spain. Art. 17(2) was inserted into the **MC in 1977**, whereas the **DTC E-NL was concluded in 1971**. Obviously, the **Court assumed the intentions of the 1977 MC to be part of the DTC**.
In an earlier case, the Court applied Art. 7 of the DTC E-NL and concluded, that due to lack of a PE in Spain, the company was not taxable in Spain. The Court refused to apply Art. 17(2) by way of interpretation and did not even take the anti-avoidance rules into consideration.

11 In the Agassi Case the question was solved based on **unilateral British tax law**, section 555/556 ICTA 1988, although the case made reference to the DTC UK-US; in the Johansson Case the court denied that Johansson was resident according to the DTC US-CH and concluded that the circumstances surrounding the formation of the interposed company, the terms of the contract and the conduct of the parties failed to deviate from the basic rule that income from services is taxable where the services are rendered.

favored by the tax authorities. It is also understood that e.g. the US major sports leagues approach Rent-A-Star Companies with reluctance. It is reported, for example, that their use by players in major league baseball, the National Football League, and the National Hockey League has not been widespread, and that the National Basketball Association[12] does not permit its clubs to contract with loan-out companies[13].

II. Domestic income allocation – the example of Switzerland

1. Non-resident artistes and sportsmen are subject to the Wage Withholding Tax Procedure (WWTP[14])

Non-resident artistes/sportsmen exercising their **personal activity** in Switzerland are **subject to limited (Federal and Cantonal) income taxation**[15] and the tax is levied at source[16].

1.1 Income directly paid to artistes/sportsmen

Since the WWTP applies irrespective of the nationality of the taxpayer, Swiss artistes/sportsmen resident abroad are also taxed at the source if they derive employment/business income from sources in Switzerland[17].

For purposes of Art. 92 DFTL, it is irrelevant whether the **performance-related income** qualifies as employment income, as self-employed service income, or even as business income. Any income that is **attributable to the artiste's /sportsman's person** rather than to the artiste's/sportsman's performance is **not subject to tax**[18].

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12 Johnson vs. Commissioner, 78 T.C. 882 (1982).

13 Betten, *The International Guide to the Taxation of Sportsmen and Sportswoman*, 2004, USA Report, 86.

14 Cadosch, The influence on Swiss tax law of the Swiss-EC agreement on the free movement of persons,2005, 54

15 Art. 5 (1) (a) DFTL.

16 Art. 92 DFTL.

17 The procedure with regard to non-residents contains some important distinctions with the WWTP for resident (foreign) taxpayers: Non-resident taxpayers do not benefit from the retroactively applied ordinary procedure for taxpayers with employment income exceeding CHF 120,000.-, or from the correction of the tax rates in individual cases.

18 Altenburger, Taxation on non-resident entertainers / Swiss contribution, *IFA 1996, Volume 20d, 132*, distinguishes between attendance fees (personenbezogenes Einkommen) and income for personal activities (auftrittbezogenes Einkommen). The attendance fee would not be subject to limited taxation in Switzerland. **Sponsoring income** is attributable to the event and not to the artiste's/sportsman's activity and is generally not subject to tax under Art. 92 DFTL. Switzerland does not levy an (ordinary) **withholding tax** on royalties domestically. **Royalty payments** are possibly also not covered by Art. 92 DFTL, since they are achieved by financial participation in the commercial exploitation

1.2 Income paid to third parties (indirectly paid to artiste/sportsmen[19])

The same rules are applicable with respect to **remunerations paid to a third party. Unless** either the **artiste/sportsman** or an **affiliated person benefits** directly or indirectly from the third person's **profit**, the **WWTP** applies only to the **part of the remuneration**[20] that is **forwarded to the** artiste/sportsman[21].

The **taxation** of the third person's **remaining profit depends** on the third person's residence. If the third person is **resident in Switzerland** or **abroad, in a non-DTC state, "domestic" tax law prevails:** In the former case, the profit element of the third person will ordinarily be taxed (unlimited tax liability of the third person in Switzerland). According to Art. 5 (2) DFTL. in the latter case, only the part of the income that is attributable to an artiste's/sportsman's performance in Switzerland is subject to tax (performance-related income), regardless of whether this third party is an individual or a legal entity.

These **rules**[22] regarding the **taxation of income paid to a third party** are currently being **challenged by the UEFA**[23]. In this case the UEFA paid remunerations to the national football federations involved. From the UEFA's point of view, **remunerations** should not to be **taxable** in Switzerland but **only** in the **state of residence** of the football players. The UEFA pointed out that it does **not pay income** related to the performance of the football player, but a "premium" to the participating football clubs[24]. According to the DTC CH-UK the remunerations related to a performance are subject to tax where the artiste/sportsman performs. Performance-related income is taxed even if it is paid to a third party.

2. Allocation rules according to DTCs[25] concluded by Switzerland

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of a personal right, which may not be performance related.

19 Art. 5 (2) in connection with Art. 92 (1) DFTL applies if the event takes place in Switzerland, although Art. 92 (1) DFTL in the official German version of the tax code, in contrast to the French and Italian version, does not define the notion sportsmen. This is considered to be an error of the Swiss legislator and does not matter, since all four languages are declared equally binding (Art. 70 (1) and (2) of the Federal Constitution as of 18 April 1999).

20 Adequate proof has to be filed with the tax authorities, e.g. loan-out contract concluded between the artiste/sportsman – third party.

21 Circular letter, published by the Swiss Federal Tax Administration, 1 July 2004; http://www.estv.admin.ch/d/dbst/dokumentation/rundschreiben/2-019-D-2005-d-Beilage4f.pdf

22 Art. 5 (2) DFTL in conjunction with Art. 92 (1) DFTL.

23 The pending case to be decided by the Tax Commission of Appeal of the Canton Berne, concerns remunerations paid by the UEFA with regard to the Champions League game FC Thun- FC Arsenal London, played in November 2005 in Berne.

24 Art. 17 (1) & (2) DTC GB-CH are similar to Art. 17 OECD MC. DTC GB-CH: http://www.admin.ch/ch/d/sr/i6/0.672.936.712.de.pdf; Zeitung „Der Bund" ,January 25 2007, http://www.espace.ch/artikel_310686.html

25 Circular letter, published by the Swiss Federal Tax Authorities; http://www.estv.admin.ch/d/dbst/dokumentation/rundschreiben/2-008-D-2004-d-

2.1 Income directly paid to artiste/sportsmen

Most of the Swiss treaties contain articles similar to Art. 17 of the OECD MC[26]. None of the DTCs concluded by Switzerland have adopted Art. 23 (B) OECD MC (credit method); however, they tend to follow the pattern of Art. 23 (A) OECD MC (exemption method)[27].

Swiss-source performance income paid to an artiste/sportsman will be **taxed at source** if:

- the artiste/sportsman is resident of a state with which Switzerland did **not conclude a DTC**;
- the artiste/sportsman is **resident in a double tax contracting state**. The corresponding **DTC allocates the right to tax to Switzerland** (state of performance) under Art. 17 (1). This is typical of most of the DTC concluded by Switzerland[28]. However, there are reservations on this in two DTCs. This will be discussed in the following.

Since **income** from the activities of artiste/sportsman does not regularly **accrue to** the artiste/sportsman but instead to **third persons**, such as a management company, an association (e.g. football team) or a Star Company, Switzerland made a reservation to Art. 17 (2) of the OECD MC to the effect that Switzerland only wants to apply Art. 17 (2) to abusive schemes[29]. Most of Swiss DTCs contain a provision similar to Art. 17 (2) OECD, with the exception of six[30].

Moreover, the **majority** of the Swiss DTC provide expressly that where there are doubts **performance-related income paid to a third party is taxed** only in the state of performance even if there is not **sufficient proof** that **either** the **artiste/sportsman** or an affiliated person **benefits** directly or indirectly from the **third person's profit.**

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26 Besides, states may limit the application of the article only to individuals carrying out independent activities, prevailing Art. 17 OECD MC of the DTC only to Art. 7 OECD MC (in most DTC still Art. 14), but not to Art. 15 OECD MC. However, Switzerland did not negotiate such a restriction in any of its DTCs.

27 Oberson/Hull, *Switzerland in International Tax Law*, IBFD 2001, 146.

28 Circular letter, 2.1, see footnote 21.

29 Therefore, separate legal entities with normal employer-employee or similar contractual relations, based on dealing at an arm's length basis, fall outside the scope of Art. 17 (2) MC: "The article [should only apply to cases mentioned in sub-paragraph 11c) above]..." OECD MC, Art. 17 MN 17. In all the other cases, the rules of business profit taxation should prevail.
Interestingly, there is an inconsistency between the "official" reservation mentioned above and the published practice (Circular letter, see footnote 25). According to this Circular letter (2.2) remunerations paid to third parties are taxed at source, even if there is no abusive structure at all, if the artiste/sportsman benefits directly or indirectly from the third person's income! Therefore, the current Swiss practice related to third party remunerations is not, as pointed out in the OECD MC, restricted to cases of abuse.

30 Ireland, Morocco, the Netherlands, Pakistan, Portugal and Spain.

If Switzerland **concluded a DTC** with the **state** of **residence of the third party**, the taxation rights of Switzerland are granted according to the business profit rule of Art. 7 (1) OECD MC, i.e. the third person maintains a PE in CH or the independent personal service income rule (former Art. 14 OECD MC).

2. 2. Special cases

With regard to the **DTC CH-NL** there is a peculiarity to be considered. Although this DTC does mention artistes and sportsmen in the respective article, the DTC allocates the right to tax to Switzerland only for artistes. Hence, sportsmen may only be taxed in the state of the performance under this treaty if they have a PE in the state of performance. With regard to the DTC CH-NL, an actual case was decided on 19 January 2007: The UEFA made payments to the national football federations involved. From the UEFA's point of view, the **remuneration** was not **taxable** in Switzerland but **only in the football players' state of residence**. The UEFA pointed out that it does **not pay income** related to the performance of the football player, **but a "premium" to the participating football clubs**.

The Tax Administration of the Canton Berne approved the appeal of the European Football Association (UEFA) against the source tax assessment with regard to the Champions League football game FC Thun – Ajax Amsterdam FC. In the decision it was pointed out that DTC CH-NL does not allocate to Switzerland the right to tax the remunerations in connection with a sportive performance in Switzerland. The DTC CH-NL does not contain a special provision with regard to the taxation of sportsmen, but only for artistes. Therefore, for sportsmen the general rules of the treaty apply. Consequently, one has to distinguish between sole traders and employees. Dutch sole traders are only taxable in Switzerland if they carry on business through a p.e.PE in Switzerland[31], which will hardly ever be the case. Dutch employees, on the other hand, will be taxed in Switzerland under Art. 15, unless the 183-day rule is applied[32].

The latter could apply to payments made by the UEFA to football players employed by the foreign club. By contrast, payments not directly paid for the performance of the players (such as performance-related premiums paid to the club) may not be taxed in the state of performance under Art. 15 of the treaty. Therefore, the corresponding DTC did not allocate any right to tax to Switzerland at all. Interestingly, there are no other legal arguments presented in this case.

[31] Art. 5 (1) DTC NL-CH.
[32] Art. 6 (2) DTC NL-CH.

III. The international allocation rules – an overview

1. A review of Art. 17 OECD Model Convention

A review of the history of Art. 17 of the current OECD MC reveals that it was inserted in the MC because it was believed that artistes and sportsmen would have a tendency not to report income earned in the source country to their country of residence[33]. The 1963 draft of the OECD MC provided in Art. 17 that the right to tax the income of a performance of artistes and sportsmen is allocated to the country of performance, but not exclusively, setting aside the normal allocation rules of Arts. 7, 14 and 15[34].

Art. 17 was extended in 1977 by adding a **second paragraph**, which provided that where **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**[35]", most often owned by themselves, which contract for the performances of the artistes and sportsmen. **Para. 4 of the 1977** Commentary indicates that the OECD did not intend to attack normal employer-employee relations in Art. 17 (2) OECD MC. The text of the 1977 MC made it clear: rather, the **purpose** was to **counteract** the **tax avoidance schemes of self-employed top artiste/sportsman**[36]. However, the wording was much broader than necessary for this object and purpose in the 1977 Commentary.

In **1987**, the **OECD** Committee on Fiscal Affairs published a **report**[37], that referred to a study based on 19 country submissions. Some countries had reported to the OECD that top artistes and sportsmen were **loaned out** by **companies**, which gave the artistes and sportsmen a small salary and received the main part of the performance income as a company profits. These considerations were mentioned as if Art. 17 (2) OECD MC had not been introduced 10 years earlier[38].

The mistrust and suspicion that rich and famous artiste/sportsman in particular were trying to escape from normal taxation[39] became more marked. The **main purpose** of the 1987 report was "to help Member countries to establish a system by which the income of artiste/sportsman could effectively be taxed in the coun-

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33 Nitikman, 269.

34 In 2001, Art. 14 was removed.

35 The (Rent-A-)Star companies provided the services and were established in a tax haven country without normal income or corporation tax and there were almost no tax treaties with such jurisdictions (Molenaar/Grahms, Rent-A-Star: The purpose of Article 17(2) of the OECD Model, *IBFD Bulletin* (2002), 500).

36 Molenaar, *Taxation of International Performing Artistes* (2005), 37.

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

38 Molenaar, *Taxation*, 41.

39 OECD, *Paris 1987*, MN 6, 7, 8,9, 25 and 26.

try of performance[40]. Six major **elements from the 1987 Report have been transferred** to the **1992 Commentary** on Art. 17 of the OECD MC[41]. With regard to the topic here, the most interesting point of these six amendments is obviously **the reversal from the limited to the unlimited approach** in the **Commentary** of Art. 17 (2) OECD MC. The unlimited approach was laid out in Para. 11 of the Commentary that was changed in 2000: **Not only Rent-A-Star Companies but also incorporated teams, troupes etc. fall within the scope of Art. 17 (2) OECD MC**. This 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 PE in the country of performance, a separate legal entity could be taxed, although it was not an artiste/sportsman itself[42].

2. Interpretation of the revised allocation rules of Art. 17 OECD MC in the 1992 Commentary

Although the text of Art. 17 OECD of the Model Convention itself remained unchanged in this context, the OECD Commentary's 1992 version, Para. 8 provided for changes. According to Art. 17 (1), the state of performance's **primary right to tax is limited** to cases were income accrues "in the entity for the individuals benefit"[43]. Therefore, the state of performance is not entitled under the look-through approach of Art. 17(1) OECD MC to tax the profit element accruing to the beneficial ownership of the third person[44]. Unfortunately, the term "income"[45] has not yet been defined.

Under **Art. 17 (2)**, by contrast, it is not the person of the artiste or sportsman himself, but a third person receiving the income of an artiste or sportsman that can be taxed in the source state, regardless of the question whether the artiste or sportsman himself receives any payments. Para. 11 of the Commentary takes the position that **Art. 17 (2)** OECD MC does not limit the application of Para. (2) to devices of tax evasion and lists three main cases for an application:

- The **management company** that receives income for the appearance of

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40 OECD, *Paris 1987*, MN 16 and 17.

41 1. a clearer definition of the term artiste, based on Para. 67-69 of the 1987 Report; 2. the income received by impresarios are not covered by Art. 17; 3. a different allocation of performance fees and royalties (special attention to sponsorship and advertising fees); 4. the approval of gross taxation; 5. the reversal from the limited to the unlimited approach of Art. 17 (2); 6. the agreement to an exception for (cultural) events, supported by public funds.

42 Molenaar/Grahms, Rent-a-star: The purpose of Article 17(2) of the OECD Model, *IBFD Bulletin* (2002), 502.

43 Fifth sentence of Para. 8 of the Commentary on Art. 17 of the OECD.

44 Juárez *Limitations to the Cross-Border taxation of Artistes and Sportsmen under the Look-Through Approach in Art. 17(1) of the OECD MC, ET* 2003, 458.

45 For details: Bramo, *The notion of "income" in the sense of Art. 17 OECD MC* in this book.

e.g. a group of artistes/sportsmen,

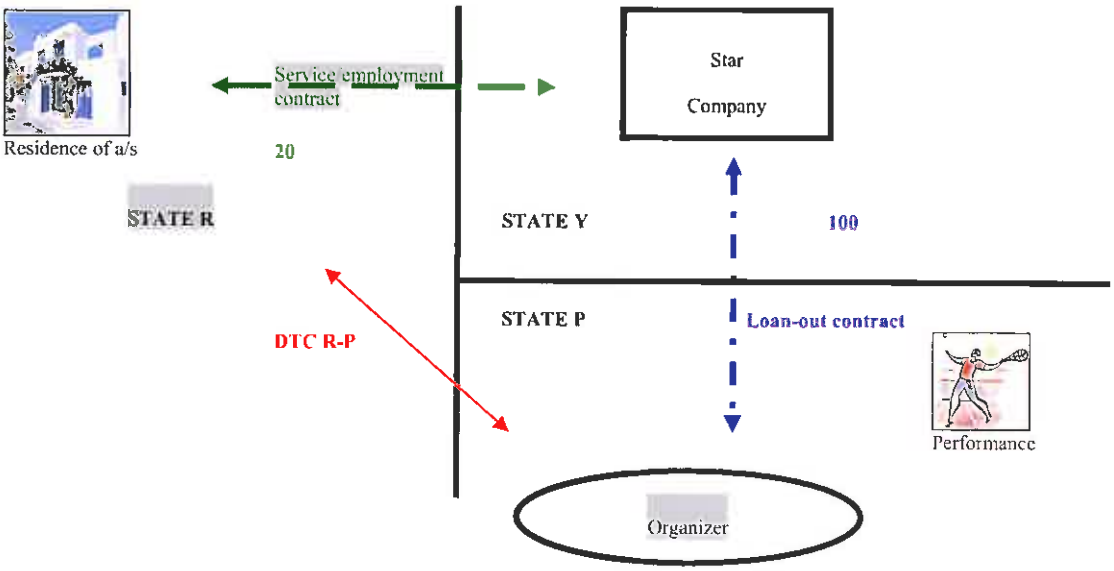
- The **team, troupe, orchestra**, etc. that is constituted as a **legal entity** and
- The "**artiste-company**", a tax avoidance device, where the performance income of an artiste/sportsman is paid to another person, the artiste company and not to the artiste/sportsman.

The first two cases were a **new interpretation** with regard to the 1977 Commentary. The **last case** corresponds to Para. 4 of the 1977 Commentary[46]. As pointed out before, the object of Para. (2) is **not to allocate** to the state of performance the taxation of **business profits**, but to obtain a right to **tax income** derived by artiste/sportsman from their **personal performance-related services** as such that **accrues** not to the artiste/sportsman himself but **to another person**[47], in other words to anyone other than the artiste/sportsman.

IV. The scope of Art. 17 (1) OECD MC

1. Interposition of a legal entity

Diagram 1



[46] See section III./1.
[47] OECD, *Paris 1987*, MN 89, 1st lemma.

Facts:

State R and State P have concluded a DTC along the lines of the OECD MC. The artiste/sportsman is resident in State R. He signed a contract (e.g. an employment contract or a service contract) with his Star Company, set up in a low-tax country Y (e.g. Switzerland). The Star Co. concluded an arrangement with the Organizer of the event in state P and "loaned out" the artiste/sportsman to the event organizer for the performance. According to the contract with the organizer, Star Co. receives 100 and pays a salary of 20 to the artiste/sportsman, which is related to the specific performance given in state P.

Solution:

According to **Art. 17 (1)** DTC R-P, the right to tax the **remuneration (20)** paid to the artiste/sportsman is allocated to State P, because the remuneration is derived from an activity performed in state P. Art. 17 (1) is applicable regardless of the fact that the income of the artiste or sportsman is paid to him by a third person (in this case his star company). If the artiste/sportsman "receives performance-related income" form his Star Co, state P has the same taxation rights as if the compensation had been paid directly to the individual performer.

However, under Art. 17(1) State P has no taxing right for the "**business profit**" portion (80). The profit element, however, accruing from a performance to the interposed legal entity would be liable to tax under Para. (2). This interpretation suggested by the OECD Commentary[48], which is followed by the Swiss tax authorities[49], is, however, not undisputed in the literature[50].

According to Swiss domestic tax law: if the artiste/sportsman or an affiliated individual benefits directly or indirectly from the interposed entity's profit, the remaining business profit must be taxed at source accordingly[51]. In this case a tax treaty (not containing an Art. 17 [2]) would restrict Swiss national law, as under tax treaties only containing Art.17 (1)[52] [citation style is not consistent!] Switzerland could not levy a tax on income derived by third persons, as far as the profit element is concerned.

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48 OECD MC, Art. 17 MN 11, 11th sentence; see footnote 30

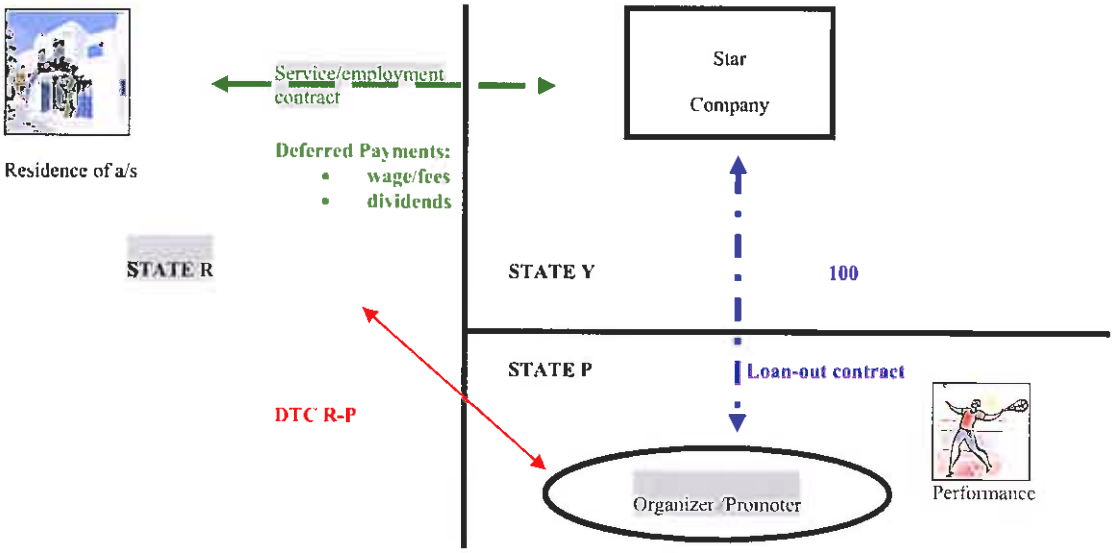
49 Circular letter of the Swiss Fed. Tax Authorities, 2.2, http://www.estv.admin.ch/d/dbst/dokumentation/rundschreiben/2-029-D-2006-d-Beilage5.pdf.

50 A. Malin, Employed Artistes and Sportsmen, in this book, who is of the opposite opinion with reference to the literature and court decisions.

51 2.2 of the Circular letter, published by the Swiss Federal Tax Authorities; http://www.estv.admin.ch/d/dbst/dokumentation/rundschreiben/2-008-D-2004-d-beilage7.pdf

52 Ireland, Morocco, Netherlands, Pakistan, Portugal and Spain, see footnote 30.

Diagram 2



Facts:

The basic facts are similar to those in diagram 1, but in this scenario, the Star Co. does not pay any remuneration in the current tax year to the artiste/sportsman. Instead, the Star Co. might most likely distribute a dividend or forward the money at a later time in the form of wages or service fees.

Solution:

Art. 17 (1) DTC R-P allocates the taxation rights with regard to *"income derived by .... as an entertainer .... or as a sportsman...from his. personal activities as such exercised in the other contracting state, may be taxed in that other"*. The artiste/sportsman might argue that no remuneration has been derived by him and, therefore, according to **Art. 17 (1) State P does not have any taxation rights**. If the remunerations will be paid to the artiste/sportsmen at a later time, Art. 17 (1) should be applicable, as income is derived by the artiste in connection with an activity (previously) performed in state P. Hence, basically the taxation rights kick in, as soon as the income from the (former) performance accrues to the artiste or sportsman.

However, there will be practical difficulties, as potential withholding taxes levied in year 1, when the payments are made by the organizer to the star company, will have to be refunded on the request of the star company, as soon as the latter proves that no income accrued to the artiste or sportsman. When in later years such payments are made to the artiste or sportsman and the taxation rights under Art. 17 (1) kick in, there are no more possibilities for state P to get hold of tax.

With regard to the profits sheltered in the Rent-A-Star Co., the question arises whether or not dividend payments might also fall under Art. 17 (1). The answer to this question is negative, since Art. 17 allocates only performance- related income derived by an artiste/sportsman and does not prevail over Art. 10 OECD MC. It follows that income transformed into dividends avoids the artiste's/sportsman's taxation in the state of performance under Art. 17 (1).

This shows that – from the states' perspective – good arguments speak in favor of introducing an Art. 17 (2) in their tax treaties, in order to solve legal and factual problems with the collection of taxes in the case of tax schemes with companies wholly owned by artists and sportsmen. Art. 17 (2) – undisputedly – grants a taxing right to the state of the performance regardless of the question whether income accrues to the artiste or sportsman himself.

2. Partnerships[53]

2.1 Transparent partnership

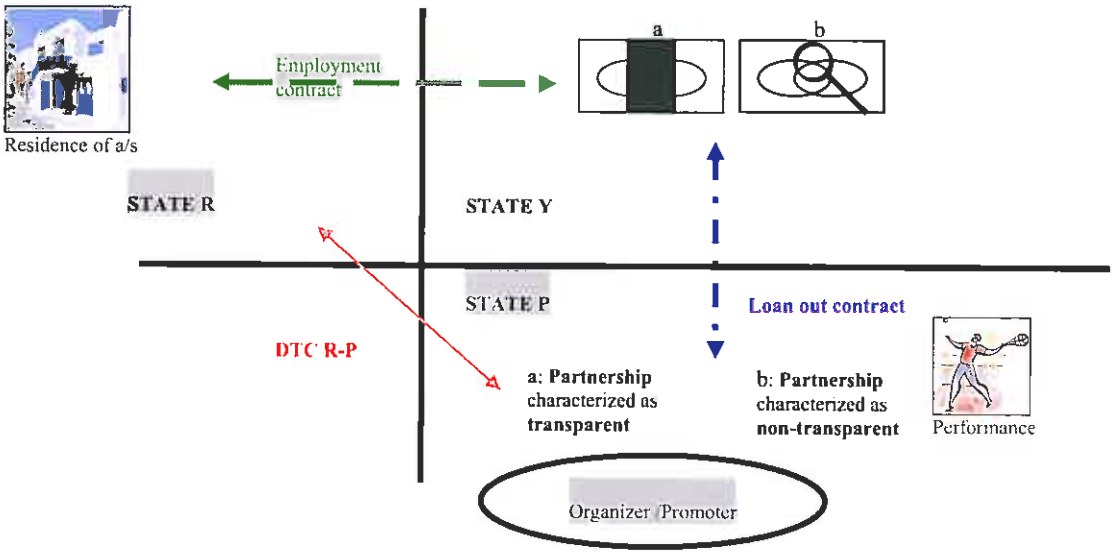
If the partnership qualifies as a **transparent partnership** according to the state of performance's **domestic** law[54], the state of performance **looks through** the partnership and each (artiste/sportsman) partner is taxed accordingly on the remuneration received for the performance in state P (Art. 17 [1] DTC PR).

[53] Neither most DTC nor the current MC specifically deals with the question of partnerships (other than, in the MC, by implicitly including partnerships in the definition of a person in the General Definition Article). The Commentary (to Art. 1/Persons covered and Art. 4/Resident), however, deals at length with the issue and acknowledges that domestic law (legal and tax) differs in the treatment of partnerships; with "some countries treating partnerships as taxable units (sometimes even as companies) whereas other countries adopt the fiscally transparent approach, under which the partnership are taxed on their respective share of the partnership's income".
For the French authorities partnerships are not fiscally transparent but merely fiscally "*translucide*" i.e. for the tax authorities they are taxable persons in their own right; the tax liability, tax audit etc. being computed and realized at the level of the entity itself, not at the level of its partners; even though the tax itself is payable by the partners, not by the entity.

[54] OECD, *The Application of the OECD MC to Partnerships, (Partnership Report), 1999*, N 10.

2.2 Non-transparent partnership/hybrid structure: conflict of characterization (Art. 17 (1))

Diagram 3: Hybrid structure / Conflict of characterization



As pointed out in III./2, Art. 17 (1) DTC R-P also covers remunerations according to personal performance paid to third parties. If the **state of performance** characterizes **partnerships** as **transparent, it** will **look** through **this third person** and treat the performance income as derived by the artiste/sportsman himself.

On the other hand, if the **state of performance** treats the **partnership as transparent** (like a legal entity) it can only tax the company income, but not according to Art. 17(1).

However, if the **state of performance** treats a partnership as **transparent**, and the **low-tax state** (state of incorporation of the partnership) on the other hand considers a partnership as **non-transparent**, a conflict of characterization arises. In this situation, the **state of performance will impose** its tax based on Art. 17 (1) OECD MC [55]. The **low-tax state**, being the state of residence of the partnership, will also **tax** the **company's revenue** accrued to the performance in state of performance. According to Vogel, the state of residence should take the state

[55] OECD – Commentary 2005, Art. 17 MN 8.

of performance's characterization for granted[56].

Scenario a)

If **state P** characterizes the partnership as **transparent**, but the low-tax state as non-transparent, Art. 17 (1) of the DTC R-P is to be applied, since Art. 1 in conjunction with Art. 4 (persons covered) characterizes the artiste/sportsman as a "person covered" according to the respective DTC. Therefore, the **DTC R-P allocates to state P the right to tax the remuneration (related to the personal performance) paid to the partnership as if it had been paid directly to the artiste/sportsman.** In conclusion, this structure does not lead to any tax benefit since sheltering does not take place at all. Therefore, it is not recommended from a tax planning perspective.

Scenario b)

If **state P** characterizes the partnership as **non-transparent**, Art. 17 (1) of the DTC R-P does not allow state P to tax the income derived by the partnership[57] (see IV./1./Diagram 1, solution). In this situation, the partnership is not liable to tax in the low-tax country (transparent) and is therefore not a resident of that state for purposes of the DTC low-tax country-P.

According to the author, the low-tax state will have to grant double taxation relief only insofar as the company's income may be taxed by state P under the DTC P- low-tax state. The state of performance, however, only taxes the income attributable to the personal performance of the artiste/sportsman. Therefore, one might argue whether third state has to grant relief since the conditions of Art. 23 A/B of the DTC are not met. Finally, the author doubts that third state will be obliged to grant relief for tax imposed in the state of performance.

V. Conclusion

It has been shown that states have a wide range of instruments in their national tax laws in order to counter tax avoidance schemes in connection with companies wholly or primarily owned by artistes or sportsmen ("star companies", also called "rent-a-star-companies"). Such basic domestic tax rules, like the look-through approach and general income attribution rules, were introduced in section I.3. and examined more closely in section II. by using the example of Swiss domestic law.

In section III. the effect of tax treaties on such national rules was examined on the basis of Art. 17 (1) and Art. 17 (2) OECD Model. It appears that Art. 17 (1)

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56 Vogel/Lehner, *DBA-Kommentar, 4. Auflage*, 2003, Art. 3 N 112.

57 Third person means company, partnership or others; either person will be subject to tax according to Swiss income tax law; Agner/Jung/Steinmann; *DBG Kommentar, 1995*, Art. 92, N 6.

enables taxation of the artiste or sportsmen, even if the income is paid to third persons. However, Art. 17 (1) requires for taxation in the state of performance that income be derived by the artiste or sportsman himself/herself. Based on this conclusion, various scenarios were identified in section IV.1 and IV.2, where source taxation in the country of performance fails because the star company does not pay the artiste or sportsman, makes deferred payments or transforms the income into dividends. In all these cases withholding taxes (if levied in the state of performance) have to be refunded on the request of the star company.

At the same time, it is clear that factual and legal problems of source taxation in connection with interposed entities can be circumvented by the states if they introduce Art 17 (2) in their tax treaties. This provision also allows source taxation of income derived by artistes and sportsmen in cases where no income accrues to the artiste or sportsman himself/herself.

VI. Appendix 1: Rates of Swiss (Federal & Cantonal) Wage Withholding Tax Rates for artistes and sportsmen

Canton	Tax at source in % of the gross income, after deducting an unspecified global deduction, amounting up to 20% of the gross income*				Remarks
	until CHF 200 per day (incl. 0.8 % Federal income tax)	until CHF 201 - 1'000 per day (incl. 2.4 % Federal income tax)	until CHF 1'001 - 3'000 per day (incl. 5 % Federal income tax)	more than CHF 3'000 per day (incl. 7 % Federal income tax)	
ZH	10.8	12.4	15.0	17.0	
BE	8.8	14.4	23.0	32.0	
LU	10	12.0	15.0	20.0	
UR	10.8	16.4	23.0	29.0	
SZ	8.8	14.4	21.0	27.0	
OW	10.0	12.0	15.0	20.0	
NW	12.8	14.4	17.0	19.0	
GL	10.8	17.4	25.0	32.0	
ZG	8.0	12.0	16.0	20.0	
FR	9.8	15.4	23.0	29.0	
SO	8.0	12.0	18.0	25.0	
BS	9.0	15.0	21.0	27.0	
BL	10.0	15.0	20.0	25.0	
SH	15.0	20.0	25.0	30.0	
AR	8.8	14.4	21.0	27.0	
AI	10.8	12.4	15.0	17.0	
SG	9.8	14.4	20.0	25.0	
GR	12.8	14.4	17.0	19.0	
AG	9.8	11.4	18.5	20.5	
TG	18.0	18.0	18.0	18.0	
TI	15.0	20.0	25.0	30.0	
VD	10.0	15.0	20.0	25.0	
VS	8.8	14.4	21.0	27.0	
NE	10.0	15.0	20.0	25.0	
GE	10.0	12.0 (1) 15.0 (2) 17.4	20.0	25.0	1) apart CHF 201-500 2) apart CHF 501-1'000
JU	10.8	17.4	25.0	32.0	

*: A higher amount may be deductible if the expense is commercially justified; Foreign withholding taxes may be deductible[58].

[58] Jau, *Causa Sport*, 2006, 450.