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International Tax Law Summer Conference in Rust: Taxation of a Racing Cyclist – Case Study

INTERNATIONAL TAX LAW SUMMER CONFERENCE IN RUST: DIE BESTEUERUNG EINES RADRENNFAHRERS – FALLSTUDIE

Michael *Lang* leitete bei der siebenten International Tax Law Summer Conference (6.–10. Juli 2008) in Rust (Österreich) am 7. Juli 2008 eine Podiumsdiskussion zum Generalthema „Tax Treaties – What Happens When States Disagree? – Qualification and Classification Conflicts in Tax Treaty Law", an der mit Heinz *Jirousek*, Michael *Wichmann*, Andrew *Dawson* und Elizabeth *Karzon* hochrangige Experten der Abteilungen für Internationales Steuerrecht der österreichischen, deutschen, britischen und US-amerikanischen Finanzverwaltung teilnahmen. Die Experten diskutierten bei dieser Konferenz – nicht in amtlicher Funktion, sondern in privater Eigenschaft – Fallstudien zu DBA-Fragen, von denen eine in der Folge auszugsweise wiedergegeben ist.

I. International Tax Law Summer Conference 2008

From 6th to 10th July, 2008, the 7th International Tax Law Summer Conference was held in Rust (Austria). At the panel discussion „Tax Treaties – What Happens When States Disagree?" – chaired by Michael *Lang* – various cases on international tax law were presented and discussed from the perspective of experts from the tax administration. Heinz *Jirousek* (Head of the Department for International Tax Law, Austrian Ministry of Finance), Michael *Wichmann* (Head of Tax Treaty Policy Division, German Federal Ministry of Finance), Andrew *Dawson* (Head of Tax Treaty Team, HM Revenue & Customs, UK) and Elizabeth *Karzon* (Branch Chief, Office of the Associate Chief Counsel, USA), participated in the panel discussion, not in their official function, but in their private capacity. This contribution summarizes the main points of the discussion on a selected case.

II. Facts of the Case and Discussion

Mr *Birow* is a resident of state A and he is employed by a legal entity (resident of state B) to perform as a racing cyclist. He worked 200 days all in all: In state A he performed 100 days (2 days races, 98 days training), in state B 50 days (2 days races, 40 days training, 8 days marketing activities), and in state C 50 days (5 days races, 45 days training). Mr *Birow* receives a salary paid by the legal entity.

Michael *Lang*: The main reason why we discuss this case is that there has been a quite recent court decision by the Swiss Supreme Court,[1]) which is also responsible for tax cases. The facts were almost identical to our case: The racing cyclist was a resident of Switzerland (state A), employed by a Dutch legal entity (state B), but was performing in races and trainings in several European countries. In addition, I have to mention that the treaty between Switzerland and the Netherlands is quite an old treaty and not completely in line with the OECD MC. The Swiss Supreme Court decided that as far as the activity is performed in the Netherlands, the taxation right for the races and the training is with the Netherlands. If third countries are concerned, this case could only fall under Art. 17 OECD MC if there is a direct connection between the remuneration and the performance as a sportsman, e. g. price money. In the given case, the sportsman would get remuneration as an employee – irrespective of where and how he performs – because of his employment

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1) Swiss Supreme Court 6. 5. 2008, 2C 276/2007.

contract. The relation between the performances in third countries was, therefore, not sufficiently direct, so the Swiss Supreme Court decided to cover the income under Art. 15 OECD MC. Due to the fact that the 183 days rule was not applicable, the Supreme Court said that all the income from the third countries is with the state of resident. So in the end the Swiss Court came to the conclusion that almost all of the income – with the exception of the income that was allocated to the Netherlands – is taxable in Switzerland. We should bear in mind this judgment, which, following Swiss colleagues, is at least under dispute, when discussing the perspectives of the different countries.

Heinz *Jirousek*: I think, or at least I hope that the Austrian Supreme Court would not follow the Swiss position. Austria inclines to apply Art. 17 OECD MC for the income derived from Mr *Birow*, as far as racing activities are concerned. The reason is that Austria sticks to the general concept of Art. 17 OECD MC saying that this article should only comprise income derived from a performance. The commentary on Art. 17 OECD MC says that other articles could also come into operation, whenever there is no direct link between the income and the performance. So Austria inclines to say that if there are training and/or marketing activities going on in the state where the performance takes place and these activities are directly linked with the performance, that part of the income is allocated to the taxation right of the state where the performance is given. A conflict of qualification arises if the states involved interpret the scope of application of Art. 17 OECD MC in a different way, e. g. if the state of resident of the legal entity also claims the taxation right in respect to the income attributable to the days spent for training or marketing activities directly linked to the performance, and makes use of Art. 15 OECD MC. Austria is an exemption state, which means that in almost all the tax treaties – except the ones with the UK, the US, and some others – normally the exemption method applies, and so we find the answers on the basis of the tax exemption method.

If Austria were state A, Austria would tax the whole income of Mr *Birow* derived from activities in state A (according to Art. 15 para. 1 DTA A/B) and the proportion of his income that corresponds to the days of training exercised in state C which are not directly connected with the race performance days in state C according to Art. 15 para 2 DTA A/C, with a view to the fact that the employee's presence in state C is less than 183 days, his employer is not a resident of state C, and the remuneration is not borne by a permanent establishment which the employer has in state C. Austria would grant tax exemption for the proportion of the salary that corresponds to the races performed outside state A; these are the two days performed in state B, the five days performed in state C, and those days of training that directly correspond to the races performed in those two states according to Art. 17 DTA A/B and A/C. Furthermore, Austria exempts the proportion of the salary that corresponds to the days of training and marketing activities performed in state B which are not directly connected with the races in state B according to Art. 15 DTA A/B. Art. 15 para. 2 DTA A/B would not apply because the income is derived from an employer who is resident in state B.

If Austria were state B, Austria would claim the taxation right for all the activities performed in state B (racing activities: Art. 17 OECD MC, other income: Art. 15 OECD MC). Activities performed outside the territory of state B would be subject to tax under the rules of domestic tax law (limited tax liability) as income from dependent activities which are utilized in Austria, where the premises of the employer are located. However, under the tax treaty law, Austria would lose the taxation right.

If Austria were state C, Austria would tax the income derived from the racing activities and the days of training, which are directly linked with the performance in state C. According to Art. 15 DTA A/C, Austria would give up the taxation right for the benefit of state A for income attributable to training activities which are not directly connected with the races performed in state C.

If Austria had to apply a tax treaty with the credit method, the same principles would apply. Austria would give tax credit whether or not the income is generated by direct racing activities or directly linked activities.

Michael *Wichmann*: I think the German perspective would be fairly close to the Austrian position. Germany as state A would tax all the income due to residence and activity and, therefore, unlimited tax liability. In the German tax treaties, basically, the credit method applies to Art. 17 OECD MC, so the question is what amount of tax from state B and C Germany would have to credit. Germany would look very closely at the training activities and how they are related to the sport activities. Training activities e. g. would be included in the income if there is a sufficient link, if the training is for a specific event. The marketing activities could only be included if they are also for a specific event and in the interest of the employer. In case of training which is not directly linked to the race, Germany would apply Art. 15 para. 2 OECD MC because of the combination of employment and activity. The unrelated training in state C could only be covered if the 183 days rule is fulfilled.

Michael *Lang*: There is a slight difference between the Austrian and the German approach concerning Art. 17 OECD MC. Austria wouldn't take the position that training activities are at all covered under Art. 17 OECD MC; they would be covered under Art 15. In contrast, Germany would cover at least some training activities under Art. 17, although it is quite difficult to distinguish between directly and not directly linked training activities. Let's have a look on the UK and the US perspective.

Andrew *Dawson*: Art. 17 OECD MC is an area that is quite difficult to apply, though I think the UK may apply it more widely than is the case in some other countries. Mr *Birow* is paid a salary by his employer, and he may try to allocate on the basis of days rather than on the basis of performances. The UK – as we all know – is a credit country. The situation would be quite simple if the UK were state A. We could then, basically, tax the whole income. But what is properly due for states B and C? State B isn't restricted to the performances itself, but can tax on a wider basis due to Art. 15 OECD MC. As state C, the UK would attempt to tax the five days of performance, because Mr *Birow's* income is generated from his racing activities. One of the most difficult questions certainly is how to allocate training days to other types of performances.

Elizabeth *Karzon*: Currently, the US does not have rules on sourcing of income for athletes. Generally, the proper source of compensation for labor or personal services is determined on the basis that most correctly reflects the proper source of that income under the facts and circumstances. Under proposed regulations (see sec. 1.861-4), if an athlete is paid to perform at a specific event in the US, but has trained for the event outside the US, the athlete could not allocate his income from the event between US and foreign sources based on the location of the training. However, if an athlete is an employee of a professional sports team that during the regular season plays many games within and without the US, a time basis method for allocating income may be acceptable. In this case, there is no clear answer. Mr *Birow* is an employee and member of a team, but there are very few race days compared to training days. State C could not tax under Art. 15 OECD MC because of the reasons mentioned before by my Austrian colleague. Since Mr *Birow's* remuneration is paid by a resident of state B, Mr *Birow's* salary attributable to state B services can be taxed in state B under Art. 15 OECD MC. Mr *Birow's* worldwide income would be taxed in state A. State C could probably tax the portion of Mr *Birow's* salary attributable to the races he rode in state C, however, under Art. 17 OECD MC.

Michael *Lang*: We have seen a lot of quite complex questions on how to distinguish between Art. 17 OECD MC on the one hand and Art. 15 OECD MC on the other hand. What we haven't mentioned but maybe would be really interesting to discuss, is that there might be an enforcement problem. Especially in cases when a performance takes place in a state where the employer is not resident (like state C in our example), it might be difficult to enforce taxation rights. This is probably not such a big problem for countries applying the credit method like the UK, the US, and Germany concerning Art. 17 OECD MC, but for other countries like Austria, where the exemption method applies. The problem could lead to double non-taxation because there is no general subject-to-tax clause (except if Art. 23A para. 4 OECD MC applies).