

## FOREIGN MUSIC ACTS AND UNITED STATES TAXATION

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I have a mansion, forget the price  
Ain't never been there, they tell me it's nice  
I live in hotels, tear out the walls  
I have accountants pay for it all  
- Life's Been Good To Me So Far, by Joe Walsh

### I. INTRODUCTION

On February 7, 1964, the Beatles landed in New York City, signaling the beginning of the "British Invasion."<sup>1</sup> Waves of the Invasion produced numerous foreign musical acts, such as The Rolling Stones, Herman's Hermits, and The Kinks.<sup>2</sup> While some of these acts have faded as music tastes have evolved and diverged

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<sup>1</sup> ENCYCLOPEDIA BRITANNICA ONLINE, British Invasion, available at <http://www.britannica.com/eb/article-9105702>.

<sup>2</sup> *Id.*

dramatically, several foreign musical acts have continued to earn significant income in America. For example, in 2006, veteran British rockers, The Rolling Stones, were the top grossing touring act in America.<sup>3</sup>

In response to the significant portion of United States tour revenues attributed to foreign musical acts, the Internal Revenue Service ("IRS") recently announced that it would closely scrutinize foreign entertainers.<sup>4</sup> Specifically, the IRS has introduced a compliance initiative targeting foreign entertainers and athletes who earn income in the United States.<sup>5</sup> This effort by the IRS includes the establishment of "an issue management team . . . assembled to improve U.S. income reporting and tax payment compliance by foreign stars."<sup>6</sup> The new management team's primary objective will be to determine the nature of guidance and the level of outreach necessary to train IRS personnel in identifying compliance issues.<sup>7</sup>

While the IRS's new initiative is geared toward "stars" who have achieved a certain level of international success, such as U2,<sup>8</sup> this note will provide an overview of some United States tax issues that concern foreign entertainers of varying levels of fame, including those performing in small venues as well as those performing in major arenas. The note begins by briefly examining the United States statutory framework. It then analyzes United States treaties pertaining to foreign musical acts, and concludes by exploring certain specific tax concerns for foreign performers.

## II. THE UNITED STATES TAX CODE: GENERAL RULES

### A. Tests for Residency

A logical first step in our discussion is to examine the United States Internal Revenue Code ("I.R.C."). The I.R.C. distinguishes among foreign citizens, or "aliens," based on their residency status; it taxes resident aliens differently from non-resident aliens.<sup>9</sup> Therefore, before exacting taxes from an alien musical act, the tax authorities must first determine its residency status.

<sup>3</sup> *Rolling Stones Top US Tour Chart*, BBC NEWS, Dec. 26, 2006, available at <http://news.bbc.co.uk/2/hi/entertainment/6216301.stm>.

<sup>4</sup> Dustin Stammer, *IRS Targeting Foreign Athletes and Entertainers*, IRS Official Says, 2007 TAX NOTES TODAY 209-3 (Oct. 29, 2007).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> I.R.C. § 871 (2008)

The I.R.C. offers two tests to determine an alien's residency. First, under I.R.C. § 7701, a foreign musical act will be deemed a resident if it is a "lawful permanent resident of the United States at any time" during the tax year.<sup>10</sup> Second, I.R.C. § 7701(b) tests for residency with the "substantial presence test" under I.R.C. § 7701(b), a foreign musical act will be deemed a resident if it is present in the United States for at least thirty-one days during the current year and has been present in the United States at least 183 days, cumulatively, over the current and previous two years.<sup>11</sup> For the purposes of the ensuing discussion, we will assume that the foreign musical acts that are mentioned, whether generally or specifically, are individual non-residents.

### B. Non-Resident Taxation Under the Internal Revenue Code

The taxation of a non-resident is bimodal and depends on whether the non-resident receives income connected with a United States business. In general, to be engaged in trade or business in the United States, the taxpayer's activities must be "considerable, continuous and regular," directly or via an agent.<sup>12</sup> The I.R.C. taxes a non-resident's income that is effectively connected to a United States trade or business at the same rates that are applicable to United States residents.<sup>13</sup> By contrast, if a non-resident alien's income is not effectively connected with a United States trade or business, the non-resident alien is subject to a 30% withholding tax on his gross income.<sup>14</sup>

### C. Source of Income

The source from which the income is derived also factors into a non-resident's United States tax obligations, and various rules are used to determine the source of income (the discussion that follows assumes that foreign musical acts generate income from royalties and performance compensation). In general, a non-resident alien performing services in the United States is deemed to be engaged in a trade or business in the United States and the compensation derived from these services will be treated, under I.R.C. § 871(b), as income effectively connected to the United States.<sup>15</sup> There is a de minimis exception available for non-resident aliens whose total annual compensation is lower than

<sup>10</sup> I.R.C. § 7701(b) (2008).

<sup>11</sup> I.R.C. § 7701(b)(3)(A) (2008).

<sup>12</sup> *Jan Casimir Lewenhaupt, Petitioner, v. Commissioner*, 20 T.C. 151 (1953); *Amodio v. Comm'r*, 34 T.C. 894 (1960).

<sup>13</sup> I.R.C. § 871(b) (for individuals) (2008).

<sup>14</sup> I.R.C. § 871(a) (for individuals) (2008).

<sup>15</sup> I.R.C. § 864(b) (2008).

\$3,000 and who are not present in the United States for more than ninety days during the taxable year.<sup>16</sup>

Under I.R.C. § 861, royalties from licensing of intangible property are sourced to the location where these intangibles are used; if the royalty stems from property that is physically located and/or used in the United States, then this income is taxed in the United States. In the context of a musician, it should be noted that the I.R.C. defines royalties to include copyrights.<sup>17</sup>

### III. TREATIES

The United States is party to more than fifty bilateral income tax treaties, and these treaties alter many of the I.R.C. provisions discussed above.<sup>18</sup> The primary purpose of these treaties is to facilitate international trade and investment by lowering tax barriers that pertain to the international flow of goods and services.<sup>19</sup> In addition, another purpose of tax treaties is to prevent double taxation.<sup>20</sup> In essence, tax treaties will only reduce a nonresident's taxable income, never increase it.<sup>21</sup> In addition, some tax treaties contain a special provision pertaining to entertainers.<sup>22</sup> Since 1977,<sup>23</sup> the United States has utilized one model income tax treaty as the foundation for treaty negotiations with other countries.<sup>24</sup> A brief overview of the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model Treaty") provides a foundation for examining the current state of United States tax treaties and non-resident musical acts.

#### A. Residency Status Under the U.S. Model Treaty

Under the U.S. Model Treaty, a taxpayer is considered a resident of a contracting state based on his tax obligation to that state by reason of "domicile, residence, citizenship . . . or any

<sup>16</sup> I.R.C. § 864(b)(1) (2008)

<sup>17</sup> I.R.C. § 861(a)(4) (2008)

<sup>18</sup> United States Income Tax Treaties A-Z, Internal Revenue Service, available at <http://www.irs.gov/businesses/international/article/0,,id=96739,00.html>

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> John P. Steines, *International Aspects of U.S. Income Taxation*, Third Edition Vol. 1, p. 95 (2007)

<sup>22</sup> See Convention Between United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. 18, December 18, 1992 (U.S.-Netherlands Tax Treaty), available at <http://www.irs.gov/pub/irs-trty/nether.pdf> and Convention Between United States of America and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. 18, September 12, 1989 (U.S.-India Tax Treaty), available at <http://www.irs.gov/pub/irs-trty/india.pdf>

<sup>23</sup> 3-41 Rhoades & Langer, *U.S. Int'l Tax'n & Tax Treaties* § 41.02

<sup>24</sup> *Id.*

other criteria of similar nature . . . ." <sup>25</sup> In the event an individual is domiciled in more than one state, his residence is deemed to be in the state where his permanent home is located, or in the state that is the center of his personal income and economic interests.<sup>26</sup> Therefore, as a preliminary matter, the residence of a non-resident foreign musical act is determined according to the treaty in effect.

#### B. Royalties and The U.S. Model Treaty

Non-resident musical acts should be aware of royalty provisions that exist in some treaties. Under the U.S. Model Treaty, the tax treatment of royalty income is based on an individual's residence.<sup>27</sup> As part of its definition of royalties, Article 12 of the Treaty states:

[P]ayments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including cinematographic films), any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience . . . .<sup>28</sup>

Non-resident musical acts should be aware that the benefits of Article 12 do not cover royalty earnings that flow from "permanent" or "fixed" establishments within the United States.<sup>29</sup> For example, United States homes that are owned by non-resident musical acts and are used to make sound recordings – regardless of whether the home is equipped with a simple sound-recording computer program or a bona fide home studio – may be deemed permanent establishments within which the works were created. Thus, any royalties earned from this work would fall outside of Article 12 protections. To illustrate further, in *Simenon v. Commissioner*,<sup>30</sup> a French author maintained a home in the state of Connecticut and often used a portion of it as an office.<sup>31</sup> The author used the residence to write his novels, promote his work, and communicate with publishers.<sup>32</sup> The tax court held that the home office was the author's business headquarters and, thus, a

<sup>25</sup> U.S. Model Income Tax Convention, art. 4, Nov. 15, 2006, available at <http://www.ustreas.gov/press/releases/reports/hp16801.pdf> [hereinafter "U.S. Model Treaty"].

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at art. 12.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Simenon v. Comm'r*, 44 T.C. 820 (1965).

<sup>31</sup> *Id.* at 825.

<sup>32</sup> *Id.*

fixed place of business where he carried on his business activities.<sup>33</sup> The home office constituted a "permanent establishment" within the meaning of the applicable treaty<sup>34</sup> and the author, therefore, could not shelter the income attributable to his work at the home from United States tax.<sup>35</sup>

### C. U.S. Model Treaty and Performance Compensation

In general, the Model Treaty's treatment of performance income hinges upon the location where the non-resident musical act performs services and the employment arrangements of such services (whether they are independent or performed while under employment by another entity).<sup>36</sup> Under certain conditions, a non-resident may benefit from limited tax relief. For instance, if a non-resident is performing services while employed by a non-resident employer, the non-resident service performer will not have United States taxable income, provided that he spends fewer than 183 days of the taxable year in the United States.<sup>37</sup>

In the context of non-resident musical acts, the U.S. Model Treaty sets forth rules that are solely applicable to entertainers and athletes in Article 16, the "Entertainers and Sportsmen" provision.<sup>38</sup> Article 16 states:

1. Income derived by a resident of a Contracting State as an entertainer, such as a theater, 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, which income would be exempt from tax in that other Contracting State under the Provisions of Article 7 (Business Profits) and 14 (Income from Employment) may be tax in that other state, except where the amount of the gross receipts derived by such entertainer or sportsman, including expenses reimbursed to him or borne on his behalf, from such activities does not exceed twenty thousand United States dollars (\$20,000) or its equivalent in ——— for the taxable year of the payment.
2. Where income in respect of activities exercised by an entertainer or sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income, notwithstanding the provisions of Article 7 (Business Profits) or 14 (Income from Employment), may be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised unless the contract

<sup>33</sup> *Id.* at 850

<sup>34</sup> *Id.* at 828.

<sup>35</sup> *Id.*

<sup>36</sup> U.S. Model Treaty, *supra* note 26 at art. 14. and art. 16.

<sup>37</sup> U.S. Model Treaty, *supra* note 26 at art. 14.

<sup>38</sup> U.S. Model Treaty, *supra* note 26 at art. 16

pursuant to which the personal activities are performed allows that other person to designate the individual who is to perform the personal activities.<sup>39</sup>

Thus, based on Article 16 of the U.S. Model Treaty, the United States may impose tax if a non-resident musical act performs in the United States and earns more than \$20,000 from those performances within the taxable year. Because the threshold dollar amount may vary by treaty, individual artists should examine the treaties applicable to them to determine their respective threshold amounts.<sup>40</sup>

The above provides a brief overview of the United States taxable income statutory framework, noting the effects of international treaties. The rest of the discussion will focus on concrete topics that may affect or interest non-resident musical acts that generate income in the United States. Specifically, the analysis will cover issues that stem from the musical acts' touring in the United States and issues that stem from royalty payments.

## IV. TOURING ISSUES

### A. Taxation on Performance

Established non-resident musical acts that frequently tour the United States, such as The Rolling Stones or U2, are likely to be familiar with their United States income tax obligations, or have the resources to employ professionals to ensure proper compliance. By contrast, non-resident musical acts on tour in the United States for the first time may perhaps be unfamiliar with the tax obligations that arise from their performances in the United States. This potential lack of knowledge may lead to unexpected tax consequences.

At a bare minimum, "underground" non-resident musical acts touring the United States should not assume that they will be able to perform in the country without being detected by the IRS. In fact, the IRS has a special unit, dedicated to examining concert venues and Internet websites in order to track performances by foreign musicians in the United States.<sup>41</sup> Moreover, those foreign

<sup>39</sup> *Id.* at art. 16.

<sup>40</sup> See Convention Between the Government of the United States of America and the Government of the Kingdom of Denmark For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes On Income, Signed at Washington on August 19, 1999, Together With a Protocol (2000) ("U.S.- Denmark Tax Treaty") (\$20,000 limit) and the Convention Between the Government of the United States and the Government of the Republic of India For the Avoidance of Double Taxation and the Prevention of Tax Evasion With Respect to Taxes on Income, art. 18, January 1, 1991 ("U.S.-India") (\$1,500 limit)

<sup>41</sup> Otis Hart, *The Business of Music - Traveling Bands, Meet the 'Taxman,'* EFFINGHAM

musical acts that do not file a tax return in the United States will be subject to a 30% withholding tax on their United States gross income.<sup>42</sup>

Consider the experience of the Psapps, a Swedish band, that toured the United States in 2006 and suffered a \$30,000 net loss.<sup>43</sup> Because it did not comply with its United States tax obligations, a 30% withholding tax was applied to its gross income, despite the band's earning no net income from the tour.<sup>44</sup> The Psapps could have easily avoided this costly outcome by filing a Central Withholding Agreement ("CWA").<sup>45</sup> Generally, underground non-resident musical acts benefit from filing a CWA with the IRS.<sup>46</sup> When a tax return and a CWA are filed, instead of withholding 30% of gross income, the IRS withholds 30% of a non-resident musical act's estimated net income.<sup>47</sup> This allows a foreign musical act to reduce its tax burden by taking into account its touring expenses.<sup>48</sup> A CWA must be signed by the artist, the manager and the withholding agent.<sup>49</sup> Revenue Procedure 89-47 discusses the detailed mechanics of a CWA.<sup>50</sup>

DAILY NEWS, Aug. 16, 2006, available at  
[http://www.ewingdailynews.com/business/local\\_story\\_228134334.html](http://www.ewingdailynews.com/business/local_story_228134334.html).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* and Rev. Proc. 89-47 ("(r)ecognizing that requiring deduction and withholding of 30 percent of gross income paid to nonresident alien entertainers and athletes for performing or participating in athletic events in the United States may result in over-withholding, the Internal Revenue Service will consider entering into a withholding agreement permitting withholding on projected net income at the 30 percent rate or at a graduated rate, provided that the requirements of sections 3.02 through 3.06 of this revenue procedure are met. In no event will a central withholding agreement reduce the amount of withheld taxes to an amount less than the anticipated income tax liability.")

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* ("(s)ubmit an itinerary of dates and locations of all performances or events scheduled during the period to be covered by the agreement, and a proposed budget containing itemized estimates of all gross income and expenses for the period")

<sup>49</sup> *Id.* The Internal Revenue Services defines Withholding Agent as "...a U.S. or foreign person that has control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding. A withholding agent may be an individual, corporation, partnership, trust, association, or any other entity, including any foreign intermediary, foreign partnership, or U.S. branch of certain foreign banks and insurance companies. You may be a withholding agent even if there is no requirement to withhold from a payment or even if another person has withheld the required amount from the payment." available at  
<http://www.irs.gov/businesses/small/international/article/0,,id=105005,00.html>

<sup>50</sup> *Id.* (provides "... (s)ubmit a list of the names and addresses of the nonresident aliens to be covered by the agreement (covered aliens). Submit copies of all contracts that the covered aliens or their agents and representatives have entered into regarding the time period and performances or events to be covered by the agreement, including (but not limited to) contracts with employers, agents, and promoters; exhibition halls and the like; persons providing lodging, transportation, and advertising; and accompanying personnel such as band members or trainers." The non-resident musical artist should then (s)ubmit an itinerary of dates and locations of all performances or events scheduled during the period to be covered by the agreement, and a proposed budget containing

### B. Loan-Out Arrangements

Non-resident musical acts may consider utilizing loan-out arrangements while they tour in the United States. A loan-out is an arrangement "whereby an employee of one company is loaned to another company to perform services for the latter. . . . compensation for the services is paid to the lending company rather than to the employee."<sup>51</sup> For example, a non-resident musician may be hired by a foreign corporation, and the latter will contract with a United States person for provision of certain services within the United States. Revenue Ruling 74-330<sup>52</sup> focuses on such arrangements in an international context, and one critical factor it mentions is the existence of an employer-employee relationship between the company and the non-resident musician.<sup>53</sup> The Revenue Ruling further discusses these arrangements in the context of the United States-United Kingdom Income Tax Convention ("US-UK Income Tax Convention") and the Internal Revenue Code.<sup>54</sup>

Example (1) of the Revenue Ruling 74-330 suggests a simple loan-out arrangement scenario. There, E is an entertainer, a resident of the United Kingdom, and a non-resident alien of the United States.<sup>55</sup> E is also the sole shareholder of UKC, a United Kingdom corporation.<sup>56</sup> An employee contract is executed between E and UKC, appointing UKC as E's agent. UKC contracts

itemized estimates of all gross income and expenses for the period. Include any documents that substantiate or support these estimates. Provide the name, address, and telephone number of the person to be contacted should the Service require additional information or documentation." Next, the non-resident musical act must "(i)dentify by name, address, and employer identification number the agent or agents who will be the central withholding agents for the covered aliens, and who will enter into a contract with the Service. A central withholding agent ordinarily [\*4] receives contract payments, keeps books of account for the covered aliens, and pays expenses (including tax liabilities) of the covered aliens during the period covered by the agreement."

The revenue procedure further states "(w)hen the Service approves the estimated budget and the designated central withholding agents, the Associate Chief Counsel (International) will prepare a withholding agreement that must be signed by each withholding agent, each covered alien, and the Assistant Commissioner (International). Ordinarily, each withholding agent will be required to agree to withhold income tax from payments to the covered alien; to pay over the withheld tax to the Service on the dates and in the amounts specified in the agreement; and to have the Service apply the payments of withheld tax to the withholding agent's Form 1042 account. Each withholding agent will also be required to file Form 1042 and Form 1042S for each tax year in which income is paid to a covered alien with respect to the period and events covered by the agreement. The Service will credit the withheld tax payments, posted to the withholding agent's Form 1042 account, in accordance with the Form 1042S. Each covered alien must agree to file Form 1040C. Send the request to the following address at least 90 days before the agreement is to take effect: Chief, Special Procedures Section")

<sup>51</sup> *Bennett v. Commissioner*, 23 T.C. 1073, 1074 (T.C. 1955)

<sup>52</sup> Rev. Rul. 74-330, 1974-2 C.B. 278.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

with X, a United States person, to loan out E's services, which E is to perform within the United States. E's rights include the power to veto the terms of the contract. Under the terms of the agreement, X will pay UKC for E's services, and E will subsequently receive its share of the payment from UKC. Additionally, X requires specific performance from E and no other person, and E must sign and guarantee all contracts with UKC.<sup>57</sup>

Under Article III of the US-UK treaty mentioned in the Revenue Ruling, industrial and commercial profits of a United Kingdom enterprise derived from offering the services of its employees to a United States clientele are exempt from income tax, unless the enterprise has a permanent establishment in the United States.<sup>58</sup> In addition, a crucial factor in loan-out arrangements is the existence of an employer-employee relationship, and an examination of the facts and circumstances of each situation will determine the existence of such a relationship.<sup>59</sup> An employer-employee relationship exists if (1) the artist "is subject to control and direction of [the corporation] as to time, place and manner of performance," (2) the artist "has an exclusive personal service contract of substantial duration," (3) the artist "is furthering the regular business of the corporation," (4) the artist "may not veto engagements arranged by [the corporation]," (5) the corporation "is responsible for furnishing [the artist] with a place of performance, appropriate costumes, make-up, scripts, musical accompaniment, or the like," (6) the artist's "salary is not based on the net profits derived in respect of his performances," and (7) the corporation "bears customary business risks in connection with furnishing [the artist's] services."<sup>60</sup> Of these factors, according to the Revenue Ruling, "the right to control [the artist] is the most important."<sup>61</sup> Therefore, for any foreign musical act that performs in the United States and is connected in any way to a loan-out arrangement, we must gauge whether an employment relationship exists, since this determination is likely to affect the non-resident musical act's tax obligations in the United States.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 9.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

## V. ROYALTY ISSUES

### A. *Royalties Versus Compensation*

Treaties do not always make the line between royalties and personal services clear, and foreign musicians under contract under loan-out arrangements should be aware of the consequences stemming from these arrangements with United States recording companies. In *Boulez v. Commissioner*,<sup>62</sup> for example, the plaintiff, Pierre Boulez, a famous music director and orchestra conductor, was a French citizen and a resident of Germany.<sup>63</sup> Additionally, Boulez was a non-resident alien of the United States.<sup>64</sup> He contracted with CBS Records, in 1969, for exclusive services as a "producer and/or performer for the recording of musical and/or literary compositions for the purpose of making phonograph records."<sup>65</sup> The contract also included Boulez's services as "producer and/or performer with the New York Philharmonic for the recording of musical and/or literary compositions for the purposes of making phonograph records."<sup>66</sup> Boulez reported approximately \$40,000 of income in 1975 and 1976.<sup>67</sup> Under the treaty then in effect between Germany and the United States, the authorities of these nations could not come to an agreement about whether to classify the payments to Boulez as compensation for personal services provided in the United States or as royalties.<sup>68</sup>

The Boulez court held that the payments by CBS records to the petitioner were, in fact, compensation for services.<sup>69</sup> Although the contract was not explicitly clear, the court's decision was influenced by two key factors. First, the court focused on exclusivity, since the terms of the contract stressed that Boulez's services were to be performed exclusively for CBS records.<sup>70</sup> Second, the court stressed that all recordings by the petitioner were and would remain the property of CBS records "free from any claims whatsoever by [the petitioner] or any person deriving any rights or interests from [the petitioner]."<sup>71</sup> The court used these factors to define compensation for services.

In its discussion of royalty payments, the Boulez court stated

<sup>62</sup> *Boulez v. Comm'r*, 83 T.C. 584 (1984).

<sup>63</sup> *Id.* at 585.

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 585.

<sup>66</sup> *Id.* at 585.

<sup>67</sup> *Id.* at 588.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 596.

<sup>70</sup> *Id.* at 592.

<sup>71</sup> *Id.* at 586.

that "it is fundamental that [the petitioner] must have an ownership interest in the property whose [sic] licensing or sale gives rise to the income."<sup>72</sup> The court cited *Patterson v. Texas Co.*,<sup>73</sup> a case that defined "royalty" as "a share of the product or profit reserved by the owner for permitting another to use the property."<sup>74</sup> Therefore, under *Boulez*, if a non-resident musical act intends for the payments received for services performed in the United States to be treated as royalty payments, it must ensure that the underlying services contract with the United States entity provides for an ownership interest in the underlying recordings.<sup>75</sup>

#### B. Endorsement Income

If a non-resident musical act does not have a permanent establishment in the United States, the artist's endorsement income will fall into one of a few different classifications of such income under the U.S. Model Treaty. Specifically, such income may potentially be classified as Royalties (Article 12), Entertainers and Sportsmen Income (Article 16) or Other Income (Article 21).<sup>76</sup> As mentioned above, this classification is relevant because Royalties (Article 12) earned by non-resident musical acts will not be taxed by the United States.<sup>77</sup> By contrast, Entertainers and Sportsmen Income (Article 16) of the U.S. Model Treaty permits the IRS to tax income earned by non-resident entertainers and sportsmen for their performances in the United States if the income surpasses a certain monetary threshold.<sup>78</sup>

To illustrate, consider endorsement income which arises when a corporation, such as Budweiser, sponsors a non-resident musical act's tour, or the foreign artist contracts to wear clothing made by a certain brand. To determine the exact U.S. tax obligations stemming from these payments, non-resident musical acts should determine which Article of the U.S. Model Treaty is relevant in such scenarios. The applicable treaty provision may be Entertainers and Sportsmen (Article 16) or Royalties (Article 12).

Despite the fact that treaties generally do not specifically mention endorsement income, the I.R.S. has implied that provisions such as Article 16 of the U.S. Model Treaty may encompass such income "if that income is proximately related to

<sup>72</sup> *Id.* at 593.

<sup>73</sup> *Patterson v. Texas Co.*, 131 F.2d 998 (5th Cir. 1942).

<sup>74</sup> *Id.* at 1001.

<sup>75</sup> *Boulez*, supra note 56, at

<sup>76</sup> The Classification of Endorsement Income Under U.S. Income Tax Treaties, 1999 IRS CCA LEXIS 205; I.R.S. Chief Couns. Adv. 199938031 (Sept. 24, 1999). ("Chief Counsel Adv. Memo")

<sup>77</sup> U.S. Model Treaty, supra note, art. 12

<sup>78</sup> U.S. Model Treaty, supra note, art. 16

an entertainer's or sportsman's 'personal activities as such.'"<sup>79</sup> Therefore, under Article 16, part of a non-resident musical act's revenue earned in the United States may be deemed endorsement income if that income could not have been earned unless a performance had taken place in the contracting state and if the income is closely linked with that performance.<sup>80</sup> For example, if Mick Jagger is paid to wear a branded product during a concert in the United States, the money received from wearing that product is likely to be categorized as endorsement income under Article 16.

The Internal Revenue Service has also implied that if endorsement income earned by a non-resident artist does not fall under Article 16, it may fall under Article 12 (Royalties).<sup>81</sup> The term "royalties" encompasses any consideration received for the use of, or the right to use, various types of intellectual property belonging to another, including an individual's "right of publicity."<sup>82</sup> An artist may thus grant permission to another entity to exploit his persona by using "[the artist's] name, likeness, etc. . ."<sup>83</sup> In this way, if endorsement income is not proximately related to the artist's performance but is paid in connection with the right of publicity, it will likely be classified as Royalties (Article 12) income.<sup>84</sup>

#### C. Holland: The Tax Haven for Rock Stars

The Netherlands is a popular tax shelter for income stemming from intellectual property, such as royalties.<sup>85</sup> Specifically, the Netherlands has become an attractive destination for financially sophisticated musical acts seeking to shelter royalty income.<sup>86</sup> In August of 2006, for example, three members of the Rolling Stones set up two private Dutch foundations to enable them to transfer assets, tax-free, to their heirs upon their deaths.<sup>87</sup> Disclosed documents revealed that similar structures enabled these musicians to pay only \$7.2 million in taxes on earnings of

<sup>79</sup> *Chief Counsel Adv. Memo*, supra note 77.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* (right to publicity may encompass "permitting another person to exploit one's own personal, in the for of one's name, likeness, etc.",

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> Lynnley Browning, *The Netherlands, the New Tax Shelter Hot Spot*, N.Y. TIMES, Feb. 4, 2007, available at <http://www.nytimes.com/2007/02/04/business/yourmoney/04amster.html?ex=1328245200&en=1da0d7016c77df26&ei=5088&partner=rssnyt&emc=rss>.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*



\$450 million – a rate of 1.5% – over the past twenty years.<sup>88</sup> Other musical acts, such as U2, have made similar arrangements, as have entertainment entities, such as the Elvis Presley estate and CKX Inc., the entertainment company that owns a portion of “American Idol.”<sup>89</sup>

By establishing holding companies to take advantages of the tax shelters available in the Netherlands, these entertainers have mimicked the practices of major multinational corporations, such as Coca-Cola, Nike, and Ikea.<sup>90</sup> Two incentives that parties considering the Netherlands as a tax shelter find appealing are the Dutch Finance Ministry’s willingness to issue advance rulings that approve tax shelters and the speed with which such rulings are executed.<sup>91</sup>

Currently, there are almost 20,000 “mailbox companies,” in the Netherlands.<sup>92</sup> The term “mailbox company” refers to corporate shells established by foreign individuals and other entities to avoid taxation on royalties, dividends, and interest payments.<sup>93</sup> Stichting Onderzoek Multinationale Corporations (SOMO), the Center for Research on Multinational Corporations, estimates that 1,165 companies worldwide use Dutch tax shelters to reduce or eliminate taxes stemming from royalties and patents.<sup>94</sup> In addition, SOMO has voiced concern that the number of “mailbox companies” in the Netherlands will continue to increase in the future.<sup>95</sup>

## VI. CONCLUSION

As the above discussion demonstrates, the United States tax implications for non-resident musical acts that generate income in the United States can be multifaceted. This note, however, does not aim to provide a comprehensive list of tax issues that may be applicable non-resident musicians. The circumstances of individual non-resident musical acts may differ, but those with dreams of “conquering” the United States, like many of their predecessors, should familiarize themselves with the consequences of generating income in the United States to avoid unexpected tax obligations.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> SOMO, *The Netherlands: A Tax Haven?*, available at [http://www.somo.nl/html/paginas/pdf/netherlands\\_tax\\_haven\\_2006\\_NL.pdf](http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf), graph on page 49

<sup>95</sup> *Id.*

## SQUEEZING THE JUICE:

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