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## Tax Planning Issues Affecting International Entertainers and Athletes

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# Tax Planning Issues Affecting International Entertainers and Athletes

Theodore Delaney Weis

## **Abstract**

This Note will focus on the major tax planning issues confronting entertainers and athletes (hereinafter collectively referred to as “performers” unless separately stated) who perform in the United States and around the world. This Note will first explore the United States rules that apply when there is no applicable treaty; then it will discuss the effect of typical treaty provisions on those basic rules and the optimal business structure by which a performer can maximize the benefits of a given treaty. In particular, the Note will examine the unfavorable provisions, from the performer’s point of view, of two bilateral tax treaties recently signed by the United States with the United Kingdom and Canada. Finally, relevant provisions of United States tax treaties with Australia, France, Germany and Italy are reviewed. The Note focuses on these nations because, along with the United States, they produce the greatest number of performers.

# TAX PLANNING ISSUES AFFECTING INTERNATIONAL ENTERTAINERS AND ATHLETES

## INTRODUCTION

Successful entertainers and athletes often accrue high earnings over a relatively short period of time.<sup>1</sup> Public recognition of performers' achievements, whether a season of play with impressive individual statistics, or the release of a hit movie or record, may suddenly and dramatically increase a performer's income.<sup>2</sup> Sound tax planning is critically important to these individuals, not only from the standpoint of minimizing taxes on unusually high income in a given year, but also in planning the individual's economic future after his career has ended.

Tax laws in both the United States and other jurisdictions are becoming increasingly complex.<sup>3</sup> As a result, tax planning for entertainers and athletes who perform in more than one country is also becoming more difficult. International tax planning draws upon three bodies of law: (1) United States tax law; (2) the applicable rules of a tax treaty between the United States and a foreign performer's state of residence; and (3) the tax laws of the foreign performer's state of residence.

This Note will focus on the major tax planning issues confronting entertainers and athletes (hereinafter collectively referred to as "performers" unless separately stated) who perform in the United States and around the world. This Note will first explore the United States rules that apply when there is no applicable treaty;<sup>4</sup> then it will discuss the effect of typical treaty provisions on those basic rules and the optimal business structure by which a performer can maximize the benefits of a

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1. R.E. MADDEN, *TAX PLANNING FOR HIGHLY COMPENSATED INDIVIDUALS* 1-3 (1983).

2. *Id.*

3. For example, the United States alone has experienced four major tax law changes in the past nine years: the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), enacted October 4, 1976; the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981), enacted August 13, 1981; the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982), enacted September 3, 1982; and the Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984), enacted July 18, 1984 [hereinafter referred to as "the Act"].

4. See *infra* text accompanying notes 9-137.

given treaty.<sup>5</sup> In particular, the Note will examine the unfavorable provisions, from the performer's point of view, of two bilateral tax treaties recently signed by the United States with the United Kingdom and Canada.<sup>6</sup> Finally, relevant provisions of United States tax treaties with Australia, France, Germany and Italy are reviewed.<sup>7</sup> The Note focuses on these nations because, along with the United States, they produce the greatest number of performers.<sup>8</sup>

### I. *FEDERAL INCOME TAXATION OF FOREIGN PERFORMERS UNDER THE INTERNAL REVENUE CODE*

Federal income tax treatment of foreign performers who are nonresident aliens<sup>9</sup> of the United States differs from the treatment accorded foreign performers who are resident aliens.<sup>10</sup> Nonresident aliens are usually taxed only on income earned from sources within the United States.<sup>11</sup> Foreign per-

5. See *infra* text accompanying notes 138-58.

6. See *infra* text accompanying notes 159-223.

7. See *infra* text accompanying notes 224-56.

8. See Ardi, *Tax Planning for Foreign Entertainers Who Perform Within the United States*, 32 *TAX LAW* 349, 350 (1979).

9. Treas. Reg. § 1.871-1(a) (1980). For foreign entertainers, the principal items of foreign source income which may be subject to federal income tax if attributable to a United States office are royalties from the foreign licensing and gain from the foreign sale of copyrights and franchises. Internal Revenue Code of 1954, *as amended*, 26 U.S.C.A. §§ 1-8023 [hereinafter cited as "I.R.C."], § 864(c)(4)(B)(i) (1954). In certain cases, the office of a United States agent of a foreign taxpayer will be treated as the office of the foreign taxpayer for this purpose. See I.R.C. § 864(c)(5) (1954).

10. Prior to the Act, *supra* note 3, the Treasury Department Regulations provided the rules defining a "resident" alien for federal income tax purposes. The Regulations stated that such a person was an individual who was actually present in the United States other than as a "mere transient or sojourner." An alien individual who came to the United States "for a definite purpose which in its nature may be promptly accomplished" or whose stay was limited to a definite period by the immigration laws, absent exceptional circumstances, was not considered a resident. Treas. Reg. § 1.871-2(b) (1957). A rebuttable presumption of resident status arose when an alien had resided in the United States for one year. Rev. Rul. 69-611, 1969-2 C.B. 150. For income tax purposes the former definition of "resident," which was phrased in terms of intent and length of stay, differed from the definition of "resident" applicable for estate and gift tax purposes, which refers to a person's domicile at time of death. Treas. Reg. § 20.0-1(b)(2) (1957).

The Act changed the definition of a "resident" alien in the Code. See *infra* note 24.

11. I.R.C. § 861(a)(3)(A) (1954), commonly referred to as "U.S. source income."

formers classified under the Internal Revenue Code<sup>12</sup> (the Code) as resident aliens are taxed in the same manner as United States citizens, that is, at progressive rates based upon their net worldwide income.<sup>13</sup> For federal income tax purposes, it is generally irrelevant whether a foreign performer who is a resident of the United States is a citizen of a foreign country.<sup>14</sup>

In order to exempt income earned for personal services performed within the United States from federal income taxation, nonresident alien performers must qualify for one of the following exemptions: 1) the "low income—short visit" exemption;<sup>15</sup> 2) any one of a number of exemptions under a tax treaty negotiated between the United States and a foreign country;<sup>16</sup> or 3) a valid "loan-out" arrangement between the performer and a corporation.<sup>17</sup>

#### A. *United States Tax Status of an Alien*

In determining the tax status of an alien, the critical question is whether the alien is a resident of the United States. The authors of the Code devoted several special sections to the taxation of nonresident aliens.<sup>18</sup> To a large extent, the effect of these sections is offset by the exemption of compensation for

12. *See supra* note 9.

13. Treas. Regs. §§ 1.1-1(b), 1.871-1(a) (1957).

14. *See* Treas. Reg. § 1.871-2(b).

15. I.R.C. § 864(b)(1). A taxpayer who satisfies the following three conditions is deemed not to be engaged in a trade or business in the United States:

- (1) The nonresident alien's gross income for services performed in the United States does not exceed U.S.\$3,000 during the taxable year;
- (2) The nonresident alien's total number of days of presence in the United States during the taxable year does not exceed ninety days; and
- (3) The nonresident alien performs his services for one of the following employers:
  - (a) A nonresident alien individual;
  - (b) A foreign partnership;
  - (c) A foreign corporation not engaged in trade or business in the United States; or
  - (d) An office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic corporation.

Income earned by a taxpayer who satisfies the three conditions is deemed not to be income from United States sources. *Id.*

16. *See infra* text accompanying notes 138-54.

17. *See infra* text accompanying notes 181-87.

18. I.R.C. §§ 861-879, 1441, 1442 (1954).

personal services found in most tax treaties entered into by the United States.<sup>19</sup> By contrast, certain United States regulations to the tax treaties deny similar beneficial treatment to the resident alien.<sup>20</sup>

While the Code treats resident aliens differently than it treats nonresident aliens, the Regulations,<sup>21</sup> prior to the Tax Reform Act of 1984 (the Act),<sup>22</sup> had set forth an arguably subjective standard for deciding whether an alien is a resident for federal income tax purposes.<sup>23</sup> For taxable years beginning after 1984, the Code defines an individual as a United States resident for one calendar year if he is a lawful permanent resident of the United States at any time during the calendar year, or if he meets the "substantial presence" test.<sup>24</sup> The Code now of-

19. For examples of exemption provisions for personal services income, see *infra* notes 176-77. Such exemptions concern income classified as compensation derived from either Independent Personal Services or Dependent Personal Services. *Id.*

20. See, e.g., Regulation § 519.102(b)(5) to the former United States-Canada income tax treaty, T.D. 5206, 1943 C.B. 526 [hereinafter cited as "Former Canada-United States Treaty"]. United States regulations to older tax treaties make it clear that the term used in tax treaties, "a resident of the other Contracting State" has generally meant a nonresident alien residing in the other Contracting State, and not a United States citizen residing there. Further, the saving clauses included in many tax treaties provide that, with respect to the revenue laws of the United States, the tax treaty provisions do not affect United States citizens or residents. See *infra* text accompanying notes 138-39; see, e.g., Former Canada-United States Treaty, *supra*, art. XVII.

21. I.R.C. § 7805(a), 68A Stat. 917 (1954).

22. Act, *supra* note 3.

23. Treas. Reg. § 1.871-2(b); see also *supra* note 10.

24. Act, *supra* note 3, § 138(a) (amending I.R.C. § 7701 (1954) and adding § 7701(b) (1984)); see *supra* note 10 (former definition of "resident" for Federal tax purposes). An individual meets the "substantial presence" test if the individual was present in the United States on at least 31 days during the calendar year, and the sum of (i) the days the alien is present in the United States during the current calendar year, plus (ii) one-third of the days the alien was present in the United States during the immediately preceding calendar year, plus (iii) one-sixth of the days the alien was present in the United States during the second preceding calendar year, equals or exceeds 183 days. However, this test may be rebutted by a showing that: (i) the alien was present in the United States during the current calendar year for less than 183 days, and (ii) the alien has closer connections with a foreign country than with the United States. In addition, days present in the United States as (i) a diplomat or a representative of a foreign government, (ii) a teacher or a trainee (limitation of two years), or (iii) a student (limitation of five years) do not count towards the "substantial presence" test. Lastly, days present in the United States do not count towards the "substantial presence" test if the alien is unable to leave the United States due to a medical condition arising while he was in the United States. *Id.*

fers a much more precise definition of residence that is based upon objective criteria and easily applies to most situations involving foreign performers.<sup>25</sup> In order to avoid the disadvantage of being treated as a resident for United States tax purposes, an alien should not apply for permanent residency in the United States, and should undertake to schedule his affairs so as to not be physically present in the United States for more than 120 days in any calendar year.<sup>26</sup>

B. *A Nonresident Alien "Engaged in Trade or Business" in the United States*

If the performer is a nonresident alien, his tax treatment turns on whether he is engaged in business in the United States.<sup>27</sup> Such a "business" normally includes services performed by a nonresident performer in the United States.<sup>28</sup> However, if a performer who can satisfy the requirements of the "low income—short visit" rule<sup>29</sup> is not "engaged in a trade or business" in the United States, the compensation he earned for those services is exempt from taxation.<sup>30</sup> Similarly, if a nonresident alien does not work, practice a profession, or engage in industrial or commercial activities in the United States, he is not "engaged in a trade or business" in the United States.<sup>31</sup> Rather than being taxed at the regular progressive rates imposed upon United States citizens and residents,<sup>32</sup> nonresident aliens must pay a flat thirty percent tax on the

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25. *Id.*

26. W.K. Norman, Remarks at the New York University Conference on Entertainment, Sports and Publishing Taxation, 4-5 (Oct. 7, 1985) (available from the New York University School of Law Institute on Federal Taxation).

27. *See* Treas. Reg. § 1.871-1(b)(1)(i)-(iii) (describing the following three classes of nonresident alien taxpayers):

- (1) a nonresident alien engaged in a trade or business in the United States at any time during the taxable year;
- (2) a nonresident alien *not* engaged in a trade or business in the United States at any time during the taxable year; and
- (3) a nonresident who was a bona fide resident of Puerto Rico at any time during the taxable year.

*Id.*

28. I.R.C. § 864(b).

29. *See supra* note 15.

30. *Id.*

31. Treas. Reg. § 1.871-1(b)(1)(i).

32. Treas. Reg. § 1.1-1.

“passive” income<sup>33</sup> they earn from United States sources.<sup>34</sup> Such “passive” income may include salaries, wages, and compensation, *if* the taxpayer earns this income in one year and pays tax on it in a subsequent year.<sup>35</sup> When nonresident aliens earn such compensation in the United States in one year, but are paid in the following year, when they are no longer working in the United States, they may defer payment of taxes.<sup>36</sup> The Code classifies a performer who is not working in the United States as not “engaged in a trade or business” in the United States,<sup>37</sup> and the Internal Revenue Service (the Service) considers such an entertainer’s income as passive, taxing it at a flat rate of thirty percent.<sup>38</sup> A nonresident alien performer working in the United States is subject to tax with respect to his taxable income<sup>39</sup> from United States sources<sup>40</sup> effectively connected<sup>41</sup> with the active conduct of a trade or business in the United States.<sup>42</sup> Under the Regulations, a nonresident alien performer’s taxable gross income can be realized in any form, not necessarily the same form as the salary or cash com-

33. Traditional types of “passive” income include dividends, rents, interest and royalties. I.R.C. § 871(a).

34. *Id.*

35. *Id.*

36. To be considered gross income in a given taxable year, income must actually have been realized (i.e., received) in that taxable year. *See* Treas. Reg. § 1.61-1 (1954).

37. I.R.C. § 864(b)(1).

38. I.R.C. § 871(a)(1).

39. Compensation derived by a nonresident alien entertainer for services performed in the United States qualifies as “taxable income” if it is from United States sources, *see infra* note 40, and is not exempt from tax under a tax treaty provision, *see infra* text accompanying notes 138-54, or the “low income—short visit” rule. *See supra* note 15.

40. The compensation is from “United States sources” if it is attributable to services performed in the United States, I.R.C. § 861(a)(3), and does not qualify under the “low income—short visit” rule. *See supra* note 15.

41. Taxable compensation is “effectively connected” if the activities of the trade or business being conducted in the United States are of primary significance in the realization of the income. *See* I.R.C. § 864(c)(2)(B); Treas. Reg. § 1.864-4(c)(3); I.R.C. § 864(c)(2)(b). As the conduct of his entertainment business in the United States is a material factor in the earning of his compensation, the nonresident alien performer has, for purposes of I.R.C. § 871(b), derived taxable income “effectively connected with the conduct of the trade or business within the United States.” *Id.* § 871(b).

42. A nonresident alien performer is deemed to be conducting “a trade or business within the United States” when he performs services, I.R.C. § 864(b), unless the performer qualifies as a “low income—short visit” taxpayer. *See supra* note 15.



pensation directly paid to him by his United States employer.<sup>43</sup>

### 1. Gains from Sale of Intangible Property

The source of a nonresident alien performer's gross income will determine whether he is subject to United States income tax on that income.<sup>44</sup> An additional consideration must be made in the case of income derived from property which has been created by performing personal services, since such income can be classified as income from either performance of services, or from the sale and use of property.<sup>45</sup> If a nonresident alien performer makes a recording in the United States, federal tax treatment of his compensation from that recording is further affected by whether he acquires property rights in the recording.<sup>46</sup> If the performer is considered to have acquired property rights, the Service will consider the place where the records are sold as the source of the income for federal income tax purposes.<sup>47</sup> However, if greater than fifty percent of the compensation received by the performer was conditioned upon the sale of records, the entire amount will be considered royalty income,<sup>48</sup> and will be taxed at a rate of thirty percent.<sup>49</sup>

Because the property rights to be sold by an artist in his recordings are intangible, the place where the contract is executed would appear to be the place where risk of loss passes.<sup>50</sup> It does not necessarily follow that the intangible property will be utilized at the same place to physically make the record-

43. Treas. Reg. § 1.61-1. Taxable gross income may consist of income that has been realized in the form of services, meals, accommodations, stock, property or cash. *Id.*

44. *See supra* notes 27-43 and accompanying text.

45. W.K. Norman, *supra* note 26, at 5.

46. Applicable contract and copyright laws, not tax laws, will determine whether the performer acquires property rights in the recording. *Id.*

47. Treas. Reg. § 1.861-7(c) states that "a sale of personal property is consummated at the time when, and the place where, the rights, title, and interest of the seller in the property are transferred to the buyer." *Id.*

48. Treas. Reg. § 1.871-11(b). Royalties for the privilege of using copyrights in the United States are considered United States source income, I.R.C. § 861(a)(4); while property located outside the United States generates foreign source income, I.R.C. § 862(a)(4).

49. *See supra* notes 33-34 and accompanying text.

50. Treas. Reg. § 1.861-7(c).

ings.<sup>51</sup>

Gains derived by a nonresident alien performer from the sale of his intangible property outside the United States are not subject to federal income tax.<sup>52</sup> Moreover, unless effectively connected with the conduct of a trade or business within the United States, gains of the nonresident alien from the same transaction within the United States would also be exempt from domestic income tax.<sup>53</sup> Consequently, by contracting for property rights in his recordings, selling outside the United States, and selling inside the United States *if* such sales are not considered conduct of a trade or business in that year,<sup>54</sup> a nonresident alien performer may sell his intangible property rights in the form of recordings and avoid paying United States income tax on gains derived from such sales.<sup>55</sup>

## 2. Licensing Income

Planning for royalty income derived from records sold by a nonresident alien performer requires careful tour and record release planning by the performer's business advisor, in order to take advantage, from a tax standpoint, of timing differences in receipt of income. The source of royalty income is the place where the underlying property rights are used.<sup>56</sup> Thus, records sold within the United States generate United States source income in the form of royalties,<sup>57</sup> while records sold outside the United States produce non-United States source income.<sup>58</sup> If a nonresident alien performer receives United States source royalty income in a year in which the performer is considered to be engaged in a trade or business in the United States,<sup>59</sup> the income would be subject to United States federal income tax at the same graduated rates as income received by United States citizens.<sup>60</sup> However, if such income is received in a taxable year in which the performer is not consid-

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51. W.K. Norman, *supra* note 26, at 5.

52. I.R.C. § 864(c)(4).

53. I.R.C. § 864(c)(2).

54. *See supra* notes 27-28, 31, 37 and accompanying text.

55. *See* W.K. Norman, *supra* note 26, at 5a.

56. I.R.C. §§ 861(a)(4), 862(a)(4).

57. I.R.C. § 861(a)(4).

58. I.R.C. § 862(a)(4).

59. *See supra* notes 27-28, 31, 37 and accompanying text.

60. *See supra* notes 39-42 and accompanying text.

ered to be conducting a United States trade or business, the income would be subject to the flat thirty percent tax.<sup>61</sup> By contrast, royalties received by a nonresident alien from record sales outside the United States are subject to federal income tax only if the nonresident alien is considered to be engaged in a trade or business in the United States in that year.<sup>62</sup>

For planning purposes, the practitioner might advise his recording artist client to schedule his United States concert tour in a year in which the artist should not expect to receive substantial royalties from United States or foreign record sales. Given the length of the average United States concert tour,<sup>63</sup> the artist will probably be considered to be actively conducting a United States trade or business in that year. The problem with this advice is twofold. First, the practitioner must speculate as to whether the artist's taxable income from touring and other United States sources will place him over the thirty percent threshold, after which he would be paying income tax at a greater marginal rate than under the gross withholding provisions.<sup>64</sup> Second, royalty income is usually not paid to performers from record companies or distributors until at least several months after sales of the record giving rise to the royalties.<sup>65</sup> Usually, the artist goes on tour for the primary purpose of promoting his record. If the artist tours in one calendar year, and receives royalties from domestic or foreign sources in the subsequent year, due to either contract provi-

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61. See *supra* notes 31-38 and accompanying text.

62. I.R.C. § 864(c)(4)(B) states as follows:

Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

- (i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale or exchange of such property) derived in the active conduct of such trade or business . . . .

*Id.*

63. The average United States concert tour for nonclassical musical acts in 1985 lasted 115 days. *On the Move*, BILLBOARD, Jan.-Dec., 1985. Because classical musical artists tour sporadically, reliable average concert tour information is not available.

64. See generally I.R.C. § 1.

65. Interview with Nicholas Gordon, partner at Franklin, Weinrib, Rudell & Vassallo, P.C., Aug. 24, 1984.

sions or careful timing, he can take advantage of this differing tax treatment.

### 3. Distinguishing Gains from Sale of Property and Licensing Income

Until 1954, the Service had taken the position that a transfer of rights in an intangible asset constituted a sale only if the taxpayer disposed of the entire "bundle of rights" comprising the asset.<sup>66</sup> This so-called "indivisibility" doctrine was adopted by the Supreme Court in the 1949 case of *Commissioner v. Wodehouse*.<sup>67</sup> In that case, a nonresident alien author who sold exclusive United States serial rights in his book, while retaining the book itself and other rights, was held to be subject to United States federal withholding tax on payments made in accordance with the agreement.<sup>68</sup> It is suggested that the transfer of both domestic serial rights and book rights would have constituted a sale for United States withholding tax purposes.<sup>69</sup> The dissent in *Wodehouse* found the transfer of the domestic serial rights sufficient to constitute a sale, rather than a royalty.<sup>70</sup> This broader interpretation of what qualifies as a sale for United States federal income tax purposes foreshadowed both future case law<sup>71</sup> and the Service's own position.<sup>72</sup>

In Revenue Ruling 54-409<sup>73</sup> the Service held that an ex-

66. W.K. Norman, *supra* note 26 (citing I.T. 2735, XII-2 C.B. 131 (1933), declared obsolete by Rev. Rul. 70-293, 1970-1 C.B. 282).

67. 337 U.S. 369 (1949).

68. The majority in *Wodehouse* relied on the decisions in *Rohmer v. Commissioner*, 153 F.2d 61 (2d Cir. 1946), *cert. denied*, 328 U.S. 862 (1946), and *Sabatini v. Commissioner*, 98 F.2d 753 (2d Cir. 1938), both of which held that book publication rights and magazine publication rights were so closely related that sale of either group of rights from the other group would not be considered a sale for tax withholding purposes.

69. W.K. Norman, *supra* note 26, at 7.

70. *Id.* at 424-25 (Frankfurter, J., dissenting).

71. See *Goldsmith v. Commissioner*, 143 F.2d 466, 467 (2d Cir. 1944) (assignment by author of motion picture rights in his play constituted a sale under capital gains provisions if exclusive, perpetual and in a particular medium); *Herwig v. Commissioner*, 105 F.2d 384, 389 (Ct. Cl. 1952) (author's exclusive and perpetual grant of all her motion picture rights in her play was one of "bundle of rights" capable of being sold as personal property, and not as a mere license); *Joseph A. Fields*, 14 T.C. 1202, 1210-14 (1950) (assignment by playwright of exclusive motion picture rights to her two plays constituted a "sale" for capital gains purposes, "indivisibility" doctrine not relevant for tax purposes).

72. See *infra* notes 73-76 and accompanying text.

73. 1954-2 C.B. 174.

clusive grant of the right to "exploit" a copyrighted work in a particular medium, such as motion pictures, in exchange for a lump sum consideration, constituted a sale for purposes of United States federal taxation.<sup>74</sup> The Service reached a similar conclusion six years later in Revenue Ruling 60-226,<sup>75</sup> there referring broadly to "sales" for "federal income tax purposes."<sup>76</sup> Since neither the Code nor the Regulations suggest that a "sale" has a different meaning for foreign purposes than it does for United States capital gain purposes,<sup>77</sup> it follows that a sale for capital gains purposes should be similarly defined for both nonresident and resident taxpayers.<sup>78</sup> Congress specifically dealt with the treatment of gains derived by nonresidents of the United States from the sale of their copyrights in the Foreign Investors Tax Act,<sup>79</sup> preempting such treatment when the gain realized is predominantly contingent in amount.<sup>80</sup> By contrast, Congress did not address the question of whether division of a copyright changes its character for purposes of that legislation.<sup>81</sup> Since Revenue Ruling 60-226<sup>82</sup> holds that disposition of partial interest in a copyright may be treated as a sale for domestic taxpayers, it appears that foreign taxpayers may expect the same favorable treatment.<sup>83</sup>

#### 4. Distinguishing Royalty Income and Services Income

In *Pierre Boulez v. Commissioner*,<sup>84</sup> a world-famous orchestral conductor entered into a contract with a United States corporation to make recordings of orchestral works both in the United States and abroad.<sup>85</sup> Under the terms of the agreement, all recordings would be owned by the corporation,

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74. *Id.* at 176. In the Ruling, the Service expressed three caveats, one of which was that the taxation of assignments by nonresident aliens had to be considered separately from the question of whether a citizen qualified for capital gains treatment. *Id.*

75. 1960-1 C.B. 26.

76. *Id.* at 27.

77. See I.R.C. § 864; Treas. Regs. § 1.864-1.

78. W.K. Norman, *supra* note 26, at 8.

79. Pub. L. No. 89-809, 80 Stat. 1539, enacted November 13, 1966.

80. *Id.* § 103(a) (adding I.R.C. § 871(e) (1966)); W.K. Norman, *supra* note 26, at

8.

81. W.K. Norman, *supra* note 26, at 8.

82. See *supra* note 75.

83. W.K. Norman, *supra* note 26, at 8.

84. 83 T.C. 584 (1984).

85. *Id.* at 585-86.

which would in turn pay the conductor, who was a French citizen and resident of Germany, based upon a percentage of its sales receipts, which the contract called "royalties."<sup>86</sup> The Tax Court found the payments made to the conductor for the recordings he made in the United States to be taxable income to him.<sup>87</sup> Under the tax treaty between Germany and the United States,<sup>88</sup> the payments to the conductor were not considered "royalties" exempt from United States federal income taxation, but instead constituted compensation for personal services subject to United States federal income tax.<sup>89</sup>

In light of the above case, it appears that a nonresident alien performer who receives compensation under a contract for an artistic performance will be considered to have received gross income from the performance of personal services if 1) under the applicable contract or property law, the performer does not own the intangible property created by his performance (i.e., master recording), and 2) the performer's contract explicitly provides for the performance of services.<sup>90</sup> In addition, certain contract language would support this determination, such as clauses acknowledging the unique nature of the performer's services, and prohibiting the performer from performing for other parties in connection with similar types of recordings.<sup>91</sup> Of little or no importance to this determination would be 1) the amount of the performer's compensation being wholly or partially dependent on sales level of the intangible property produced, 2) protection granted to or applied for by a performer or corporation under applicable copyright laws, and 3) the manner in which the tax laws of the performer's country of residence would tax the income.<sup>92</sup>

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86. *Id.*

87. *Id.* at 596.

88. Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Income, July 22, 1954, United States-Federal Republic of Germany, 5 U.S.T. 2768, T.I.A.S. No. 3133, amended by Protocol Modifying the Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, September 17, 1965, United States-Federal Republic of Germany, 16 U.S.T. 1875, 1883, T.I.A.S. No. 5920, reprinted in 1 *TAX TREATIES* (CCH) ¶ 3003 [hereinafter cited as "Germany-United States Treaty"].

89. 83 T.C. at 36.

90. W.K. Norman, *supra* note 26, at 9.

91. *Id.*

92. *Id.*

C. *Considerations for the International Athlete*

Because the Code provisions focus on where a taxpayer performed the services,<sup>93</sup> athletes employed by teams that play both in the United States and elsewhere<sup>94</sup> must allocate their compensation between sources within and without the United States. This problem arises most frequently when an athlete receives part of his regular annual salary ratably throughout the year, including during the off-season and in training camp. In such a case, United States Treasury Department Revenue Ruling 76-66<sup>95</sup> provides that the athlete should allocate his salary among sources on the basis of services performed during the regular season, rather than on a yearly basis.<sup>96</sup>

In 1984, the United States Tax Court resolved a salary allocation issue involving a National Hockey League player who was both a Canadian citizen and resident. In *Linseman v. Commissioner*,<sup>97</sup> the athlete received a bonus of U.S. \$75,000 for the 1977-78 season from a United States based hockey team that played league games in both the United States and Canada.<sup>98</sup> The Court found that the primary purpose of the bonus payment was to induce Linseman to sign the contract with the team, and was not compensation for services he was to perform.<sup>99</sup> Nevertheless, the court stated, Linseman should allocate a portion of the U.S. \$75,000 bonus to the United States, based upon the proportional number of games his team contemplated playing within and without the United States during the season.<sup>100</sup> Although the bonus was not compensation for past services, the court found that the places where the services were to be performed in the future should serve as the

93. I.R.C. § 864(b)(1).

94. Of the twenty-six teams in Major League Baseball, two teams, the Toronto Blue Jays of the American League, and the Montreal Expos of the National League, play their home games in Canada. Of the twenty-one teams in the National Hockey League, seven teams (Montreal Canadiens, Toronto Maple Leafs, Quebec Nordiques, Edmonton Oilers, Calgary Flames, Winnipeg Jets and Vancouver Canucks) play their home games in Canada. N.Y. Times, Mar. 3, 1985, § 5, at 8, col. 4 (National Hockey League standings list all Canadian and United States teams).

95. Rev. Rul. 76-66, 1976-1 C.B. 189.

96. *Id.*

97. 82 T.C. 514 (1984).

98. *Id.* at 516.

99. *Id.* at 518.

100. *Id.* at 522.

basis for allocation.<sup>101</sup>

Nonresident alien athletes who compete in individual sports in the United States, such as tennis, boxing, and golf, are treated much the same as those athletes who compete on teams. The Code provides that compensation earned by these athletes as United States source income is effectively connected with the active conduct of a trade or business.<sup>102</sup> Athletes are subject to federal income tax on the income they earn from their participation in tournaments and matches in the United States.<sup>103</sup>

## II. TAXATION OF UNITED STATES PERFORMERS ABROAD

### A. *The Foreign Earned Income Exclusion: Section 911*

If he elects, a United States citizen may be entitled to exclude up to U.S. \$80,000<sup>104</sup> of "foreign earned income"<sup>105</sup> from his gross taxable income,<sup>106</sup> either by qualifying as a "bona fide" resident<sup>107</sup> in a foreign state, or by residing in a foreign country for 330 days during any twelve-month pe-

101. *Id.*; see also *Stemkowski v. Commissioner*, 690 F.2d 40 (2d Cir. 1982), *aff'd in part, rev'd in part and remanded*, 76 T.C. 252 (1981). In that case, the Second Circuit reversed the Tax Court in holding that a standard National Hockey League employment contract compensated the petitioner, a professional hockey player, for training camp, the regular season and the playoffs, but agreed with the Tax Court in finding that the contract did not encompass the off-season. *Id.* It has been observed that this decision allowed Stemkowski to allocate a larger portion of his income to non-United States sources, thereby reducing his United States tax liability, since Stemkowski's team trained in Canada. W.K. Norman, *supra* note 26, at 6.

102. I.R.C. § 871(b).

103. See *supra* notes 39-42 and accompanying text.

104. Act, *supra* note 3, § 17 (amending I.R.C. § 911 (1954)). Prior to the Act, resident aliens and United States citizens living abroad could exclude from taxable income a maximum of U.S. \$80,000 of foreign earned income in 1983, to increase in 1984 to U.S. \$85,000, in 1985 to U.S. \$90,000, and, in 1986 and thereafter to U.S. \$95,000. Under the Act, the maximum foreign earned income exclusion will remain at U.S. \$80,000 until taxable years beginning in 1988, when the maximum exclusion will increase to U.S. \$85,000, to U.S. \$90,000 in 1989, and to U.S. \$95,000 in 1990 and thereafter. *Id.*

105. See I.R.C. §§ 911(b)(1), (d)(1) (1985). "Foreign earned income" of an individual is the amount received from sources outside the United States which constitute earned income, see *infra* note 116, for services performed by him during the period he either qualifies as a "bona fide resident" of the United States, see *infra* note 107, or meets the "substantial presence" test. See *infra* text accompanying note 108.

106. I.R.C. § 911(b).

107. I.R.C. § 911(d)(5) states the test of bona fide residence as follows:



riod.<sup>108</sup> Unlike a nonresident alien performer, who can incur a lower tax rate by deferring receipt of payment for personal services,<sup>109</sup> a United States resident performer has received foreign earned income in the taxable year during which the related personal services are performed, even if he receives payment in a different year.<sup>110</sup> For example, assume that a motion picture actor, who is a United States resident, agrees to appear in a movie to be filmed in Europe. His total compensation for the film is U.S. \$225,000. If he renders two-thirds of his services in connection with a motion picture during 1985, and the remaining one-third of his services in 1986, he may exclude U.S. \$80,000 from the U.S. \$150,000 he earned in 1985, limited by the U.S. \$80,000 exclusion ceiling.<sup>111</sup> The actor could then exclude all of the U.S. \$75,000 he receives in 1986.<sup>112</sup> Thus, when negotiating a contract that requires a United States resident client to film or record abroad, a tax attorney should evaluate the tax-saving opportunities provided by using this attribution rule in connection with the exclusion provisions of Section 911.

Expenses incurred by an individual while earning personal services income are usually deductible as ordinary and necessary business expenses.<sup>113</sup> However, Section 911 does not allow an individual to deduct such expenses if they stem from earning foreign source income.<sup>114</sup> If the performer elects to use the foreign earned income exclusion, and the excluded amount is less than the total income eligible for the exclusion,

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If

- (A) an individual who has earned income from sources within a foreign country submits a statement to the authorities of that country that he is not a resident of that country, and
- (B) such individual is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings,

then such individual shall not be considered a bona fide resident of that country for purposes of paragraph (1)(A).

*Id.*

108. I.R.C. § 911(d)(1).

109. *See supra* notes 32-38 and accompanying text.

110. I.R.C. § 911(b)(2).

111. *See supra* note 104.

112. *Id.*

113. I.R.C. § 162 (1954).

114. Treas. Reg. § 1.911-6(a) (1985).

the performer calculates the amount of disallowed expense deductions as follows:

$$\frac{\text{Excluded Foreign Source Earned Income (exclusion)}}{\text{Total Eligible Foreign Source Earned Income}} \times \text{Expenses Allocable to Foreign Earned Income}^{115}$$

For example, suppose the motion picture actor earns U.S. \$100,000 of Foreign Source Earned Income (FSEI) during 1985, and incurs U.S.\$5,000 of unreimbursed business expenses that are directly allocable to such earnings. Of the U.S.\$5,000 business expenses, U.S.\$4,000 could not be claimed by him as a deduction on this 1985 tax return, because the Code requires that he allocate such expenses directly to the excluded income, calculated as follows:

$$\frac{\text{U.S. \$80,000 (exclusion)}}{\text{U.S. \$100,000 (FSEI)}} \times \text{U.S. \$5,000} = \text{U.S. \$4,000}$$

Deductions that the actor may not allocate directly to earned income<sup>116</sup> are unaffected by the disallowance provisions, and the Code allows him to deduct the total amount of such expenses.<sup>117</sup>

#### B. *The Foreign Housing Cost Exclusion or Deduction*

In addition to the foreign source earned income exclusion,<sup>118</sup> a United States taxpayer may also separately elect to exclude certain housing costs from foreign earned income.<sup>119</sup> The performer may exclude housing costs when an employer pays for or supplies his housing. The amount of the exclusion is the excess of actual housing expenses paid or incurred over a base amount.<sup>120</sup> In lieu of the exclusion, the performer may take a deduction for the same amount when his employer does not provide his housing expenses, or when the performer is

115. *Id.*

116. Treas. Reg. § 1.911-3(b) defines earned income as "wages, salaries, professional fees and other amounts received as compensation for personal services actually rendered including the fair market value of all remuneration paid in any medium other than cash." *Id.*

117. I.R.C. § 911(c).

118. See *supra* notes 104-17 and accompanying text.

119. I.R.C. § 911(a)(2).

120. I.R.C. § 911(c).

self-employed.<sup>121</sup> In either case, the Code limits the housing cost amount to foreign source earned income, less any previously excluded amounts.<sup>122</sup>

The Code allows the performer to elect a deduction for housing expenses that are not employer-provided,<sup>123</sup> even if the performer does not itemize deductions on his tax return. Also, if the performer treats excess housing costs as a deduction, that is, not provided by the employer, or if the performer is self-employed, the performer may carry over the housing deduction to the subsequent year.<sup>124</sup>

Thus, for purposes of the foreign housing cost election, a United States resident movie actor should either contract with a foreign producer as a self-employed individual, or forego housing reimbursements by the producer if he is the production company's employee. From the actor's point of view, a self-employment arrangement would be more advantageous than having the producer, as employer, either pay for or reimburse the actor for his housing expenses incurred while on location in a foreign state.<sup>125</sup>

### C. *Qualifications for the Exclusion Provisions*

To qualify for the exclusion provisions of Section 911, a performer must have a "tax home"<sup>126</sup> in the foreign state, and must either be a "bona fide resident"<sup>127</sup> of the foreign country, or meet the "physical presence" test.<sup>128</sup> In general, a tax home is the taxpayer's principal work location.<sup>129</sup> It is possible for an individual to have a United States tax home during some or all of the period necessary to satisfy the physical presence test.<sup>130</sup> In order for a taxpayer with foreign earned income to *not* be

121. I.R.C. § 911(c)(3).

122. I.R.C. § 911(c)(3)(B).

123. I.R.C. § 911(c)(3).

124. I.R.C. § 911(c)(3)(C).

125. *See supra* text accompanying notes 118-24.

126. Treas. Reg. § 1.911-2(b) states that an individual's "tax home" is located at his regular or principal place of business. If the individual has no regular or principal place of business due to the nature of the business, the tax home is his regular place of abode in a "real and substantial sense." *Id.*

127. *See supra* note 107.

128. Treas. Reg. 1.911-2(d); *see supra* text accompanying notes 107-08.

129. *See supra* note 126.

130. Treas. Reg. § 1.911-2(b).

considered a bona fide resident of a foreign country, the taxpayer must formally state to the authorities of the foreign country that he is not a resident of the foreign country, and he must not be held subject to income tax as a resident of the foreign country with respect to his earnings while in the foreign country.<sup>131</sup>

The physical presence test is generally much easier to satisfy than the bona fide residence test. The physical presence standard is objective, and thus does not require that the performer supply evidence of his intent. It requires only that the performer be physically present in a foreign state for 330 full days during a period of twelve consecutive months.<sup>132</sup> Moreover, under the physical presence standard, the performer need not spend the entire 330 days working and earning income.<sup>133</sup>

#### D. *The Foreign Tax Credit*

In general, the Code allows United States citizens a credit against their United States income tax for income taxes paid to foreign states.<sup>134</sup> However, the foreign income tax liability generated by the United States performer's foreign source income can be taken as a credit for United States tax purposes only to the extent it does not exceed the performer's United States income tax liability on the same income.<sup>135</sup> The usual result of this policy is that the taxpayer's ultimate tax burden will equal the tax computed at the higher of the United States' or the foreign state's effective tax rates. The performer may either choose to receive a credit on the tax he paid to a foreign state, or use his foreign taxes as an itemized deduction.<sup>136</sup> However, when the performer elects a credit, he may not take any portion of the taxes imposed as a deduction, including any excess foreign tax credits.<sup>137</sup>

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131. I.R.C. § 911(d)(5).

132. Treas. Reg. § 1.911-2(a).

133. Treas. Reg. § 1.911-2(d)(2).

134. I.R.C. § 901 (1954).

135. I.R.C. § 904 (1954).

136. I.R.C. §§ 164(a), 275(a). *See generally* 6 STAND. FED. TAX REP. (CCH) ¶ 4303 (1984).

137. Treas. Reg. § 1.901-1(c).

### III. THE IMPACT OF TREATY PROVISIONS ON FEDERAL INCOME TAXATION OF INTERNATIONAL PERFORMERS

The Code excludes from gross income any income subject to either exemption or a reduced tax rate by any tax treaty to which the United States is a party.<sup>138</sup> Moreover, the terms of any tax treaty entered into by the United States take precedence over any other Code provisions.<sup>139</sup> At present, the United States has income tax treaties with thirty-four other nations.<sup>140</sup> In addition, the United States has signed several new treaties that the Senate has not yet ratified, and is negotiating, or will negotiate, other tax treaties in the near future.<sup>141</sup>

#### A. Common Provisions in Earlier Treaties

Tax treaties are important to foreign performers because foreign performers who come to the United States to perform personal services frequently receive large amounts of income over relatively short periods of time.<sup>142</sup> Foreign performers often benefit from two provisions generally found in income tax treaties to which the United States is a party: 1) a "commercial traveler" provision,<sup>143</sup> and 2) an "industrial and commercial profits" provision.<sup>144</sup>

Commercial traveler provisions exempt from tax in the host state<sup>145</sup> income earned in that nation by a foreign performer who temporarily visits the host state for business or educational purposes.<sup>146</sup> Some commercial traveler provisions, like the exemption provided by Section 861(a)(3), limit the amount of income that a taxpayer earns free of tax in the host country.<sup>147</sup> Also, a commercial traveler provision often re-

138. I.R.C. § 894 (1954).

139. I.R.C. § 7852(d).

140. INTERNAL REVENUE SERVICE, U.S. DEP'T OF THE TREASURY, PUB. NO. 515, WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS 15 (1984).

141. T.D. News Rel. B-291, May 16, 1984.

142. See *supra* text accompanying note 1.

143. See *infra* text accompanying notes 145-48.

144. See *infra* text accompanying notes 149-54.

145. A "host state" can be defined as the nation in which the activities take place.

146. See *infra* note 148.

147. See, e.g., Convention Between the United States of America and Switzerland

quires, as a condition to the tax exemption, that the temporary visitor perform his services in the host country as an employee of, or under contract with, a resident of the host country.<sup>148</sup>

An even more common provision found in United States income tax treaties is the industrial and commercial profits rule.<sup>149</sup> The rule exempts from United States income tax the industrial and commercial profits of a foreign business enterprise that engages in trade or business in the United States, unless these profits are attributable to a "permanent establishment"<sup>150</sup> in the host jurisdiction. A foreign corporation that

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for the Avoidance of Double Taxation with Respect to Taxes on Income, May 24, 1951, United States-Switzerland, 2 U.S.T. 1751, 1758, T.I.A.S. No. 2316, art. X *reprinted in* 3 *TAX TREATIES* (CCH) ¶ 7403 [hereinafter referred to as "Switzerland-United States Treaty"]. This treaty imposes a U.S. \$10,000 limit in the case of payments received from a person other than a resident or corporation or other entity of Switzerland. *Id.* art. X.

148. For example, the commercial traveler provision of the tax treaty with the Federal Republic of Germany is contained in Article X(2), which provides:

Compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed in the United States by a natural person resident in the Federal Republic shall be exempt from tax by the United States if—

- (a) he is present in the United States for a period or periods not exceeding a total of 183 days during a taxable year,
- (b) such labor or personal services are performed as an employee of, or under contract with, a natural person resident in the Federal Republic or a German company, and such compensation is borne by such resident or company, and
- (c) such compensation is not borne by a permanent establishment which such resident or company has in the United States.

Germany-United States Treaty, *supra* note 88, art. X(2). The Treasury Department has interpreted the phrase "for or on behalf of a person resident in [a foreign state]" in tax treaties as requiring that the services be performed in connection with an employment relationship, Rev. Rul. 74-330, 1974-2 C.B. 278, 280, and that the compensation be paid by an employer resident in that state. *See Technical Explanation of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains*, 3 *TAX TREATIES* (CCH) ¶ 8103DD [hereinafter cited as "United Kingdom Technical Memorandum"].

149. *See infra* text accompanying notes 150-54.

150. The term "permanent establishment" has various definitions among the income tax treaties entered into by the United States; however, the major basic components of each definition are the same. The definition found in article II(1)(1) of the former United Kingdom Treaty is illustrative:

The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless

furnishes a performer's services in the United States relies on this provision for exemption from federal income tax on the income it receives for providing such services, provided it does not maintain a permanent establishment in the United States.<sup>151</sup> However, other treaties, such as the one between the United States and Switzerland,<sup>152</sup> exclude remuneration for personal services from their definition of industrial and commercial profits.<sup>153</sup> In such a case, a corporation furnishing

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the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, April 16, 1945, United States-United Kingdom, art. II(1)(1), 60 Stat. 1377, 1379, T.I.A.S. No. 1546, amended by Supplementary Protocol, 6 U.S.T. 37, T.I.A.S. No. 3165, Supplementary Protocol, 9 U.S.T. 1329, T.I.A.S. No. 4124, and Supplementary Protocol, 17 U.S.T. 1254, T.I.A.S. No. 6089. The definition of "permanent establishment" in more recently concluded United States treaties has been based upon the definition set forth in the Organization for Economic Cooperation and Development Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital, reprinted in 1 TAX TREATIES (CCH) ¶ 151 [hereinafter cited as "OECD Model Treaty"]. In Rev. Rul. 67-321, 1967-2 C.B. 470, the Service ruled that a foreign corporation that presents a floor show in the United States does not have a "permanent establishment" within the United States. Ardi, *supra* note 8, (citing Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277 (1976)).

151. See, e.g., Rev. Rul. 67-321, 1967-2 C.B. 470.

152. Switzerland-United States Treaty, *supra* note 147.

153. See, e.g., *id.* art. II(1)(h), which provides that "[t]he term 'industrial or commercial profits' includes manufacturing, mercantile, mining, financial and insurance profits, but does not include income in the form of dividends, interest, rents or royalties or remuneration for personal services." It is possible, however, that the exclusion of "remuneration for personal services" from the definition of "industrial or commercial profits" in the Switzerland-United States Treaty extends only to compen-

the services of a performer could not use an industrial and commercial profits rule as the basis for an exemption of income.<sup>154</sup>

These two common tax treaty provisions have been largely rendered inapplicable to performers in recent treaties entered into by the United States with other nations. The United States has tax treaties with the six countries<sup>155</sup> that provide the United States with most of its foreign talent. Four of the six treaties have been signed within the past six years, and each of the recent treaties uses a form of the "Artistes and Athletes" provision of the Model Income Tax Convention of the Organization for Economic Cooperation and Development<sup>156</sup> and the United States Treasury Department's Model Income Tax Treaties of 1977 and 1981.<sup>157</sup> Treaties containing this provision discriminate against entertainers and athletes as a group by providing for separate tax treatment that expressly denies various treaty benefits to performers.<sup>158</sup>

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sation for personal services to the extent that such compensation is dealt with elsewhere in the treaty, and that therefore the exclusion does not apply to payments to a corporation for furnishing the services of its employees.

154. The industrial and commercial profits rule of the Germany-United States tax treaty provides that:

Industrial or commercial profits of an enterprise of one of the contracting States shall be exempt from tax by the other State unless the enterprise is engaged in trade or business in such other State through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such other State on the industrial or commercial profits of the enterprise but only on so much of them as are attributable to the permanent establishment or are derived from sources within such other State from sales of goods or merchandise of the same kind as those sold, or from other business transactions of the same kind as those effected, through the permanent establishment.

Germany-United States Treaty, *supra* note 88, art. III(1). Article III(5) provides that "[t]he term 'industrial or commercial profits' means income derived by an enterprise from the active conduct of a trade or business, including income derived by an enterprise from the furnishing of services of employees or other personnel, but does not include . . . income dealt with in . . . Article X (labor and personal services)." *Id.*

155. These are the United Kingdom, Canada, Australia, France, Germany and Italy. See Ardi, *supra* note 8.

156. OECD Model Treaty, *supra* note 150, art. 17.

157. Convention Between the Government of the United States of America and the Government of . . . . . for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, *reprinted in* 1 TAX TREATIES (CCH) ¶¶ 153, 158.

158. Fraade, Gardner & Stewart, *The IRS, the INS and the Foreign Entertainer*, 5 COMM/ENT L.J. 191, 220 (1983); see Ardi, *supra* note 8, at 374.



B. *The Tax Treaty Between the United States and the United Kingdom: Seed of Discrimination*

The tax treaty between the United States and the United Kingdom<sup>159</sup> (the United Kingdom-United States Treaty) was the first treaty entered into by the United States that expressly discriminated against entertainers as a class.<sup>160</sup> Although the United States Senate Foreign Relations Committee strongly opposed the Article, the Senate did not suggest any modifications to the discriminatory provision, and approved the treaty.<sup>161</sup>

Article 17(1) of the United Kingdom-United States Treaty states that a Host State<sup>162</sup> will tax an entertainer<sup>163</sup> who is a resident<sup>164</sup> of a Contracting State<sup>165</sup> on income received by the entertainer for personal services performed in the Host State, unless the entertainer's total gross receipts for such activities in the Host State are less than U.S. \$15,000 for the taxable

159. Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, United States-United Kingdom, 31 U.S.T. 5668, T.I.A.S. 9682, *amended* by Notes exchanged Apr. 13, 1976, and by Protocols signed Aug. 26, 1976, Mar. 31, 1977 and Mar. 15, 1979, *reprinted in* 3 TAX TREATIES (CCH) ¶ 8103 [hereinafter referred to as "United Kingdom-United States Treaty"].

160. Fraade, Gardner & Stewart, *supra* note 158, at 220.

161. Ardi, *supra* note 8, at 374 (citing *Hearings on the Tax Treaties with the United Kingdom, the Republic of Korea, and the Republic of the Philippines Before the Senate Committee on Foreign Relations*, 95th Cong., 1st Sess. 245-91, 303-12 (1977)).

162. *See supra* note 145.

163. United Kingdom-United States Treaty, *supra* note 159, art. 17(1), defines entertainers as individuals "such as theatre, motion picture, radio or television artists, and musicians, and . . . athletes . . ." *Id.* art. 17(1).

164. United Kingdom-United States Treaty, *supra* note 159, art. 4, defines a "resident of the United Kingdom" as:

- (i) any person, other than a corporation, resident in the United Kingdom for the purposes of United Kingdom tax; but in the case of a partnership, estate, or trust, only to the extent that the income derived by such partnership, estate, or trust is subject to United Kingdom tax as the income of a resident, either in its hand or in the hands of its partners or beneficiaries; and
- (ii) a corporation whose business is managed and controlled in the United Kingdom.

*Id.* art. 4(1)(a).

165. *Id.* art. 3(1)(i). The term "Contracting State" is defined as "the United States or the United Kingdom, as the context requires." *Id.*

year in question.<sup>166</sup> The Treaty includes in this U.S. \$15,000 limitation any expenditures generally related to the entertainer's activities,<sup>167</sup> wherever such expenditures are actually made.<sup>168</sup> Thus, if the total amounts paid to the entertainer, including reimbursed expenses and expenses borne on the entertainer's behalf by others, exceed U.S. \$15,000, the Host State will tax the entire amount.<sup>169</sup> The Treaty's U.S. \$15,000 limitation applies to gross receipts from all of the performer's engagements in the Host State, not to each separate engagement.<sup>170</sup> Unfortunately for the performer, he cannot avoid the U.S. \$15,000 limitation by deferring his gross receipts, or by prepaying his expenditures related to performance of his personal services in a given taxable year. The performer should attribute to the year in which he performed all amounts paid to him, in connection with such performance, during taxable years prior or subsequent to that year.<sup>171</sup>

Paragraph 1 of Article 17 takes precedence over the Independent and Dependent Personal Services provisions of the United Kingdom-United States Treaty.<sup>172</sup> The period of time a performer is present in a Host State is irrelevant to whether he will be taxed in that state.<sup>173</sup> Paragraph 1 thus negates the advantages of the "low income—short visit" exception found

166. *Id.* art. 17(1) states:

Notwithstanding the provisions of Article 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised, except where the amount of the gross receipts derived by an entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities do not exceed 15,000 United States dollars or its equivalent in pounds sterling in the tax year concerned.

*Id.*

167. Such expenditures include those relating to meals and lodging, travel, and payments to band members, agents or other persons. *United Kingdom Technical Memorandum, supra* note 148.

168. *Id.*

169. *Id.*

170. Fraade, Gardner & Stewart, *supra* note 158, at 221.

171. *United Kingdom Technical Memorandum, supra* note 148.

172. United Kingdom-United States Treaty, *supra* note 159, art. 17(1). Article 14 of the Treaty is entitled "Independent Personal Services," while article 15 deals with "Dependent Personal Services."

173. *United Kingdom Technical Memorandum, supra* note 148.

in the Code.<sup>174</sup> In contrast to the income of a performer, income of entertainment industry executives, such as film or music company administrators, or creative people besides the performer, such as producers, directors or technicians, does not fall within the provision.<sup>175</sup> Instead, the Treaty applies the less stringent provisions of Article 14<sup>176</sup> or Article 15<sup>177</sup> to the non-performing members of the entertainment industry.

Paragraph 17(1), like the other provisions of the Treaty that involve personal services income,<sup>178</sup> does not prevent the performer's state of citizenship or residence from simultaneously taxing the same income.<sup>179</sup> However, Article 23 of the Treaty provides for a foreign tax credit for income taxes paid to the other state, thereby enabling an entertainer to avoid double taxation.<sup>180</sup>

Paragraph 2 of Article 17 attempts to minimize or eliminate tax benefits to performers who attempt to perform personal services through "loan-out" corporations.<sup>181</sup> The entertainer may take advantage of this "loan-out" structure by forming a corporation and entering into a contract with the corporation, through which he agrees to furnish his services to producers or promoters. Usually, the corporation is wholly owned by the artist. The artist's spouse, personal manager or

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174. See *supra* note 15 and accompanying text.

175. *United Kingdom Technical Memorandum*, *supra* note 148.

176. United Kingdom-United States Treaty, *supra* note 159, art. 14, Independent Personal Services, exempts from taxation by the United Kingdom income derived by a United States resident for the performance of independent personal services if either: 1) the United States resident is present in the United Kingdom for less than 183 days in the taxable year, or 2) the United States resident has no fixed base available to him on a regular basis in the United Kingdom. *Id.*

177. *Id.* art. 15, Dependent Personal Services, in pertinent part, exempts from taxation by the United Kingdom income derived by a United States resident employee in the form of salaries, wages or similar remuneration if: 1) the United States resident is present in the United Kingdom for less than 183 days in the taxable year, 2) the remuneration is paid by a non-United Kingdom resident, and 3) the payor of the remuneration is not a permanent establishment or fixed base of the employer in the United Kingdom. *Id.*

178. See *supra* notes 176-77.

179. See *supra* note 61; *Report of the Senate Foreign Relations Committee on the Income Tax Treaty with the United Kingdom and Two Protocols*, reprinted in 3 TAX TREATIES (CCH) ¶ 8103EE.

180. *Id.*; United Kingdom-United States Treaty, *supra* note 159, art. 23.

181. See generally Rev. Rul. 74-330, 1974-2 C.B. 278 (tax treatment in "single loan-out" arrangements); Rev. Rul. 74-331, 1974-2 C.B. 282 ("double loan-out" arrangements).

business manager may be additional shareholders.<sup>182</sup> The corporation itself would join with another entity, such as a production company, as shareholder, partner or joint venturer.<sup>183</sup>

A loan-out arrangement creates two contractual relationships, an independent contractor relationship and an employer-employee relationship.<sup>184</sup> In an independent contractor relationship, the corporation agrees with the producer or promoter to provide the services of the performer. Generally, the corporation promises not to deduct withholding or other employment taxes from the producer's or promoter's payment to the corporation. In return, the promoter or producer promises to provide the performer's services.<sup>185</sup> In an employer-employee relationship, the performer contracts with the corporation to create a second taxpayer, the corporation. This employment relationship permits the performer to consider various tax planning strategies, such as a variety of employee benefit programs<sup>186</sup> and planning on a fiscal year basis. From the standpoint of the performer, these benefits will override the disadvantages of deducting withholding and other employment taxes from the artist's gross receipts.<sup>187</sup>

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182. Short, *Tax Benefits of the Entertainer's Loan-Out Corporation*, 1 COUNSELING CLIENTS IN THE ENTERTAINMENT INDUSTRY, Practising Law Institute, 527, 530-42 (1982).

183. *Id.*

184. *Id.*

185. See generally Rev. Rul. 75-503, 1975-2 C.B. 352 (boxer and manager enter into exclusive personal services contract).

186. For example, a United Kingdom performer who forms a single loan-out corporation in the United States can have the corporation adopt a qualified pension plan and trust, and pay out part of the compensation received by the corporation as a contribution on behalf of the artist to the trust. Distributions the artist receives from the plan at the specified retirement age will receive favorable tax treatment. See W.K. Norman, *supra* note 26, at 11-12. See generally Short, *The Effects of the Tax Equity and Fiscal Responsibility Act of 1982*, 2 COUNSELING CLIENTS IN THE ENTERTAINMENT INDUSTRY, Practising Law Institute 527 (1984).

187. In addition to utilizing employee benefit programs, a United Kingdom resident performer could use non-United Kingdom single loan-out companies to achieve further tax benefits. The performer could form a Netherlands holding company which itself forms a Netherlands Antilles services company. The services company could then contract with United States promoters to receive 1) royalty income for licensing the performer's intangible rights, and 2) performance income for the performer's services rendered outside the United States. Under certain conditions, it has been noted that both kinds of income could be exempt from United States income tax, subject to a comparatively negligible Antilles income tax, and not subject to United Kingdom income tax until distributed to the performer. See W.K. Norman, *supra* note 26, at 12. For an extended discussion of the tax benefits of a loan-out corporation, see Short, *supra* note 182, at 530-42.

If taxable income relating to the "personal activities" of a United Kingdom performer benefits the performer in some way, Article 17(2) of the United Kingdom-United States Treaty allows the United States to tax this income, even if the income accrues to a third party.<sup>188</sup> When income accrues to the benefit of another person,<sup>189</sup> the Host State may tax the income, notwithstanding the provisions of the articles on Business Profits,<sup>190</sup> Independent Personal Services<sup>191</sup> or Dependent Personal Services.<sup>192</sup> If the performer can establish that neither he nor persons<sup>193</sup> related to him<sup>194</sup> directly or indirectly participated in the performer's profits, including the receipt of deferred compensation, bonuses, fees, dividends or partnership or other distributions, the Host State will not consider such income to accrue to the benefit of another person for purposes of Article 17(2).<sup>195</sup>

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188. United Kingdom-United States Treaty, *supra* note 159, art. 17(2).

189. "Another person" includes another individual, a corporation, partnership, estate, trust, and any other body of persons. United Kingdom-United States Treaty, *supra* note 159, art. 3(1)(c). "For purposes of Paragraph (2), income is considered to accrue to the benefit of another person where that other person has control over or the right to gross income derived in respect of an entertainer or athlete's services as such. This rule applies regardless of whether the other person is a 'sham' corporation or conduit." *United Kingdom Technical Memorandum, supra* note 148.

190. United Kingdom-United States Treaty, *supra* note 159, art. 7.

191. *Id.* art. 14.

192. *Id.* art. 15. Since a United States resident performer cannot realize income tax benefits by forming a domestic loan-out corporation to perform services in the United Kingdom, it is suggested he contract as an individual with United Kingdom promoters, thereby enabling him to claim a foreign tax credit on his United States federal tax return for United Kingdom income tax incurred. W.K. Norman, *supra* note 26, at 22; *see supra* notes 134-37 and accompanying text.

The effective rate of United Kingdom income taxation would be reduced if a portion of the services compensation received by the United States performer is paid to a Netherlands licensing and administrative services company, in the form of royalties and fees for management services. W.K. Norman, *supra* note 26, at 22.

193. *See supra* note 189.

194. Related persons may be any of the following: 1) an employee or agent of the performer; 2) a person regularly employed by the performer in an advisory capacity, such as an attorney, accountant or investment advisor; or 3) a person related to the performer in accordance with Article 9, paragraph 5 ([Associated] Enterprises), *United Kingdom Technical Memorandum, supra* note 148.

195. *Id.* art. 17(2).

C. *The United States' Tax Treaty with Canada: Drawing an Unequal Line*

The Canada-United States Income Tax Convention<sup>196</sup> (the Canada-United States Treaty) ratified in October of 1984, contains several provisions that have a direct effect on specific facets of the music, film and sports industries. A Toronto-based tax consultant has openly accused the Treaty of singling out the industry in particular, and warns that the treaty has potentially disastrous results for United States performers.<sup>197</sup> The United States and Canada spent ten years negotiating the Treaty, but United States entertainers who perform in Canada will probably wish the two nations had never signed the Treaty, while Canadians performing in the United States will welcome the comparatively favorable treatment they receive under the Treaty's provisions.

Article XVI of the Canada-United States Treaty governs "Artistes and Athletes." Paragraphs (1) and (2) of this Article are virtually identical to the corresponding provisions of the United Kingdom-United States Treaty.<sup>198</sup> Like the United Kingdom-United States Treaty, the maximum tax-free compensation that a performer is allowed in a taxable year is U.S. \$15,000, and the length of the entertainer's stay in the Host State is of no consequence.<sup>199</sup> The Article does not strip the Host State of its ability to apply the provisions of the articles dealing with Independent Personal Services and Dependent Personal Services.<sup>200</sup>

Under the Canada-United States Treaty, United States actors performing in Canada will be required to pay a 15% with-

196. Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, September 26, 1980, amended by Protocols signed June 14, 1983, and March 28, 1984, United States-Canada, 51 U.S.T. 5986, T.I.A.S. 5206, reprinted in 1 *TAX TREATIES* (CCH) ¶ 1317.

197. Adilman, *Canadian Treaty Hits U.S. Acts*, *VARIETY*, Nov. 21, 1984, at 1, col. 2.

198. Canada-United States Treaty, *supra* note 196, art. 17; see United Kingdom-United States Treaty, *supra* note 159, art. 17.

199. See *supra* text accompanying note 173.

200. Canada-United States Treaty, *supra* note 196, arts. XIV and XV. "Thus, an entertainer or athlete resident in a Contracting State and earning U.S.\$14,000 in wages borne by a permanent establishment in the other State may be taxed in the other State as provided in Article XV." *Technical Explanation of the Income Tax Convention Between the United States and Canada with Respect to Taxes on Income and on Capital*, reprinted in 1 *TAX TREATIES* (CCH), § 1317Q [hereinafter referred to as "*Canada Technical Explanation*"].

holding tax on compensation earned by them.<sup>201</sup> However, if the performer has formed a "loan-out" company,<sup>202</sup> no foreign tax credit will be allowed to flow through that company to the performer.<sup>203</sup> Canada, on the other hand, has no similar provisions for loan-out companies because Canadian performers do not use loan-outs.<sup>204</sup> For example, if a United States performer receives a fee of U.S. \$200,000 for personal services rendered in Canada, the performer pays 15% in Canada and his company receives a foreign tax credit of U.S. \$30,000,<sup>205</sup> with the remaining U.S. \$170,000 going to the performer's company. In the United States, the profits of a loan-out company normally accrue to the artist at year's end.<sup>206</sup> If the performer is in the fifty percent tax bracket, he would effectively be paying tax on U.S. \$170,000. This results in a form of double taxation to the performer, the prevention of which is a basic purpose of the Treaty.<sup>207</sup> In this limited context, the treaty does not appear to achieve that purpose.

A second problem with the Canada-United States Treaty primarily concerns United States film actors and their profit participations, granted to top actors and directors by contract, based upon a certain level of success at the box office. The Treaty will apply the fifteen percent withholding tax to profit percentages earned from the film, no matter what year or years such payments are received, and notwithstanding the fact that the film was made by a United States production company.<sup>208</sup> The Treasury Department specifically states that athletes who are members of teams in international sports leagues, such as the National Hockey League or the Major Leagues in baseball, are exempted from these provisions.<sup>209</sup>

Another Treaty provision provides that Canadian music performers who reside in Canada but record in the United

201. Adilman, *supra* note 197, at 138; Canada-United States Treaty, *supra* note 196, art. XXIV(5).

202. See *supra* text accompanying notes 181-87.

203. Canada-United States Treaty, *supra* note 196, arts. XVII, XXIV.

204. Adilman, *supra* note 197, at 138.

205. I.R.C. § 901.

206. Short, *supra* note 182, at 532.

207. Canada-United States Treaty, *supra* note 196, Preamble.

208. Adilman, *supra* note 197, at 138; Canada-United States Treaty, *supra* note 196, arts. XVII(3), XXIV(5).

209. *Canada Technical Explanation*, *supra* note 200, art. XVI(3).

States will no longer have to pay United States tax on the worldwide sales of their albums, as had previously been the case.<sup>210</sup> Because the new Treaty changed the previous Treaty's definition of "permanent establishment,"<sup>211</sup> Canadian music performers who sign worldwide recording contracts with United States record companies and record in the United States are now not deemed to have created a permanent establishment in the United States.<sup>212</sup> Prior to the new provisions, the Canadian performers had been taxed on such worldwide sales, even if actual United States sales only accounted for a small portion of total sales.<sup>213</sup> Other aspects of the Treaty favorable to Canadians but unfavorable to Americans involve financial holdings retained in the home country for nonresident individuals, and domestic relations matters such as alimony and child support payments.<sup>214</sup>

The First Protocol to the Canada-United States Treaty<sup>215</sup> contains two significant provisions relating to income earned by athletes. First, Paragraph (3) of Article XVI states that the rules contained in Paragraphs (1) and (2) do not apply to income of an athlete when that athlete is employed by a team in a league that plays regular season games in both Canada and the United States.<sup>216</sup> In that case, the athlete would be taxed under the more favorable provisions of Article XV, concerning

210. Adilman, *supra* note 197, at 138.

211. Compare Canada-United States Treaty, *supra* note 196, art. V(7) ("a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on") with Article I of the Former Canada-United States Treaty, *supra* note 20, reprinted in 1 *TAX TREATIES* (CCH) ¶ 1205 ("enterprise of a Contracting State").

212. Adilman, *supra* note 197, at 138. The Canada-United States Treaty, *supra* note 196, art. V(7) states that:

[a] resident of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

*Id.*

213. *Id.*

214. Adilman, *supra* note 197, at 138; Canada-United States Treaty, *supra* note 196, arts. XXIV(8), XXV(3).

215. Protocol Amending the Convention Between Canada and the United States of America With Respect to Taxes on Income and on Capital, June 14, 1983, reprinted in 1 *TAX TREATIES* (CCH) ¶ 1317P [hereinafter cited as "Canada Protocol"].

216. Canada-United States Treaty, *supra* note 196, art. XVI(3). For a list of the teams involved, see *supra* note 94.



Dependent Personal Services.<sup>217</sup> Additionally, Paragraphs (1) and (2) of Article XVI do not apply to income of a team that plays regular season games in both the United States and Canada. Such a team will not be taxed in a Contracting State under Paragraph (2) merely because a team member participates in the profits of the team based on contingencies, such as level of ticket sales.<sup>218</sup> Moreover, the Treaty does not apply to incentive payments made by a team to an athlete based on his performance.<sup>219</sup>

Second, Paragraph 4 states that, notwithstanding the provisions relating to independent and dependent personal services,<sup>220</sup> when a resident team pays a nonresident player a "bonus payment,"<sup>221</sup> the payment is subject to tax in the payor team's state.<sup>222</sup> Such a payment is not included in computing the amount of gross receipts of an athlete in a calendar year for purposes of Paragraph (1).<sup>223</sup>

#### D. *The United States' Tax Treaty with Australia*

##### Loan-out corporations under the old Australia-United

217. *Canada Technical Explanation*, *supra* note 200, provides that: the athlete's remuneration would be exempt from tax in the Contracting State of source if he is a resident of the other Contracting State and earns \$10,000 or less in the currency of the State of source, or if he is present in that State for a period or periods not exceeding in the aggregate 183 days in the calendar year, and his remuneration is not borne by a resident of that State or a permanent establishment or fixed base in that State.

*Id.*

218. An example of such a clause is the clause contained in the contract recently signed by Toronto Blue Jays pitcher Bill Caudill. Chass, *Sutcliffe's Price: A King-Size Bed*, N.Y. Times, Mar. 3, 1985, § 5, at 4, col. 1.

219. Canada-United States Treaty, *supra* note 196, art. XVI(4); *Canada Technical Explanation*, *supra* note 200.

220. Canada-United States Treaty, *supra* note 196, art. XVI(4) (referring to arts. XIV, XV of the Treaty).

221. A "bonus payment," for purposes of the Canada-United States Treaty, is a payment other than salaries, wages, or like remuneration, that is made to induce an athlete to sign an agreement relating to the performance of the athlete's services. *Report of the Senate Foreign Relations Committee on the Income Tax Treaty Signed with Canada*, reprinted in 1 TAX TREATIES (CCH) ¶ 1317U art. XVI.

222. Canada Protocol, *supra* note 215, art. VII(4). The tax on the bonus payment is limited to fifteen percent of the gross amount of such payment. *Id.*

223. *Treasury Department Technical Explanation of the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, as amended by the Protocol signed at Ottawa on June 14, 1983, and the Protocol signed at Washington, D.C. on March 28, 1984*, reprinted in 1 TAX TREATIES (CCH), ¶ 1317S.

States tax treaty<sup>224</sup> could not use the industrial and commercial profits rule to shelter personal services income of a performer. While the commercial traveler provision of the treaty<sup>225</sup> permitted an Australian performer total exemption from United States tax on his personal services income under certain conditions,<sup>226</sup> the definition of industrial and commercial profits under the old treaty<sup>227</sup> did not include "remuneration for personal services." Thus, the industrial and commercial profits rule<sup>228</sup> posed a serious problem for an Australian corporation employing an Australian performer.

The new Australia-United States Treaty<sup>229</sup> adopts the Model Treaty provisions pertaining to "Artistes and Athletes," but reduces to \$10,000 the maximum amount of gross receipts a nonresident performer can earn in the Host State without being taxed by that Host State under Article 17.<sup>230</sup> Like the other provisions dealing with personal services income, this rule will not prevent the state of residence of the performer (and, in the case of the United States, the state of citizenship) from simultaneously taxing such income, subject to a foreign

224. Convention Between the Government of the United States of America and the Government of the Commonwealth of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, May 14, 1953, United States-Australia, 4 U.S.T. 2274, T.I.A.S. No. 2880, *reprinted in* 1 TAX TREATIES (CCH) ¶¶ 403P-424.

225. *Id.* art. IX(1).

226. *Id.* art. IX(1) stated that:

An individual who is an Australian resident shall be exempt from United States tax on remuneration or other income received, in respect of personal (including professional) services performed in the United States, on or after the effective date of this Convention if—

- (a) during the taxable year in which the services are performed he is present in the United States for a period or periods not exceeding in the aggregate 183 days; and
- (b) the services are performed for or on behalf of an Australian resident.

*Id.*

227. *Id.* art. II(1)(n).

228. *Id.* art. III(1).

229. Convention Between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, August 6, 1982, United States-Australia, T.I.A.S. No. 10773, *reprinted in* 1 TAX TREATIES (CCH) ¶¶ 402A-403C [hereinafter referred to as "Australia-United States Treaty"].

230. *Id.* art. 17(1).

tax credit.<sup>231</sup> The Senate Foreign Relations Committee stated that the intent behind the provision is to prevent performers from avoiding tax on earned income in one of the countries by taking advantage of treaty provisions.<sup>232</sup>

#### E. *The United States' Tax Treaty with France*

Under the original provisions of the existing<sup>233</sup> treaty between the United States and France<sup>234</sup> (the France-United States Treaty), if a French performer worked in the United States as an independent contractor, he could be exempt from federal income tax without setting up a "loan-out" corporation. The treaty provided that compensation earned by a French resident performer for "independent activities"<sup>235</sup> in the United States was exempt from tax if, for a maximum of 183 days during the taxable year, the performer was physically present in the United States, and maintained a fixed base<sup>236</sup> in the United States.<sup>237</sup> However, the France-United States Treaty imposed more stringent requirements upon a French performer working in the United States as an employee. In order to be exempt from federal income tax, the employee 1) could not have been physically present in the United States for more than 183 days during the taxable year, 2) his employer must not have been a United States resident, and 3) the employee's compensation must not have been paid by a per-

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231. *Report of the Senate Foreign Relations Committee on the Income Tax Treaty with Australia signed August 6, 1982, reprinted in 1 TAX TREATIES (CCH) ¶ 403E.*

232. *Id.*

233. A third Protocol to the France-United States Treaty, ratified August 23, 1985, changes the applicable treaty provisions for performers for taxable years beginning on or after October 1, 1985. *See infra* note 247 and accompanying text.

234. Convention Between the United States of America and the French Republic With Respect to Taxes on Income and Property, July 28, 1967, United States-France, 19 U.S.T. 5280, T.I.A.S. No. 6518, amended by Protocols, October 12, 1970, 23 U.S.T. 20, T.I.A.S. No. 7270, and November 24, 1978, 30 U.S.T. 5109, T.I.A.S. No. 9500 and January 17, 1984 [hereinafter cited as "France-United States Treaty"].

235. *Id.* art. 14(3), which states as follows:

The term "independent activities" means all activities—other than commercial, industrial or agricultural activities—carried on on his own account independently by a person who receives the proceeds or bears the losses arising from these activities.

*Id.*

236. A "fixed base" for purposes of the France-United States Treaty is analogous to the definition of "permanent establishment." *See supra* note 150.

237. France-United States Treaty, *supra* note 234, art. 14(2).

manent establishment of the employer in the United States.<sup>238</sup>

The industrial and commercial profits provision of the France-United States Treaty<sup>239</sup> differs from its counterpart in the Australia-United States Treaty<sup>240</sup> in that personal services income is included in the definition of industrial and commercial profits in the France-United States Treaty.<sup>241</sup> Thus, loan-outs were possible for French performers who wanted to avoid United States income tax under the Treaty in cases when the employer-employee or independent contractor provisions were not applicable.<sup>242</sup> The central issue for French resident performers under the Treaty before the new protocol was whether they had an employment relationship with United States promoters, or performed independent personal services for such promoters.<sup>243</sup> Recent private letter rulings issued by

238. *Id.* art. 15.

239. *Id.* art. 6(1).

240. *See supra* note 229.

241. France-United States Treaty, *supra* note 234, art. 6(6).

242. It has been suggested that, due to certain French tax laws, a performer who is a French resident may not organize a loan-out company outside of France to avoid French income tax, because the income of the loan-out company would be attributable to any shareholder who performs services. W.K. Norman, *supra* note 26, at 11.

243. In the case of United States artists performing in France, the use of a loan-out structure is said to aid in minimizing French income tax risks regarding income earned from personal service contracts with French promoters, *id.* at 21, and is considered helpful in proving that the United States performer is not performing as an employee of the French promoter, but is either providing independent services, or services as an employee of a United States corporation. *Id.*

As a more exotic alternative, a United States performer could utilize a "double loan-out" structure. First, the performer forms a company in a so-called "tax haven," such as the Cayman Islands, and contracts with that company to perform services abroad. The Cayman Islands company then assigns its personal services contract with the performer to a United States secondary loan-out corporation, which in turn directly enters into contracts with foreign promoters to perform services in their respective countries.

If the Cayman Islands company meets each of the following two conditions, its net income should not be subject to current United States income tax:

- 1) United States persons who own 10% or more of the voting stock of the corporation, directly or indirectly (defined as "U.S. shareholders," I.R.C. § 951(b)), own less than 50% of the company, I.R.C. § 957(a); and
  - 2) Five or fewer United States citizens or residents do not in the aggregate own more than 50% of the value of the company's outstanding shares.
- Id.*

If correctly structured and operated, the United States loan-out corporation will not be subject to French income tax. The United States performer will be subject to United States income tax on the compensation he receives from the Cayman Islands company, Treas. Reg. § 1-1.1(b), but should be exempt from French income tax on

the Service have held that an orchestra conductor,<sup>244</sup> a concert artist touring the United States,<sup>245</sup> and a performer in commercials<sup>246</sup> performed independent personal services and were exempt from United States taxation under the France-United States Treaty. The new third protocol to the Treaty<sup>247</sup> adopts the 1981 Treasury Department Model Treaty "Artistes and Athletes" rule, with a U.S. \$10,000 monetary limitation.

#### F. *The United States' Tax Treaty with Germany*

The commercial traveler and industrial and commercial profits provisions of the income tax treaty between Germany and the United States are discussed above.<sup>248</sup> Income earned in the United States by a German performer who visits the United States for a limited time will be exempt from United States taxation, so long as the German performer furnishes his services as an employee of, or under contract with, a German company that bears his compensation.<sup>249</sup> Industrial or commercial profits earned by a German entity, doing business in the United States and not considered a permanent establishment, are exempt from United States taxation, but not if such income stems from the furnishing of personal services.<sup>250</sup> The Germany-United States Treaty has not been amended to include the "Artistes and Athletes" provisions of the Model Treaties, and the Germany Treaty's provisions are representa-

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compensation he earned for performance of services in France, as long as he is considered to have furnished either independent services, or services as an employee of the United States secondary loan-out company. France-United States Treaty, *supra* note 234, arts. 14, 15. See generally W.K. Norman, *supra* note 26, at 22-23.

244. Private Letter Rulings 7918093 (Jan. 31, 1979) and 7809022 (Nov. 29, 1977).

245. Private Letter Rulings 7926025 (Mar. 27, 1979), 7838063 (June 22, 1978) and 7812038 (Dec. 21, 1977).

246. Private Letter Ruling 7806050 (Nov. 11, 1977).

247. Protocol to the Convention Between the French Republic and the United States of America With Respect to Taxes on Income and on Property, signed January 17, 1984, reprinted in 2 TAX TREATIES (CCH) ¶ 2836D.

248. See *supra* notes 148, 154.

249. See *supra* notes 145-48 and accompanying text. A United States performer furnishing services in Germany may utilize the "double loan-out" structure, see *supra* note 243, as long as he is treated, for German income tax purposes, as an "employee of," or "under contract with," the United States secondary loan-out company. See Germany-United States Treaty, *supra* note 88, art. X(2)(b).

250. See *supra* notes 149-54 and accompanying text.

tive of the pertinent provisions in all the treaties before the advent of the "Artistes and Athletes" provisions.

### G. *The United States' Tax Treaty with Italy*

The "Artistes and Athletes" provision of the new Italy-United States tax treaty<sup>251</sup> (the Italy-United States Treaty) provides a significant variation to the Model Treaty provision. As in similar provisions found in most other new treaties, an Italian performer's income derived from personal services he performed in the United States is subject to federal income tax under the Treaty if the total income received is greater than a certain amount.<sup>252</sup> However, his personal services income will also be subject to federal income tax if he is physically present in the United States for a period exceeding ninety days in the taxable year, no matter how small the income.<sup>253</sup>

The provision takes precedence over the Italy-United States Treaty's provisions on Independent and Dependent Personal Services<sup>254</sup> by adding another monetary threshold for taxation at source, and a shorter time limit for presence in the United States.<sup>255</sup> Even if the performer's income escapes taxation under the "Artistes and Athletes" provision, the income may still be taxed by the host state if it falls under the above personal service income provisions.<sup>256</sup>

251. Convention Between the Government of the United States of America and the Government of the Republic of Italy for the Avoidance of Double Taxation With Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion, signed April 17, 1984, United States-Italy, — U.S.T. —, T.I.A.S. No. — (does not yet appear in official treaty reporters), *reprinted in* 2 *TAX TREATIES* (CCH) ¶¶ 4328-4336 [hereinafter referred to as "Italy-United States Treaty"].

252. The threshold amount in the Italy-United States Treaty is \$12,000. *Id.* art. 17(1)(a).

253. *Id.* art. 17(1)(b).

254. *Id.* art. 17(1). Article 14 of the Italy-United States Treaty is entitled "Independent Personal Services," while article 15 is entitled "Dependent Personal Services."

255. *Treasury Department Technical Explanation of the Convention Between the Government of the United States of America and the Government of the Republic of Italy for the Avoidance of Double Taxation With Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion and an Accompanying Protocol and Exchange of Notes Signed at Rome on April 17, 1984*, *reprinted in* 2 *TAX TREATIES* (CCH) ¶ 4336C.

256. *Id.*

### CONCLUSION

Entertainers and athletes once were able to enjoy either partial or total exemption from taxation on their personal services income earned worldwide. Now that several nations have incorporated the "Artistes and Athletes" provisions of the Model Treaties into both the old and new tax treaties, international performers have fewer opportunities to avoid taxation of their income by at least one state. The United Kingdom-United States Treaty allows the host state to tax the performer for personal service income in excess of \$15,000, no matter how brief his stay. The Canada-United States Treaty seems to discriminate even further against United States performers than against their Canadian counterparts, and acknowledges the special situation confronting professional athletes performing in both the United States and Canada. The Australia-United States Treaty is similar to the United Kingdom-United States Treaty, but allows an even lower threshold beyond which a host state may tax a performer's personal services income. The France-United States Treaty made it more advantageous for a performer to furnish personal services as an independent contractor than as an employee, but the proposed Protocol would relegate the performer to the same tax treatment as under the United Kingdom-United States Treaty. The Germany-United States Treaty remains the last true vestige of advantageous tax treatment for the performer, by the use of loan-out corporations. The new Italy-United States Treaty is perhaps the toughest rule for performers, limiting both income and time limits to comparatively miniscule amounts in relation to the other treaties. Consequently, attorneys representing entertainers and athletes who perform in these countries must continue to adopt innovative strategies for sheltering the income of their clients.

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