THE TAX CLUB

Article 17 – the Artiste Clause – Time for Reconsideration?

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The issue addressed in this paper, in its narrowest sense, is whether in light of the more general limitation on benefits provisions commonly found in most modern tax treaties,[1] the so-called "Artiste Clause,"[2] also found in almost all modern tax treaties,[3] should continue to impose additional limitations to treaty benefit entitlements based solely on the nature of one's business or profession.[4] In a broader (perhaps overly broad) sense the issue raised is whether in a treaty context primary jurisdiction to tax income generated by transitory activities in the source State should reside with the source or residence State; if the former, the avoidance of double

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1 See, e.g., Article 22, 1996 U.S. Treasury Model Income Tax Convention, 1 CCH Tax Treaties ¶214 (hereinafter 1996 U.S. Model Treaty); Article 26, U.S.-Netherlands Treaty; Article 28, U.S.-German Treaty; and the discussion generally in Feingold, Entitlement to Treaty Benefits: a Comparison of the Dutch and German Solutions (Tax Club, September 13, 1994). All references to a particular provision of a tax treaty is to the provision of the tax treaty currently in force, unless otherwise indicated.

2 Although appearing as different article numbers in various tax conventions, except as otherwise indicated, the Artiste Clause is referred to in this paper as Article 17 because it has been historically so numbered in the OECD and U.S. Model Income Tax Conventions.

3 See, e.g., Article 17, 1996 U.S. Model Treaty; Article 17, U.S.-U.K. Treaty; Article 18, U.S.-Netherlands Treaty; Article 18, U.S.-Mexico Treaty.

4 It is interesting to note that the OECD in its report regarding the taxation of entertainers, artistes and sportsmen states at the very outset that: "The main principle which underlies this report is that income from entertainment and sporting activities should be taxed in the same way as income from any other activities. Exceptions to this principle should be kept to a minimum." OECD Model Income Tax Convention, Vol. II Issues in International Taxation, The Taxation of Income Derived from Entertainment, Artistic and Sporting Activities, ¶14 (March, 1987) (the "1987 OECD Artist Report").

taxation, a principal purpose for entering into tax treaties,[5] would be relegated to the foreign tax credit or exemption provisions of the applicable treaty,[6] or of internal law.[7]

It has long been tax treaty policy not to require adherence to source country fiscal rules with respect to income derived from transitory activities. This principle has manifested itself in a number of treaty provisions which require as a threshold for source country taxation that income is attributable to, or a deduction borne by, a permanent establishment situated in the source State,[8] that the taxpayer is present in the source State for more than a specified period,[9] or that the taxpayer is employed by a resident of the source State.[10] In each of the above instances, before the source State may impose its tax, the taxpayer's activities must have had some degree of regularity, continuity or permanence so that the activities come within the jurisdiction of the source State's taxing rights,[11] and it would not be overly burdensome to require that the taxpayer become acquainted with and subject to the tax laws of the source country. On the other hand, where some minimum threshold of activities in the source State does not exist, it has been

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5 The prevention of tax avoidance and evasion is another stated purpose.

6 See, e.g., Article 24, U.S.-Mexico Treaty; Article 25, U.S.-Netherlands Treaty.

7 See, e.g., IRC section 901 et seq.

8 See, e.g., Articles 7 and 15, 1996 U.S. Model Treaty.

9 See, e.g., Article 14, U.S.-U.K. Treaty.

10 See, e.g., Article 15, U.S.-U.K. Treaty.

11 Commentary to Article 7(1) at para. 3, 1963 OECD Draft Double Taxation Convention.

thought that requiring adherence to source country tax rules was generally not worth the bother, particularly where the taxpayer was likely to be subject to tax in his country of residence.[12]

Consider, for example, individual "X" who is resident of Country A. X is employed by large company, C, also a bona fide resident of Country A, that is engaged in an active trade or business in Country A. C does not maintain a permanent establishment in the U.S. C requests that X go to the U.S. for a period of six weeks to assist in the negotiation of an agreement. Assume further that X's work in the U.S. for C is successfully completed within six weeks after which he leaves the U.S. never to return. C awards X a substantial bonus (i.e., in excess of $3,000) in addition to his salary measured in part by the profits generated by the contract he negotiated.

In the above illustration, apart form any special rules under an applicable treaty with the U.S., X would be subject to U.S. federal income tax on the portion of his salary and bonus from C attributable to his U.S. services regardless of whether such salary or bonus were paid to him currently or in a subsequent year,[13] and C would be required to deduct and withhold U.S. federal income and payroll taxes from the portion of X's salary which relates to the U.S.[14] While it is possible that X would be able to credit the U.S. tax due on his salary against his tax

12 Commentary to Article 5(1) at para. 6, 1963 OECD Draft Double Taxation Convention.

13 IRC §§864(b), 864(c)(6), 871(b)(1).

14 And both X and C, respectively, would be required to file U.S. federal income tax returns regardless of whether they were exempt from U.S. tax by virtue of an applicable tax treaty provision. I.R.C. §864(b)(1); Treas. Reg. §§1.6012-1(b) and 1.6012-2(g)(1).

liability in Country A,[15] or treat a portion of his salary as exempt from tax in Country A, depending on whether Country A used a foreign tax credit or exemption method for the avoidance of double tax, what is undoubtedly certain is that absent a treaty exemption X would be liable for the payment of U.S. taxes.

If X were resident in a country that had a tax treaty with the U.S. which contained a dependent personal service exemption similar to Article 15 of the 1996 U.S. Model Treaty,[16] X would be exempt from U.S. federal income tax on the salary and bonus he received from C, provided, as has been posited in the above illustration, C neither was a resident of the U.S. nor maintained a permanent establishment in the U.S., and further provided that X was not present in the U.S. for more than the period proscribed in Article 15 – generally 183 days.[17]

The exemption afforded X under the dependent service exemption of the type illustrated would not obtain if X's employer, C, were a U.S. corporation or had maintained a permanent establishment in the U.S. and the compensation payable to X attributable to his work in the U.S. had been borne by such permanent establishment. In either of such cases, C could, subject to the usual limitations, deduct the salary payable to X against income which otherwise

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15 See, e.g., Article 23, 1996 U.S. Model Treaty.

16 See, e.g., Article 15, U.S.-Swiss treaty; Article 15, U.S.-U.K. treaty.

17 In our newer treaties, the 183 maximum period is any period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable year. See Article 15, U.S.-Swiss Treaty; Article 15, U.S.-France Treaty. In our older treaties, the period is a period or periods not exceeding 183 days in the tax year concerned. See Article 15, U.S.-U.K. Treaty. A similar change was made in the 1992 OECD Model Tax Income Convention and is contained in the current OECD Model.

would be subject to U.S. tax.[18] Nor would the exemption obtain if X were present in the U.S. for more than the proscribed 183-day period.

Thus, if either C's activities in the U.S. were undertaken in a manner that would indicate that its activities were not transitory in nature (for example it had a permanent establishment), or if X were present in the U.S. for a period or periods which ordinarily would be considered sufficient to require him to be subject to tax on a regular basis, the dependent service exemption does not apply. However, where the activities and presence are in fact transitory, as in the case posited above, the general rule has been to vest primary tax jurisdiction over the compensation payable to X in his country of residence.

That this rule makes eminent sense can be best illustrated to lawyers if instead of the illustration above, we considered the case of L, a U.S. citizen and resident and a lawyer who, in the course of his professional activities, spends time in, for example, Germany in connection with such professional activities. Furthermore, let us assume that L earns a very substantial fee for his work. Although L could not avail himself of a dependent service exemption, not being an employee, he could avail himself of the independent personal service exemption contained in

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[18] If C were not a resident of Country A, but rather of Country N which did not have a tax treaty with the U.S., X could still qualify for the dependent service exemption even though C would be subject to U.S. income tax on its net profit and therefore be able to claim the benefit of the deduction for salary paid to X without regard to whether it maintained a permanent establishment in the U.S. Cf. Rev. Rul. 70-247, 1970-1 C.B. 156. However, if C were considered to have maintained a permanent establishment in the U.S. within the meaning of the treaty Country A had with the U.S. to which the salary payable to C were allocable under such treaty, the dependent service exemption probably would not apply.

Article 14 of the U.S.-German treaty, provided the fee which he received was not attributable to a fixed base L maintained in Germany.[19]

Thus, in the treaty context, under the general rule the primary jurisdiction to tax compensation from both dependent and independent services resides with the country of residence. Primary jurisdiction to tax such income shifts to the country of source if the activities giving rise to the income are not transitory. For this purpose, transitory means that the employer, in the case of a dependent service situation, is not a resident of, nor does it have a permanent establishment in, the source country, and the service provider is not present in the source country for too long a period. In the case of independent services, transitory means the lack of a fixed base to which the income could be attributable.

A similar rationale exists for the exemption afforded business profits of an enterprise otherwise entitled to treaty relief which is not attributable to a permanent establishment. Absent such an exemption, business profits which are attributable may be subject to tax by the source country. Significantly, in calculating the base upon which the tax may be calculated, allocable expenses are required to be allowed as a deduction.[20] Thus, if an enterprise of the U.S. maintaining a permanent establishment in, e.g., Germany, has attributable revenue of $100, and allocable expenses of $70, it would suffer German tax on $30. Presumably, the German tax imposed on the $30 of profit would be available for purposes of computing the

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19 The independent service exemption is also contained in the U.S. Model, the OECD Model and virtually all of the treaties to which the U.S. is a party. Certain of the older treaties also impose a 183-day period proscription. See Article 14, U.S.-U.K. Treaty.

20 Article 7(3), 1996 U.S. Model Treaty.

foreign tax credit in the U.S.[21] On the other hand, business profits of the U.S. enterprise which are not attributable to a permanent establishment in Germany should not be subject to German tax.

In the above illustrations, vesting either the country of residence or the source country with primary tax jurisdiction should be neutral with respect to the treaty objective of the prevention of fiscal evasion if, as we assume, in the case of an individual taxpayer the term resident includes only those persons who are liable to tax in the country of residence,[22] or in the case of an enterprise to which the business profits exemption might apply, treaty benefits are extended only to those persons to whom benefits were intended to apply. Given these assumptions, ceding primary tax jurisdiction to the country of residence eliminates any issue of double taxation without resort to the tax credit or exemption systems of the applicable treaties or of internal law, or the competent authority or mutual agreement provision of an applicable treaty.[23] In addition, eliminating the source country tax for the transient activities of individuals would appear to promote rather than hinder international commerce.[24]

Article 17, which, as more fully described below, overrides Articles 14, 15 and in certain circumstances Article 7 (the business profits exemption) with respect to income derived from the personal activities of artistes and athletes in their capacities as such, was initially

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21 See IRC §901 et seq.

22 See Commentary to Article 4(1) at para. 8, 1977 OECD Model Income Tax Convention.

23 See, e.g., Article 24, 1996 Model Tax Treaty.

24 Commentary to Article 15 at para. 3, 1963 OECD Model Income Tax Convention.

conceived to prevent high earning artistes and athletes from artificially structuring their arrangements so as to come within the four corners of the personal service exemptions afforded under an applicable treaty. Indeed, it is difficult to discuss the background of Article 17 without considering the very situations at which it was directed.

As noted previously, absent the application of an independent or dependent personal service exemption afforded by an applicable tax treaty, an individual who performed services in the U.S. would be subject to U.S. income tax on the income derived therefrom. To avoid this result, nonresident alien individuals sought to come within the dependent personal service exemption by being employed by a suitable foreign employer that could avail itself of a business profits exemption under an applicable treaty.[25] As a result, on the face of it, both the employer and the individual performing the services were exempt from U.S. tax.[26]

This result, i.e., that both the employee and the employer would be exempt from U.S. tax on income generated from the personal services of an individual who was a bona fide employee of a foreign employer, of course, was contemplated by the dependent service and business profits exemptions. If an individual did not qualify as a bona fide resident of a treaty country[27] or otherwise was not a bona fide employee of the foreign corporation purporting to

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25 The Service had ruled that income from the furnishing of services constituted industrial and commercial profits. Rev. Rul. 54-119, 1954-1 C.B. 156. Furthermore, the Service had ruled that the conduct of a concert tour of limited duration did not constitute a permanent establishment. Rev. Rul. 67-321, 1967-2 C.B. 470.

26 Rev. Rul. 70-247, supra.

27 See Johansson v. U.S., 336 F.2d 809, 64-2 USTC ¶9743 (5th Cir. 1964).

provide his services,[28] the dependent exemption would not apply either because not being a resident of the treaty country he was not entitled to treaty benefits, or because he did not come within the literal terms of the dependent service exemption.[29]

The principle of equal tax treatment for artistes[30] had for a long time been balanced by the concern that equal tax treatment was a prescription for tax avoidance in the source country through the use (or possible abuse) of the tax treaty provisions discussed above coupled with the perceived wide-spread use of aggressive planning techniques in the country of residence that made it seem probable that if the source country were to cede primary tax jurisdiction to the country of residence, the result would be that little or no tax would be collected. Given this perception it was not difficult for countries in which significant personal appearance revenues were likely to be generated to adopt the principle that income derived from personal appearance activities of artistes should be taxed in the country of source, regardless of whether an individual artiste could come within an otherwise applicable treaty exemption.

In the U.S. this policy initially manifested itself with the issuance of the so-called lend-a-star rulings.[31] At the time of their issuance, the principal concern was the use (or misuse) of Article XI(1) of the then U.S.-U.K. treaty by British performers. Article XI(1) exempted a

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28 See, e.g., Johansson, supra; Rev. Rul. 74-330, 1974-2 C.B. 278, Example (1).

29 In the latter connection, of course, a different result might obtain if the treaty in question had an independent personal service exemption. See Rev. Rul. 75-503, 1975-2 C.B. 352.

30 1987 OECD Artist Report, supra note 4. See Macdonald, Annotated Topical Guide to U.S. Income Tax Treaties, Vol. 4, Sec. 15 at 3343-44.

31 Rev. Rul. 74-330, 1974-2 C.B. 278; and Rev. Rul. 74-331, 1974-2 C.B. 281.

U.K. resident from U.S. tax on compensation received for services performed for or on behalf of a U.K. resident, provided the individual performing the services was not present in the U.S. for as many as 183 days during the year. Thus, a nonresident alien, U.K. resident individual who planned to appear in concert in the U.S. could enter into an employment agreement with his own U.K. corporation ("UKC") pursuant to which UKC would be granted the sole and exclusive right to use the in-concert personal appearance services of the individuals for the purpose of putting on, promoting or producing concerts featuring such artiste. Furthermore, pursuant to the terms of the typical employment agreement, UKC was granted the further right to hire out or sublet the individual's services to an end-user. In a typical case, UKC would enter into one agreement with a general promoter in the U.S. pursuant to which UKC would lend-out the individual's services to the promoter for a fee, out of which UKC would pay the individual the salary due under his employment agreement. Typically such salary had a fixed component and a contingent component which depended on the success of the venture. Alternatively, UKC would enter into numerous agreements with a number of different local promoters in the U.S. each with respect to a portion of a concert tour, would receive the fee from the various promoters, and would pay the salary due the individual.

For purposes of our discussion, we will assume (which, of course, was not always the case) that all of the formalities of the contractual arrangements were strictly observed, that UKC earned a reasonable profit, and that the individual concerned reported the salary he received from UKC as required in accordance with U.K. law. Apparently aware that under the applicable provisions of U.K. law then extant, U.K. resident individuals could exclude from income subject

to tax the compensation derived from their services rendered wholly outside the U.K.,[32] the policy was to limit the availability of the personal service exemption.

Rather than attempting to strengthen the provisions in the then existing treaty that in certain circumstances required certain individual residents to be subject to tax in the U.K. in order to obtain treaty benefits,[33] the IRS sought to limit the availability of the exemption afforded by Article XI(1) by pronouncing first that, in order to meet the "for or on behalf of" requirement contained therein, a U.K. individual had to be employed by a U.K. resident company.[34]

Although the Service acknowledged that the common-law tests of employment contained in the regulations[35] should be determinative for purposes of Article XI(1), and that under that test the legal right to direct the performance of the services is the most significant factor, in several of the examples in the lend-a-star rulings the Service concluded that an employment relationship did not exist where the employer obligated itself to pay the purported employee salary which at least in part was based on the employer's profits.[36] As an alternative

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32 It is understood these rules were tightened in 1974 so that in order for an individual to take advantage of the special regime with respect to foreign (i.e., non-U.K.) emoluments, the individual had to be employed outside the U.K. for a "continuous period or periods" of significant duration during a 365-day rolling period. With somewhat great fanfare, the more limited benefit of the tightened rules was recently eliminated entirely with effect from March 17, 1998.

33 Cf. Article 4(5), U.S.-U.K. treaty.

34 Possibly a shaky conclusion to the extent employment was required since the inclusion of the term professional services in Article XI(1) implied that both a dependent and an independent exemption could apply so long as the principal for whom services were performed was a U.K. resident.

35 Treas. Reg. §31.3401(c)-1(b); Bartels v. Birmingham, 331 U.S. 126 (1947).

36 Rev. Rul. 74-330, supra, Examples (1) and (2).

basis for the denial of the exemption afforded by Article XI(1), the Service concluded, in Example (3) of Rev. Rul. 74-330, that notwithstanding the form of the arrangements as loosely described above, the person that borrowed the individual's services from UKC would be considered his employer. Since such company was a U.S. corporation, the exemption afforded by Article XI(1) did not apply.[37] Although UKC was considered an agent of the individual, the Service ruled that it was nevertheless entitled to the business profits exemption in respect of its net profits under the applicable provisions of the U.S.-U.K. treaty.

The position taken by the Service regarding employment and agency was somewhat questionable. Indeed, the courts have consistently rejected the Service's argument that income received by a personal service corporation is the income of the individual who performs the services, holding that so long as the corporation actually conducts business and enters into agreements to provide the services of the individual, the employment relationship, as well as the company's role as principal, will be respected.[38] Notwithstanding that the Service's position was somewhat questionable, the lend-a-star rulings were incorporated by reference in the regulations until recently.[39]

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[37] Rev. Rul. 74-331, supra, reached similar conclusions with respect to double loan-out agreements.

[38] See, e.g., Sargent v. Commissioner, 929 F.2d 1242 (8th Cir. 1991); Keller v. Commissioner, 77 T.C. 1014 (1981), aff'd, 723 F.2d 58 (10th Cir. 1983); Fogelsong v. Commissioner, 691 F.2d 848 (7th Cir. 1982).

[39] Compare Treas. Reg. §1.1441-4(a)(1) prior to its amendment by T.D. 8734, with Treas. Reg. §1.1441-4(a)(1) after such amendment.

Regardless of how one might feel regarding the lend-a-star rulings, shortly after they were issued, they largely became moot with the introduction of Article 17 into the 1975 U.S.-U.K. Treaty.[40] With minor variations and in many cases subject to a de minimis rule, the first paragraph of Article 17, the text of the U.S. Model of which is appended at the end of this paper, provides that notwithstanding the independent and dependent personal service exemptions which are contained in the treaty, income derived by entertainers, artistes, sportsmen, etc. (for convenience referred to as "artistes") from their personal activities as such, may be taxed in the source State. Where operative, the first paragraph of the artiste clause expressly makes the independent and dependent exemptions inapplicable to income of an artiste, regardless of the arrangements under which their affairs are structured. Thus, an individual U.K. resident artiste would be taxed in the source State with respect to income derived from his personal activities as an artiste, regardless of whether such individual's activities in the source State were transient in nature, and regardless of whether such individual were employed or the identity or residence of his employer. Nor does it matter whether the individual was subject to or subjected to tax in his country of residence. In other words, insofar as the income of artistes covered by Article 17(1) is concerned, there is a reversal of the general rule for income derived from transient activities: the country of source is given the primary right to tax such income, with the result in the U.S. that in cases where an artiste clause of the type described was in a tax treaty, the Service no longer had

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[40] Article 17 (or at least the first paragraph thereof) appeared in the 1963 OECD Model Income Tax Convention. However, the Artiste Clause was not commonly included in U.S. tax treaties until the 1975 U.S.-U.K. Treaty.

to rely on the questionable interpretation of the law of employment or agency as enunciated in the lend-a-star rulings.

Before considering the balance of Article 17 and its implications, several observations are in order. First, only income derived from the personal activities of artistes in their capacity of being artistes is covered by Article 17(1). Second, although the term artiste has been defined broadly,[41] the definition does not extend to "behind-the-scenes" personnel, such as administrative, technical or management personnel.[42] In a situation in which an individual performs publicly and also acts behind the scenes (for example an actor/director), it is possible that an apportionment of the compensation payable might be necessary, with the portion allocable to the acting covered by Article 17(1), and the balance not.[43] Thus, Article 17(1) discriminates against only certain income of an artiste, presumably because such income is easy to see and is perceived likely to be large and it is feared such income could possibly avoid taxes in the country of residence.

As noted above, income derived by an artiste which is not attributable to his personal services as an artiste is not covered. For this purpose, it appears that there must be a link between the generation of the income and a public exhibition for the income to be covered. Thus royalties for the use of intangibles created by an artiste would generally not be covered by Article 17(1); such income ordinarily would be covered by an applicable royalty article of the

41 OECD Commentary to Article 17, Paragraph 1.

42 Id.

43 1987 OECD Artist Report, supra note 4, at paras. 68 and 69.

treaty.[44] Income derived by an artiste in respect of his activities in connection with the creation of an intangible that are not directly attributable to an exhibition may nevertheless be considered compensation under the laws of the source State,[45] and not a royalty under an applicable royalty provision of a treaty. Nevertheless, it appears arguable that such income would not come within Article 17(1) except to the extent such income were directly linked to a personal exhibition in the source State.[46]

The purpose of Article 17(2) is to put teeth into Article 17(1) by ensuring that income which would otherwise be covered by Article 17(1) does not escape source country taxation simply because such income "accrues to another person." Article 17(2) provides, in effect, that where income which otherwise would be covered by Article 17(1) does not accrue to an artiste, but rather accrues to another person, e.g., an artiste company such as UKC in the above discussion, that income (of such other person) may be taxed by the source State notwithstanding the dependent and independent personal service and business profits exemptions. In the Treasury's view,[47] the source-State tax permitted by virtue of Article 17(2) is imposed on the person providing the services of the artiste, rather than on the artiste. This result seems correct

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44 See OECD Commentary to Article 17(1) at paragraph 9.

45 See Ingram v. Bowers, 47 F.2d 925, 926 (S.D.N.Y. 1931), aff'd, 3 U.S.T.C. ¶915 (2nd Cir. 1932); Boulez v. Commissioner, 83 T.C. 584, 590 (1984).

46 For example, compensation for services rendered in connection with the creation of a recording before a live audience. OECD Commentary to Article 17(1) at paragraph 9.

47 Treasury Department Technical Explanation of the United States Model Income Tax Convention (September, 1996) ("Technical Explanation"), CCH Tax Treaties, Volume I, ¶214A at p. 10,609-35 (copy attached).

because if income covered by Article 17(2) were considered to be the income of the artiste, such income would already have been covered by Article 17(1), and there does not appear to be any intention to cover the same income twice, once under Article 17(1) and once under Article 17(2). Indeed, the Technical Explanation states that at least under U.S. principles, the income taxable by Article 17(2) is reduced by and to the extent of salary payments to the performer covered by Article 17(1).[48]

From this it could be argued that Article 17(2) should be treated as applying only to income not otherwise considered the income of the artiste under ordinary tax principles. For example, Article 17(2) is supposed to operate in situations in which the artiste company is neither a sham nor a conduit for the artiste. This, however, seems to fly in the face of the basis for the provision: to counter abusive or sham arrangements artificially created by artistes and their aggressive advisors. Thus, to read the provision in this manner would be to conclude that the provision can apply only where there was little reason for the provision in the first place (other than the perception that home country taxation was being avoided) and this may therefore prove too much.

Another possible interpretation is that Article 17(2) literally deals only with income that the artiste purposely left on the table, i.e., income which, but for the relationship between the artiste and the artiste company, would have accrued directly to the artiste. This interpretation would suggest that Article 17(2) is, in effect, a transfer pricing provision. If some amount which could have accrued to the artiste, nevertheless was left behind in (i.e., as the profit

48 Technical Explanation at p. 10,609-35.

element of) another person under normal transfer pricing principles, such amount should be reallocated to the artiste. Of course, in the absence of common control, it is difficult to imagine that any material amount which could have accrued to the artiste would be left behind. But even in cases of common control it is possible for an arm's-length consideration to be paid to an artiste with a reasonable profit left in an artiste company; and it would certainly be possible to structure an arm's-length consideration which had a profit or deferred compensation element. Moreover, if all Article 17(2) was supposed to do was to reallocate to the artiste that which he or she purposely left behind, the reallocated income would fall under Article 17(1), not Article 17(2), and such income would be taxable to the artiste. As noted above, the income taxable under Article 17(2) is not taxable to the artiste.

Treasury is of the view that the abuse to which Article 17(2) was directed does not exist and therefore Article 17(2) would not apply where it can be established that the relationship set forth in the last clause of Article 17(2) does not exist. The last clause of Article 17(2) of the U.S. Model[49] provides that Article 17(2) does not apply if it can be established that neither the artiste nor a person related thereto participates directly or indirectly in the profits of the other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, or partnership or other distributions. Literally under Article 17(2), there is an irrebuttable presumption that an abusive case exists if the artiste has some right, either by ownership or contract, to a participation in profits or deferred compensation from the other person. Presumably, this would be so even if the artiste has not exercised that right in an abusive manner;

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49 Which is contained in most U.S. tax treaties.

there is nothing to indicate that the person to whom Article 17(2) is directed may avoid the consequences of Article 17(2) by establishing that no abuse has occurred where an artiste has any of the proscribed relationships with such person. Interestingly, in a case within the last clause of Article 17(2), i.e., a non-abusive case, although the income of the other person is not covered by Article 17(2), the income generated by an artiste employed by such person is nevertheless covered by Article 17(1). Accordingly, Treasury seems clearly to have intended Article 17(1) to apply to situations which Treasury has opined are not abusive.

In the latter connection, in connection with the U.S.-Italy treaty, Treasury has stated that for purposes of Article 17(2), a person may be considered to be related to an artiste if he is regularly employed by the artiste in an advisory capacity such as his attorney, accountant, or investment advisor.[50] At least one country has taken the view in practice that ownership by, e.g., an attorney who has represented the artiste from time to time of a company which does not furnish the services of artistes or is entitled to receive or receives any amount which could be covered by Article 17(1) is nevertheless an artiste company (because of the relationship) and the relationship alone converts business profits generated from an activity which is related to the artiste's activities into Article 17(2) income.

As noted previously, for U.S. tax purposes it would seem that only the profit of the person furnishing the services of the artiste attributable to the income which would be covered by Article 17(1) if accrued directly by the artiste would be denied the benefit of the business profits

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50 See Treasury Technical Explanation of the U.S.-Italy Treaty, 1 CCH-Tax Treaties, ¶4850, at 33,039.

exemption by virtue of Article 17(2). Consider the situation of a so-called artiste company ("AC") all the shares of which are owned by the artist ("A") in question. Further assume that AC not only employed A (for convenience a solo performer) but also a battery of technicians, administrators, stagehands, managers, directors, producers, and a variety of other types who would not fall within the category of artiste. Further assume that AC put on a performance in the U.S. at which each of the non-artiste types performed very valuable functions and also at which A performed. Assume further that AC received $1,000,000 for the performance, and paid the non-artiste types aggregate salary and fees of $500,000 and a salary to A of $450,000, leaving AC with a profit of $50,000. Finally, assume AC did not have a permanent establishment in the U.S.

In the above illustration, the $450,000 paid to A would be covered by Article 17(1). How much of the $50,000 profit of AC is covered by Article 17(2)? As noted previously, Article 17(2) covers income which otherwise would be covered by Article 17(1) and Article 17(1) covers only income of an entertainer from his personal activities as such. The issue is whether some portion of the profit of AC relates to the activities of the non-artiste types, i.e., it has not been earned from the artiste's activities as a performer, but rather has been earned from the others' activities of producer, etc. – non-covered activities. Suppose further that the artiste himself also acted as producer, and in which case the question is whether a portion of the profit of AC relates to the artiste's producer activity – also a non-covered activity. It does not appear that the latter argument would prevail in circumstances where the artiste's activities as producer were negligible, but could conceivably prevail where A in fact performed substantial non-artistic services and AC paid A a separate and somewhat standard producer's fee therefor.

Finally, it should be noted that Article 17(2) does not deem a person covered by the provision to have a permanent establishment in the source State. Rather, literally, it only denies the benefit of the business profits exemption. Absent that benefit, the source country is free to impose its tax in accordance with its law. In certain countries, the tax is imposed on gross revenue and the amount of tax thereby imposed could exceed the tax that would have been imposed had the person subject to Article 17(2) been subject to tax on its net profit by virtue of having a permanent establishment or fixed base in the source State. Although this should come as no surprise in light of the recommendation of the OECD that a high withholding tax rate should apply,[51] it seems somewhat bizarre in light of the purpose of Article 17(2) to ensure that "Article 17(1) income" would not escape the tax that would be due if the other person had a permanent establishment in the source State to which such income is attributable.[52]

An issue might arise in a case where Article 17(2) applies to a person who in fact had a permanent establishment in the source State and the source State imposed a tax on the person in excess of the amount that would be due under the business profits provision. In that case, it might be possible for that person to raise an argument under the non-discrimination provision of an applicable treaty.[53]

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[51] 1987 OECD Artiste Report, supra note 4, at para. 47.

[52] Of course, the issue does not arise in the U.S.; absent the business profits exemption, the other person is subject to tax at the regular rates on net profit in the absence of special circumstances.

[53] See, e.g., Article 24(3), 1997 OECD Model Treaty.

It must be remembered that when Artiste Clauses were first introduced into tax treaties, tax treaties generally did not contain comprehensive limitation on benefits provisions. A limitation on benefits provision limits the benefits of a treaty to qualified residents, including, among others, individuals who are resident, within the meaning of the applicable fiscal domicile article,[54] as well as resident corporations that meet certain criteria. An individual who meets the definition of resident contained in an applicable fiscal domicile article will be subject to tax in his country of residence on his worldwide income by reason of his domicile or residence.[55] Although a resident individual will be subject to tax in his country of residence, as has been noted elsewhere,[56] an individual who meets the definition of resident qualifies for treaty benefits without regard to whether such individual "erodes his tax base" by making deductible payments abroad.

On the other hand, a non-publicly-traded resident corporation may qualify for treaty benefits as of right only if it either is engaged in an active trade or business in the resident country or if it meets both an ownership and base erosion test. A corporation which meets these tests is likely to be subject to tax in its country of residence. Of course, the country of residence may allow deductions which would not have been allowable in the source State. For example, in

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54 See, e.g., Article 4, U.S.-Netherlands Treaty.

55 See generally, Article 4, U.S.-Netherlands Treaty. However, a U.S. citizen or green card holder is not automatically a resident of the U.S. within the meaning of an applicable fiscal domicile article absent a substantial U.S. presence even though such a resident is subject to U.S. income tax on his worldwide income without regard to whether he has such a substantial U.S. presence.

56 Feingold, Entitlement to Treaty Benefits: A Comparison of Dutch and German Solutions,

the U.S. a current deduction generally cannot be taken for "deferred compensation" until paid,[57] and a more stringent rule applies in cases where the payee is related to the payor.[58] The application of Article 17(2) to the income left behind in an artiste company may neutralize tax planning techniques which are legitimate in the resident country simply because they are not allowed in the source country.

Similarly, it might be possible for an individual who qualifies as a resident to reduce the basis upon which his home country charges tax by making deductible payments to third-party residents. In certain circumstances, such payments are unlikely to implicate the tax system of the source country, with the result that income of an artiste who qualifies as a resident may be subject to an effective rate of residence taxation at a somewhat lower rate than the nominal rate. While it may be possible that legal reduction in residence country taxation is of some concern to a source country, it would seem that if there were a concern that the laws of a residence country allowed for the wholesale legal avoidance of residence country taxation, that concern more properly should lead to a different and perhaps more far-reaching remedy than an artiste clause. In other words, it is not at all clear why this concern should be dealt with only in the case of artistes, rather than more generally. Furthermore, it would also seem possible for qualified residents to reduce their effective rate of home country tax without making payments to third-country residents. For example, certain countries may allow their residents to contribute

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supra note 1, at page 24.

57 IRC §404.

58 IRC §267; see also IRC §163(e)(3).

substantial sums to pension trusts. The imposition of source country tax on such residence income may in certain cases make such legitimate home country planning more difficult to accomplish.

It is perhaps easier to explain the continued inclusion of Artiste Clauses in tax treaties with comprehensive limitation on benefits provisions using the "revenue principle" alluded to above: artistes' earnings are too easy to see and appear to be too large for source countries to give up their "share" of the tax revenue therefrom.

In summary, the initial inclusion in treaties of Artiste Clauses as a departure from the principle that income from transitory activities should not be subject to tax in the source country had as its genesis the presumption that artistes who avoided source country tax were also likely to be able to avoid substantially all home country tax. By inclusion in our treaties of comprehensive limitation on benefits provisions, the opportunity for both the avoidance of source country taxation and the unanticipated reduction of home country taxes should be substantially reduced. Moreover, whatever opportunities remain apply equally to artistes and others. Accordingly, it appears that the avoidance of treaty abuse can no longer serve as the principal basis for the Artiste Clause.

Perhaps the "revenue principle" does provide a more convincing rationale. However, if indeed this is the overriding principle, countries such as the U.S., which previously had calculated that they would lose more revenue than they gained if there were no Artiste Clause, might wish to redo their sums in light of the revenues lost to their treaty partners who aggressively enforce source country taxation. Moreover, even assuming one can make a

convincing case for the continued inclusion of the Artiste Clause in tax treaties, less clear is whether the real objectives could be served as well with a less draconian Article 17(2). For example, certain of the harsh results that flow from a literal application of Article 17(2) could be avoided if instead of overriding Articles 14, 15 and 7, the amount covered by Article 17(2) were considered attributable to a permanent establishment maintained in the source State. In this manner, at least expenses allocable to the income covered by Article 17(2) would be allowed. Furthermore, this result would be consistent with what was presumably the more limited objective of the Artiste Clause – to ensure that income from certain designated transitory activities will be subject to primary tax jurisdiction by the source State.