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Robert Mitchum 17 - Australian Taxation Office 0: The Taxation of International Athletes

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Abstract
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Keywords
income tax, double taxation ageement, FCT v Mitchum, United States, Australia

ROBERT MITCHUM 17 - AUSTRALIAN TAXATION OFFICE 0: THE TAXATION OF INTERNATIONAL ATHLETES

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Pre-Game Commentary

If only Robert Mitchum[1] had opened the batting for the West Indies or participated in the Haka at the start of a Bledisloe Cup[2] match, his effect upon the Australian taxation source rules may have been inconsequential. With a physical presence comparable to Muhammad Ali, Mr Mitchum may have been more suited to boxing than acting. To comment upon the various hearings of *FCT v Mitchum*[3] in boxing style, 'Mr Mitchum suffered a low blow in the first round, yet recovered to deliver a second round knock down and a lucky third round knock out.' The case focused on the derivation and source of income under s25 (1)(b) of the *Income Tax Assessment Act* 1936 (Cth), (ITAA) and the provision of dependent services under Article IX (2) of the *Switzerland/Australian Double Taxation Agreement*[4]. The purpose of this paper is to examine whether the High Court would have reached a similar ruling in *FCT v Mitchum* if Article 17 of the *United States/ Australia Double Taxation Agreement* had been in effect.

Article 17 of the *United States/Australia Double Taxation Agreement* is based on Article 17 of the Organisation for Economic Co-operation and Development (OECD) model convention on the prevention of double taxation and fiscal evasion which outlines the rights of taxing states to tax international entertainers. Article 17 is included in all DTAS negotiated by the Australian Taxation Office (ATO), and classifies an entertainer as 'international' if they perform in at least two countries, one of which is Australia.[5] Under both domestic and double tax treaty interpretation, Mr Mitchum would be classified under the same heading as Michael Jackson, Michael Crichton,[6] Michael Jordan and Michelangelo. It is understandable that the ATO is enthusiastic about artists and entertainers who generate millions of dollars of revenue each year in Australia.

This paper examines the taxation of international athletes. Part one will examine the taxation of athletes resident in a non-Double Taxation Agreement country. Part two will investigate taxation of athletes within a Double Taxation Agreement environment. Part three compares Article 17 in the various DTAS Australia is a party to and Part Four will consider tax-planning opportunities for the international athlete.

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1 1917-1997.
2 Two Match Rugby Union competition between Australia and New Zealand, played annually.
3 *Federal Commissioner of Taxation v Mitchum* (1965) 113 CLR 401.
4 Schedule 15 *ITAA*.
5 Delany PT, 'International Entertainers: A Comparison of the Taxing Rules' 1996 Vol December 1995/ January 1996 *The CCH Journal of Australian Taxation* 52.
6 Author of novel *The Lost World*.

This article concludes that there are numerous tax planning opportunities available for the Australian and international athlete. The possibilities of tax minimisation are increased through the existing loophole formed by the High Court decision in *FCT v Mitchum.*[7] However, the broad interpretative approach adopted by the High Court to Part IVA may limit the use of loan-out corporations and other structures used by international athletes to mitigate their Australian taxation liabilities.

First Quarter - Australian Taxation of the International Athlete

The nature of international sport requires athletes to travel to other countries to compete. Australia is a frequent destination of these athletes to compete, train and endorse products. The taxation of an international athlete in Australia may be in one of two forms:

1. Under domestic legislation;

2. Under a Double Tax Agreement (DTA).

Non-DTA Environment: Source

Australia has the right to tax residents on domestic and foreign source income and also the right to tax non-residents on Australian source income.[8] However, what is Australian source income?

The word "source" is not defined in the *ITAA* but its meaning has been considered frequently by Australian courts in various contexts. In the early case of *Nathan v FCT*,[9] Isaacs J, stated:

> The legislature in using the word "source" meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact.[10]

Where payment is received for services or employment the common approach of the court is to source the income where the work or service is performed. This broad statement was enunciated by Jordan CJ in *C of T (NSW) v Cam & Sons Ltd*.[11] In this case the taxpayer employed two men to work on trawlers. Trawling was carried out in the open sea, both within and outside the territorial waters of New South Wales. The men were engaged in New South Wales on the morning of each cruise that lasted from nine to 25 days. They were paid in New South Wales on their return. The place where the work was performed was held to be the source of the income. Wages for work performed within New South Wales territorial waters were subject to New South Wales tax. Wages for work performed outside those waters was not.[12] Jordan CJ further suggested that in an ordinary case where there was nothing special in the

7 *Federal Commissioner of Taxation v Mitchum* (1965) 113 CLR 401.
8 s25(1)(a) & (b) *ITAA*.
9 (1918) 25 CLR 183.
10 Ibid at 188.
11 (1936) SR (NSW) 544.
12 Lehman and Coleman, *Taxation Law in Australia*, The Law Book Company, Sydney (1996) 974.

circumstances of the contract or the payment, 'the all-important factor is the doing of the work'.[13]

This approach was adopted by the High Court in *FCT v French*.[14] In this case the taxpayer was an engineer and spent two or three weeks each year working in New Zealand. The High Court held this income to be sourced in New Zealand and the taxpayer was therefore subject to a s23 (q) exemption to Australian tax.[15] Dixon CJ, considered the cases of *Robertson v FCT* [16] and *Watson v C of T (WA).*[17] With reference to these cases, his Honour, emphasised on the status of the employee and the contractual position of the parties. In the case of *Robertson*,[18] the taxpayer was a director of a company who spent two years overseas.[19] The Commissioner held that this income was sourced outside Australia yet Dixon CJ expressed his disagreement with this decision.[20] He suggested that there were three different categories of worker: director, employee and independent contractor.

He stated that where the employee is a Director the source of earnings would most likely be the place of contract and or payment. It is suggested in light of this decision, that importance must be placed on the status of the worker. If one were to hypothesise that a worker from each category was employed by a company and received remuneration for overseas work, the following continuum could be created.

Place of Work		Place of Contract and or Payment
Employee	Director	Independent contractor[21]

This illustrates the opinion of Chief Justice Dixon expressed in *Robertson v FCT.*[22] Athletes are commonly independent contractors and if suitable contractual structures are developed they may source income outside of Australia for services performed within Australia. Such structures were examined by the High Court in *FCT v Mitchum.*[23]

Mr Mitchum leaves the field

The late Mr Mitchum once again raises his head in this paper to demonstrate a possible taxation loophole in regard to source. In *FCT v Mitchum,*[24] Mr Mitchum had entered into a contract with Mandeville Films SA, a company incorporated in Switzerland. Under this contract the company agreed to employ him to render his services as a consultant to the producer and to:

13 (1936) SR (NSW) 544.
14 (1957) 98 CLR 198.
15 Lehman and Coleman, *Taxation Law in Australia,* The Law Book Company, Sydney (1996) 975.
16 (1937) 1 AITR 152.
17 (1930) 44 CLR 94.
18 (1937) 1 AITR 152.
19 Ibid.
20 Ibid.
21 Lehman and Coleman, *Taxation Law in Australia,* The Law Book Company, Sydney (1996) 975.
22 (1937) 1 AITR 152.
23 *Federal Commissioner of Taxation v Mitchum* (1965) 113 CLR 401.
24 Ibid.

> [A]dvise in the connexion of the selection and suitability of principal members of the cast and to assist the producer in the selection, training and coaching of the other members of the cast, and to consult with the producer in connexion with the revision and/or changes of the screenplay, and also to act, play, perform, and take part in two motion picture photoplays and in rehersals etc for and as directed by the company at such studios and places and on such locations as that company might from time to time designate.[25]

Under this agreement Mandeville Films agreed to pay Mr Mitchum a sum of $50,000 US dollars for each two month photoplay. On 8th July 1959 the Swiss company agreed to lend the services of the respondent to Warner Bros Pictures Inc of California (Warner California) to portray the role of Paddy Carmody in a photoplay entitled 'The Sundowners'. This photoplay was to be filmed in England and Australia. It was understood and agreed between the Swiss company and Warner California that Warner California should have the right to lend the services of Mr Mitchum to Warner Bros Production Limited (London). However, notwithstanding the loan of Mr Mitchum's services he should be deemed to be rendering services under the agreement between the Swiss company and Warner California.

Mr Mitchum came to Australia for eleven weeks in 1959 to film 'The Sundowners'. During this period the Swiss Company assigned their right to Mr Mitchum to a company named DRM Productions Inc incorporated in California. At the conclusion of filming Warner California paid the sum of $50,000 US dollars to DRM Productions in discharge of the Swiss Company's obligations to Mr Mitchum.

The Australian Commissioner of Taxation assessed Mr Mitchum to tax on the amount attributed to his eleven weeks work in Australia. This amount was 16,675 pounds.

Counsel for the Commissioner sought to extract a rule of law from the High Court decision in *French v FCT*.[26] The rule advocated was that:

> Where the consideration for payment of the money which constitutes income from personal exertion is the performance of work or rendering services, the source of that income is the place at which the work is done or the services performed, unless there are special circumstances necessitating or at any rate warranting a contrary conclusion.[27]

This argument was firmly rejected as 'unacceptable' by Barwick CJ at 407, as

> The conclusion as to the source of income for the purposes of the Act is a conclusion of fact. There is no statutory definition of 'Source' to be applied, the matter being judged as one of practical reality.[28]

The result was that Mr Mitchum was not liable to pay Australian tax on the earnings received by him, as this income was not sourced in Australia. It is submitted that commentators have exaggerated the effect of *Mitchum's* [29] case, and if one considers

25 Ibid at 402-404.
26 (1957) 98 CLR 198.
27 *Federal Commissioner of Taxation v Mitchum* (1965) 113 CLR 401 at 405.
28 Ibid at 407.
29 *Federal Commissioner of Taxation v Mitchum* (1965) 113 CLR 401.

the more recent cases of *FCT v Efstathakis* [30] and *Spotless Catering Pty Ltd v FCT* [31] the true effect of this case may be limited.

In *Spotless*[32] the High Court held that source of income is a question of practical reality. According to the High Court, practical reality is not so much a test as an attitude of mind in which the Court should approach the task of judgment, and this reality is subject to variation, for reality, like beauty, is in the eye of the beholder.[33] Yet, in an attempt to reduce this ambiguity, the High Court clarified the interpretation of source when referring to *FCT v Efstathakis* [34] and stating that:

> The answer is not to be found in the cases, but in the weighing of the relative importance of the various factors which the cases have shown to be relevant.[35]

From the discussions on source by over twenty High Court justices this seems to be the most useful approach.

The overall effect of the decisions, especially in light of *Mitchum's* case, is that the place of contract and the place of payment, may be sufficiently important to make them the source of the income. Therefore in the absence of a DTA, reliance on this dictum will be important to an international athlete. Notwithstanding that performing the services or competing in Australia will represent a large element in any evaluation of source, careful drafting may enable taxpayers to keep the source of income outside Australia. Further, it may at least provide a ground to argue for apportionment of source in accordance with the principle laid down in *C of T v Cam & Sons Ltd*.[36]

This position may be altered where an athlete enters the DTA environment under Article 17, or, comparably to Mr Mitchum, under Article 14 on the provision of independent personal services.

Second Quarter - Bring on the DTAS

The OECD Model Double Tax Convention is designed to prevent:

> The imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject-matter and for identical periods.[37]

Double tax agreements are often referred to as double tax treaties or conventions. As the name implies, the principal purpose of these agreements is to prevent double taxation and fiscal evasion. The double taxation agreements to which Australia is a party have no legal effect until incorporation into domestic law under the *International Agreements Act* 1953(Cth).[38] Once enacted, s4(2) of the *International*

30 (1978) 38 FLR 276.
31 *FCT v Spotless Services Ltd* (1996) 186 CLR 404.
32 Ibid.
33 Jackson JD, 'Two Methods of Truth in Criminal Procedure' (1998) *Modern Law Review* 51, 549 at 557.
34 (1978) 38 FLR 276.
35 Ibid at 4259.
36 Above n 18.
37 *Australian International Taxation Agreements* (1997) CCH Australia 31.
38 Ibid at 31.

Agreements Act[39]1953 (Cth) operates so that the DTA will prevail over any inconsistent provisions in the *ITAA* or any other Australian taxing statute. [40]

These agreements include provisions for the taxation of income derived from personal services and work undertaken in Australia by non-residents, who are a resident of the other contracting state. The relevant Articles of the OECD model tax treaty that apply to athletes are Articles 14, 15 and 17.[41]

Article 14 - Independent Personal Services

This article of the OECD Model Tax Treaty provides that income derived by a resident of one contracting state from personal services or other activities of an independent character shall be taxable only in that State, unless that resident has:

> A fixed base regularly available to him in the other State for the purposes of performing his activities.[42]

This article is concerned with professional services and with other activities of an independent character. This excludes industrial and commercial activities and professional services performed through employment. The definition of professional services is provided in paragraph two of the article.[43] The OECD commentary suggests that this definition has only an explanatory character and is not exhaustive. Moreover, as stated above, this article operates in a similar manner to Article 7. Where a taxpayer has a fixed base in another country they will be subject to taxation in that country.

It was under this Article that Mr Mitchum was assessed in *FCT v Mitchum*[44]. As the determination in *FCT v Mitchum* was that his income was not sourced in Australia and therefore did not satisfy s25(1)(b), this Article was not discussed by the High Court. However, if considered, the result would have been consistent with Mr Mitchum being taxed in his resident state. It is unfortunate that the High Court did not discuss this article in further detail as the term 'fixed base' remains uncertain. It is suggested in the OECD commentary that a physician's consulting room would satisfy this requirement,[45] yet would a movie set? This issue may have been resolved in Mitchum's case, yet for the purposes of foreign or international athlete it is suggested that a hotel, sporting ground or sporting club may not constitute a fixed base.

Article 14 provides authority on the taxation of independent personal services, yet which jurisdiction has the taxing rights over an *employee* who is working in a foreign country?

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39 1953(Cth).
40 *Australian International Taxation Agreements.* (1997) CCH Australia 31 at 34.
41 Note that all Articles apply, yet these will have the most common implication to an international athlete.
42 Article 14 of the *OECD Model Tax Convention on Income and Capital.*
43 Lehman and Coleman, *Taxation Law in Australia*, The Law Book Company, Sydney (1996) 977.
44 (1965) 113 CLR 401.
45 Baker P, *Double Taxation Conventions and International Law* (2nd ed) Sweet and Maxwell, London (1994).

Article 15 - Dependent Personal Services

The provisions of this Article answer the above question. Within this Article of the OECD Model treaty:

> Salaries, wages and similar remuneration derived by a resident of one contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other State. Nevertheless, the remuneration shall be taxable only in the taxpayer's state of residence if the following provisions are all satisfied:
>
> (a) he is not resident in the other state for more than 183 days of the relevant fiscal year, and
>
> (b) the remuneration is paid by or on behalf of an employer who is not resident of that other State; and
>
> (c) the remuneration is not borne by a permanent establishment or fixed base of the employer in that other State.[46]

The effect of this Article is quite clear and favours the state where an athlete is resident. This article was examined in the case of *FCT v Efstathakis*[47] and in the earlier case of *Johannson v US*.[48]

In the latter case the taxpayer was a professional boxer who was employed by a Swiss company of which he was the sole director and shareholder. This company negotiated with an American sporting agent for Ingemar Johansson to compete against a local champion in the United States. In this case the United States Supreme Court held that this employment situation was a mere sham and rejected the taxpayer's source argument. It is suggested that this decision influenced the IRS to pass United States Revenue Ruling 74-330.[49] This ruling penetrates a corporate veil to uncover the operations of a business that employs a sole sportsperson. The ruling states that where the circumstances indicate that the athlete is more an employee of a United States company, the athlete will be taxed in the United States. The circumstances that are taken into account are:

- Did the employer have control over the employee?
- Is there a long-term personal contract?
- Who is responsible for providing accommodation, costumes, etc.?
- Does the employer bear the customary business losses?[50]

In Johansson's case the athlete signed the contracts as guarantor for the Swiss company and performed his services on the United States company's premises and

46 Article 15 of the *OECD Model Tax Convention on Income and Capital.*
47 (1978) 38 FLR 276.
48 *Johannson v US* (1964) 336 F2d 809 (USCA 5Cct).
49 1974-2 CB 278.
50 Baker P, *Double Taxation Conventions and International Law* (2nd ed) Sweet and Maxwell, London (1994) 318.

subject to their control. The sole purpose of Ruling 74-330 and this case is to extend the taxing rights of the United States. It is suggested that a similar decision would not be arrived at today due to the redundancy of Revenue Ruling 74-330, and the introduction of Article 17(2) of the DTAS entered into by the United States. A full discussion of Article 17(2) will be provided below.

It is submitted that the complexities of these two articles would have been considered in far more detail in the sporting world if it had not been for the introduction of Article 17 which now deals specifically with international entertainers.

Article 17 - Artistes and Sportsmen

Article 17 applies notwithstanding the provisions of Articles 14 and 15 where an entertainer derives income in a foreign country. The title of the Article was changed from 'Artistes and Athletes' to 'Artistes and Sportsmen' and correlative changes were made in the wording of the Model Article.[51] This article was introduced in response to the mobility of international entertainers and their ability to engage in tax avoidance activities. The Article has four paragraphs, the first two being commonly inserted into Double Taxation Agreements. The first step in deciding upon the application of article 17, which applies only to entertainers, is to determine whether the taxpayer is an international entertainer.

Who is an international entertainer?

The word entertainer is defined in the DTAS to mean a person who performs personally in the theatre or in motion pictures, or is a radio or television artiste, a musician or an athlete. This is the wording of Article 17 and the commentary expands on this definition. The commentary was also amended in 1992 with paragraph three, five and six expanding the clarification of sportsmen and sporting activities.[52] It provides:

> The Article also applies to income from other activities which are usually regarded as of an entertainment character, such as those deriving from billiards and snooker, chess and bridge tournaments. [53]

It is suggested that this extensive definition is required to cover the dynamic forum of entertainment.

Article 17(1)

This paragraph of the article reads:

> Notwithstanding the provisions of Articles 14 and 15, income derived by a resident of a contracting state as an entertainer, such as theatre, motion picture, radio or television artiste, or a musician or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other state.

51 Ibid at 316.
52 Ibid.
53 Ibid.

The drafting of this provision makes it clear that its operation is not limited to independent personal services but includes dependent services. Thus, income accruing to an entertainer will not fall under Article 15(2). Article 17(1) applies to both employed and independent athletes. The distinction between the two types of entertainer was examined in a case decided by the Hoge Raad.[54] In this case five British resident musicians played at a series of concerts in Holland as supporting personnel to a famous singer. They argued that the Article applied solely to self-employed entertainers. The Hoge Raad rejected this argument and stated that Article 17(a) applied to all entertainers, notwithstanding Articles 14 and 15, and the remuneration was taxable in The Netherlands.[55]

Article 17(2)

This article was added when the Model was revised in 1977 and is aimed to limit the evasion of tax through the use of an 'artiste-company'. [56] This paragraph states:

> Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Article 7, 14 and 15, be taxed in the Contracting states in which the activities of the entertainer or athlete are exercised.[57]

This provision, as stated in the OECD commentary, is inserted to counteract tax avoidance where the remuneration for an athlete's performance is paid to another person. This provision counters loan out contracts, trusts and companies that do not have a permanent establishment in the country of performance.

What income falls within Article 17?

An athlete is subject to this Article where they derive income from their capacity as an athlete. Therefore, if an athlete were to visit Australia to work in an unrelated field Article 17 would not apply to this income. This raises questions as to which activities are related to working as a professional athlete.

If you consider the golfers Greg Norman and Jack Nicklaus, these athletes visit Australia to compete in golfing tournaments and also to design golf courses. Is the income derived from designing golf courses attributable to performing work in their capacity as an athlete? If you interpret Article 17 narrowly, this type of activity would not generate income from a demonstration of their sporting talents and therefore fall beyond the limits of the Article. If a wide interpretation is given, which considers the normal tasks undertaken by a golfing professional, then it may be possible for this income to be related to their profession. There is no clear direction provided by the ATO on this issue and therefore each athlete will be assessed individually.

54 Decision of 23 November, 1983 BNB 1984/33.
55 Baker P, *Double Taxation Conventions and International Law* (2nd ed) Sweet and Maxwell, London (1994) 317.
56 Ibid.
57 Ibid.

It is submitted that activities which international athletes commonly derive income from would be within the ordinary earnings of an athlete. Such activities are comparable to the eligible income of a sportsperson listed in the income averaging provisions of the *ITAA*.[58] These eligible income activities include:

- income derived from endorsing a product;
- appearing or participating in an advertisement;
- appearing or participating in an interview, and
- services as a commentator and any similar services.[59]

A practical problem with the income of athletes is that most activities performed in a foreign country are identified under one contract and no separate payment is made for each activity. This makes apportionment overly complex. Athletes derive the majority of their income from personal exertion, yet the sale of merchandise also considerably supplements their income.

Sale of Merchandise

Performers such as Michael Jackson generate substantially more wealth from the sale of merchandise than as an entertainer. With an athlete this ratio is normally reversed. There are some exceptions such as Michael Jordan who promotes Nike apparel and his own aftershave products[60] and professional surfers who sell personally designed boards and clothing.

The sale of such products is in the nature of a business operation and must therefore be assessed under the business profits article of the applicable Double Taxation Agreement. These business profits articles are not excluded by the operation of Article 17.

Article 7 is the business profits article of most Australian Double Tax Agreements and provides:

> The profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment situated therein.

For a business to be taxable in Australia it must be:

1. an enterprise;
2. have a permanent establishment in Australia; and
3. generate profits from that Permanent Establishment.

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58 1936 (Cth).
59 Division 16A s158(b) and (c) *ITAA*.
60 Aftershave products were released in early 1997 under the name 'Jordan'.

The first element of 'enterprise' was discussed by the High Court in *Thiel v FCT*,[61] where McHugh J confirmed an enterprise to be 'one or more transactions entered into for business or commercial purposes.'[62] This wise definition would comprehensively cover the sale of merchandise at sporting events.

Permanent Establishment is defined in Article 5 as a branch or dependent agent or construction site and so on. It is submitted that the sale of goods for temporary periods at golf clubs, surf clubs and areas surrounding sporting contests would not constitute a permanent establishment. Therefore, where there is no permanent establishment, business profits are taxable in the vendor's resident country.[63] It is this second element of Article 7 that would restrict its application to touring athletes and entertainers.

The third element merely indicates that the profits assessed to Australian taxation are only those of the Permanent Establishment.

The above is a general evaluation of the taxing treatment of an athlete's income, however, specific sportspersons are taxed in different ways under the differing Double Tax Agreements. It is the purpose of this paper to now compare and contrast the operation of Article 17 in the double taxation treaties that Australia has entered into.

Third Quarter - Compare and Contrast

Article 17 of the OECD Model Convention is located in all of the DTAS Australia has entered into. Certain treaties have the entertainer article as Article 9 and 14, but most countries have adopted the Model convention precedent. It would be easy to determine the taxation of international athletes if all countries followed a common form, but certain policy objectives of foreign governments have engendered changes to Article 17. It is beyond the scope of this comparison to detail all forms of Article 17 and therefore I will examine only the state funding exception, the variations of Article 17(2) and the interpretation difficulties created by the United States adaptation of Article 17.

Sri Lanka Subsidy

Within the Sri Lanka/ Australia DTA there is the inclusion of Article 17(3) which states:

> Notwithstanding the provisions of paragraph (1), income derived by an entertainer from his or her personal activities as such in one of the Contracting States shall be taxable only in other Contracting State if those activities in the first mentioned State are supported substantially from the public funds of that other State or of one of its political subdivisions or local authorities.

Other countries that have inserted variations of this provision are China, Fiji, Korea, Norway, Philippines, Thailand, Spain, Indonesia, Hungary and Poland. The House of Representatives attempted to explain the reasoning for this exception in the

61 90 ATC 4717.
62 Ibid at 4724.
63 Article 5 *OECD Model Tax Convention on Income and Capital.*

explanatory memorandum to the *Income Tax (International Agreements) Amendment Bill* (No 2) 1991. The explanation provided was that this section is designed to facilitate cultural and sporting exchanges between the two countries.[64] It is submitted that this is an insubstantial justification, surely an exchange requires representation by both parties. The evident problem with this exception is that very few Australian sporting teams are government funded. In contrast, the majority of Asian sporting teams is supported by the Government and therefore exempt from taxation. Consider the following practical effect of this provision:

In the 1993/1994 cricket season the Sri Lankan cricket team won the limited overs Benson and Hedges World Series in Australia and New Zealand. The result is that the substantial prize-money won in this event is exempt from taxation in Australia. Conversely, if the Australian cricket team had won the World Series in 1995/1996 in Sri Lanka they would have incurred Sri Lankan taxation on the prize-money.

It is suggested that the reason of cultural exchange is contradictory as it significantly favours developing nations and nations that support their sporting teams. A cultural exchange requires joint participation and with few Australian sporting bodies governmentally supported there is little incentive provided under this article.

Exceptions to Article 17(2)

Certain countries have expressed contempt for the wide application of the Model Convention's Article 17(2). The source of the contempt is the use of the words

> …accrues not to the entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Article 7, 14 and 15, be taxed in the Contracting states in which the activities of the entertainer or athlete are exercised.

Therefore Germany, Japan and the Netherlands have adopted a more liberal wording. The French have adopted the following wording.

> Notwithstanding anything contained in Articles 5 and 7, where the services of an entertainer mentioned in paragraph (1) are provided in one of the States by an enterprise of the other State, the profits derived by that enterprise from providing those services may be taxed in the first-mentioned State if the entertainer performing the services or a relative of such person, controls, directly or indirectly, that enterprise.[65]

This wider requirement of control is comparable to the exception in the Canadian and Swiss DTA. In these DTAS the section provides that paragraph (2) will not apply where neither the entertainer nor persons related to the entertainer participate directly or indirectly in the profits of the other person referred to in that paragraph.

Most DTAS do not define relative or person related, however the Netherlands DTA defines relative in Article 17(3) as 'brother, sister, spouse, ancestor or descendant.' It

64 *Income Tax (International Agreements) Amendment Bill* (No2) 1991.
65 Article 17(2) of the France/ Australia DTA.

is submitted that a similar interpretation would be made within the other jurisdictions, subject to domestic interpretation rules and the *Vienna Convention on the Law of Treaties*.[66]

New Zealand

As our trans-Tasman neighbours continue to permeate our sporting competitions and comprise the majority of athletes who visit Australia, it appears that our sporting competitions are expanding to include New Zealand athletes.[67] For this reason, especially in the sport of Rugby League, a special insertion has been made into Article 18(3) of the Australia/ New Zealand DTA. This stipulates:

> The provisions of paragraph 1 and 2 shall not apply to the income of a sportsperson, being a resident of one or both of the contracting states for the purposes of its tax, derived as a member or associate of a recognised team regularly playing in a league competition organised and conducted solely in both Contracting States, except in respect of performance as a member or associate of a national representative team of either contracting state.

This is a generous insertion and the application of this section should expand as the sporting fields of netball, rugby union and so on develop to include teams from both sides of the Tasman. The most interesting part of this provision is the definition of associate. This word is defined in Article 18(4) as any 'manager, coach, trainer, runner, physician, physiotherapist or other provider of a like support service'.

United States/ Australia Double Taxation Agreement

The majority of visiting athletes to Australia are resident in New Zealand. The next highest proportion are resident in the United States. These athletes are therefore covered under the United States/ Australian DTA, which has created certain interpretative problems over the last decade. Article 17(1) of the DTA provides:

> Notwithstanding the provisions of Articles 14 and 15, income derived by entertainers 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 any such entertainer, including expenses reimbursed to him or borne on his behalf, from such activities does not exceed ten thousand United States dollars or its equivalent in Australian dollars for the taxable year or year of income concerned.

The clarity of this provision is clouded by the wording 'reimbursed to him or borne on his behalf'. This wording was discussed by the Administrative Appeals Tribunal Tax Appeals Division[68] in the case of *FCT v Robinson*.[69] In this case the taxpayer was an English musician who toured Australia. He had his travelling and accommodation expenses paid for by a US entertainment company. The issue for discussion was whether these payments were made on behalf of the entertainer. The AAT and Federal

66 *Australian International Taxation Agreements* (1997) CCH Australia 35
67 For example Superleague, Super 12's, Lawn Bowls, Squash, and Golf.
68 Re: Taxation Appeals No VT 87/3401 AAT No 5723 Taxation.
69 (1992) 92 ATC 4424.

Court held these payments were not made on behalf of the entertainer.[70] The reasoning behind both judgments was that where an entertainer's contract provides for the provision of travelling and accommodation so that the entertainer can be in a particular place at a particular time to perform, these payments are made on the contracting company's own behalf and not on behalf of the entertainer. [71]

A useful analogy is provided by Deputy President Todd in the AAT.[72] He states that where a sporting body or club contract a person to play for them and agree to pay an athletes medical expenses in respect of sporting injuries, this would *not* be on behalf of the athlete.

This case sparked the ATO's implementation of *Income Taxation Ruling* IT 2323. This ruling comments on the case *FCT v Robinson* [73] and determines that expenses 'borne on behalf' of an entertainer are to include travelling expenses (both international and domestic), accommodation, meals, costumes, make-up, payments to agents and any other payments made to or on behalf of the entertainer.[74] Even though this ruling attempts to elucidate the situation, it cannot escape the use of the words 'on behalf of', therefore those payments not covered may still receive judicial interpretation in line with the principle espoused in *FCT v Robinson.*[75]

The above discussion demonstrates the complexity of calculating the taxation of international athletes. Each country follows a different formula and the divergence of authority on Article 17 raises two main problems. First, the intricacies are so complex that it is difficult to assess the taxation of an international athlete. And secondly, the variations of Article 17 render it redundant in preventing fiscal evasion.

In the world of international professional sport, athletes often have the ability to reside where they choose and participate in countries of their choice. They are also able to incorporate in the jurisdiction of their choice and possess the finances to support broad tax planning structures and fund expert taxation advisers. As stated above, the main purpose of the introduction of Article 17 was to combat widespread income-splitting and use of loan-out corporations. This paper will now evaluate the use of loan-out corporations. If countries continue to alter the model treaty they risk broadening the gaps in the double tax agreement net, enabling skilled tax advisers to circumvent the provisions of the treaty.

Fourth Quarter – Tax Planning Opportunities for the International Athlete.

> The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether to avoid them, by means which the law permits cannot be doubted. *Gregory v Helvering* 293 US 454 (1935).

70 Ibid.
71 Re: Taxation Appeals No VT 87/3401 AAT No 5723 Taxation at paragraph 17.
72 Ibid at paragraph 10.
73 Ibid.
74 Income Taxation Ruling IT 2323 at paragraph 9.
75 (1992) 92 ATC 4424.

A successful plan for the minimisation of an athlete's global taxation must carefully consider the following:

- the tax laws of the country in which the services are being performed;
- the applicable tax treaties;
- the nationality of the athlete; and,
- where the athlete is resident.

If these factors are not coordinated an athlete could incur substantial tax on global income. Two tax planning possibilities will be examined. First, the creation of loan out contracts for an athlete resident in a non-DTA country; and secondly, loan out contracts in a DTA environment.

Place of Contracting for a non-DTA athlete.

An athlete resident in a non-DTA country relies on the Australian source rules when earning income in Australia. These non-statutory rules are discussed above with a particular focus on the case *Mitchum v FCT.*[76] In this case Barwick CJ stated that, in the absence of statutory source rules, relative weight should be given to all of the factors contributing to the earning of the income. Given the decision in *Mitchum*, the place of contract and payment may be sufficiently important to make that place the source of the income.

Therefore, an athlete who is not contracted to perform at a specific sporting event in Australia may possess enough contractual flexibility to source the income in a non-DTA country such as a tax haven.

Tax Planning for the Athlete Competing in a DTA Environment.

> The major problem that Australian sports suffer from is that the international stars come out here and are charged up to the top marginal rate for their prize money, whereas they can go elsewhere in the world and be charged a very minimal tax rate of 5 to 10 percent. The big names would not come here if we couldn't structure the arrangements to minimise the tax.[77]

In an article written by Elizabeth Walter, leading Australian sports lawyers were enigmatic in describing the ways in which Article 17 can be circumvented. However one tax specialist stated:

> There is a practice that is not uncommon in the US relating to sportsmen which might be the case here. It might be that a sportsman or entertainer enters into a contract with a company like IMG rather than contracting with a company they have a stake in. IMG would pay the entertainer, and that would be the end of his financial remuneration. It's then up to the company to do as well as it can out of

76 (1965) 113 CLR 401.
77 Walter E, 'Legal pitfalls in the World of Entertainment' (1985).

> the tour. In theory, the lump sum paid to the performer would not be subject to Australian tax. [78]

Such a statement is true, depending on the applicable DTA. Certain double tax agreements are less stringent and may therefore be circumvented through the use of private companies. Conversely some DTAS are narrower and do not allow the use of such a contractual structure.

The Loan-out Corporation.

In its simplest form, the loan-out corporation consists of two contractual relationships. The first contract entered into is between the athlete and the company, where the athlete agrees to provide personal services to the company in exchange for mutually acceptable remuneration. The second contract is between the company and the producers, teams, clubs or agents who ordinarily contract with the athlete for their services. In the United States these entities are common and there is also a prevalence of double loan-out corporations which insert another entity between the club and the athlete.

How Does a Loan-out Corporation Circumvent the Operation of Article 17?

A loan-out corporation is designed to impact on the operation of article 17(2). This article in the OECD Model reads as follows:

> Where income in respect of activities exercised by an entertainer in his capacity as such accrues not to the entertainer but to another person, that income may, notwithstanding the provision of Articles 7 Business profits), 14 (Independent personal services) and 15 (Dependent personal services), be taxed in the Contracting State in which the activities of the entertainer are exercised, unless it is established that neither the entertainer nor any person related to him participates directly or indirectly in any profits of such other person in any manner including the recei8pt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

It is clear that the simple structure of a loan out corporation would not circumvent this paragraph, yet there are many varieties of Article 17(2). As seen in the above discussion on Article 17(2), Canada, Switzerland and the Netherlands have adapted the paragraph to limit its application to only those corporations in which the athlete or a relative has a direct or indirect interest. It is evident after examining all of the DTAS Australia have entered into that this paragraph has been adapted in three different forms. The first is the exact implementation of the Model convention.[79] The second includes a requirement that the entity be one in which the athletes themselves or a relative have a direct or indirect interest. This paragraph reads:

> Where income in respect of activities exercised by an entertainer in his capacity as such accrues not to the entertainer but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer are exercised, unless

78 Ibid at 149.

79 This form of Article 17(2) has been implemented by New Zealand, The Philippines, Malaysia, Sweden, Denmark and Singapore.

> it is established that neither the entertainer nor any person related to him participates directly or indirectly in any profits.[80]

This version allows for the use of a loan-out corporation in which an athlete or relative would have no interest. Further, as discussed above at 3.2 the word 'relative' has not been defined in any DTA apart from The Netherlands/ Australia DTA. In this DTA relative is defined as brother, sister, spouse, ancestor or descendant. This definition allows a Dutch athlete to enter into a loan-out agreement with a private company controlled by a brother-in-law, cousin, or uncle.

France, Germany and Japan have implemented a third rendition of Article 17(2). This article provides that an entity of the other Contracting State will only incur taxation in the Contracting country in which the services were performed if the athlete *himself* controls or has direct control of the entity. This interpretation is broader than the second adaptation of Article 17(2) and allows a loan-out corporation to be controlled by an athlete's spouse or other relative. Therefore athletes resident in France, Germany or Japan possess greater freedom to arrange their contractual affairs through incorporating.

One country has decided to avoid the provisions of Article 17(2) altogether. The United Kingdom has no equivalent of Article 17(2) in its DTAS. This provides British resident athletes with complete flexibility in mitigating their taxation.

As no reasoning is found in explanatory memorandums to justify these differences it is open to speculation. The majority of countries who have implemented the athlete or relative controlled entity are predominantly capital exporting countries with large international sporting companies, agents and productions companies. These countries such as the United States, Netherlands and Canada, are preserving their interest in the taxation paid by these international sports and marketing companies. Conversely, the countries that have implemented the Model Convention Article 17(2) are mostly Asian countries with few international sport-stars and multinational sports marketing companies.

The future possibility of taking advantage of loan-out corporations may be limited considering the investigation of such structures by the IRS, and the broadening of Part IVA in the Australian *ITAA*.

Is a Loan-out Corporation a Sham or a Scheme?

Loan-out corporations have come under frequent scrutiny in the United States over the past decade. The IRS analyses loan-out agreements with the intent of determining if, in fact, the international athlete is performing services as an employee of a corporation in a dependent capacity. As seen in the discussion of the case of *Johansson v US*,[81] where a non-resident entertainer or athlete is a sole shareholder of a corporation and negotiates, signs, and guarantees the contract which loans the services, the IRS view the non-resident as a provider of independent services, not as an employee of the corporation.[82] The position is similar if the corporation is

80 Article 17(3).
81 *Johannson v US* (1964) 336 F2d 809 (USCA 5 Ct).
82 Rev Rul 74-330, 74-331.

controlled by independent third parties who each earn a small dividend while all company profits are paid to the athlete in the form of a salary or bonus. [83]

It is submitted that for a loan-out corporation to satisfy the current United States requirements, the international athlete should own no stock in the entity, exercise no control over the loan-out agreements and perform under a fixed salary contract.

Whether the Australian Taxation Office will adopt a similar approach is unknown. The contentious issue is that a loan-out corporation may have no meaningful reason for existence, apart from tax minimisation, and may fall foul of Part IVA of the *ITAA.*

Part IVA of the *ITAA* contains the general anti-avoidance provisions in Australian taxation law. This Part was inserted into the *ITAA* in 1981 and imposes a 50% penalty tax,[84] which is reduced to 25% if there is a reasonable argument that Part IVA does not apply.[85] Part IVA will apply to a scheme which has resulted in a tax benefit, and the sole or dominant purpose of this scheme was to obtain a tax benefit. It is beyond the scope of this paper to examine the elements of Part IVA and this part will only be discussed in regard to loan-out corporations.

The IRS in the United States has passed certain revenue rulings and has litigated on the legality of loan-out corporations. However, there are two main differences between the rulings and the interpretation of Part IVA. The differences provide uncertainty as to the validity of loan-out corporations used by athletes competing in Australia.

The first difference is that the IRS conceded that the validity of a loan-out corporation is determined not by the corporation's purpose, but rather by the manner in which it operates.[86] This contrasts with Part IVA which requires that the sole or predominant purpose of a scheme is to obtain a taxation benefit.[87] The second notable difference is that in the United States a loan-out corporation avoids being classified as a sham if it performs some other function besides that of tax minimisation. This reasoning does equate with the judicial reasoning of the High Court of Australia in the case of *FCT v Spotless*[88] where Brennan CJ stated that an argument of commerciality would not prevent the court finding a scheme for the purposes of Part IVA.[89]

Whether these differences would impact significantly is again open to speculation. The Government explanatory memorandum on Part IVA states that:

> [T]he test for application of the provisions is intended to have the effect that arrangements of a normal business or family kind, including those of a tax planning nature, will be beyond the scope of Part IVA.[90]

It is suggested that incorporating is a normal and common way for individuals to legitimately take advantage of opportunities available for the arrangement of their

83 Baker P, *Double Taxation Conventions and International Law* (2nd ed) Sweet and Maxwell, London (1994) 318.
84 s226 (2) (a).
85 s226(2) (b).
86 Dobray D, Kreatschmann T, 'Taxation Issues Facing the Foreign Athlete or Entertainer' (1988) 9 *New York Law School Journal of International and Competition Law* 286-287.
87 S177C *ITAA.*
88 *FCT v Spotless Services Ltd* (1996) 186 CLR 404.
89 Ibrodem at 6-7.
90 Rodman S, 'Pig in a Poke' (1995) 29 *Taxation in Australia* 532.

affairs. Therefore an international athlete may be able to take advantage of incorporation to favourably arrange their business affairs. It is submitted that the purpose of Part IVA is not to inhibit the legal right of a taxpayer to minimise their taxation, yet the uncertainty of its application surely limits the freedom of a taxpayer to legitimately mitigate their Australian taxation. I would suggest the current interpretation of Part IVA runs counter to one of the traditional principles of tax law: a statute should impose taxation in clear and unambiguous terms, and a taxpayer should be free from taxation unless he comes within the letter of the law. [91]

Final Siren

Whether this prediction on the future investigation of loan-out corporations prevails or is discarded by the court, there will always be tax-planning mechanisms available for the international athlete. Due to their mobility athletes may reside in most jurisdictions and are commonly required to travel and compete in varying jurisdictions. As seen in this paper, due to the complex rules and regulations that govern international and domestic taxation, the global taxation of the international athlete is not elementary to calculate. Moreover, tax planning for these individuals requires careful attention to be paid not only to the Australian taxation laws, but also to the specific provisions of Australian treaties with other nations. It is only through a comprehensive knowledge of this law that tax planning for such individuals becomes possible.

Post-Game Wrap Up – How is Mr. Mitchum?

As stated in the introduction, if Mr. Mitchum's case fell before the High Court today, the interpretation of Article 17 would deem him assessable to taxation in Australia. In the absence of a DTA the court would find his creative directing and producing to be an incidental part of being a professional motion picture actor and he would be assessed on his entire earnings in Australia.

91 *Ramsay v IRC* [1982] AC 300 per Lord Wilberforce.