

ACHIEVING PARITY IN THE TAXATION OF NONRESIDENT ALIEN ENTERTAINERS

I. INTRODUCTION

Many United States taxpayers eagerly awaited the implementation of a fairer tax system that would more equitably apportion their tax obligation. The reform movement sought to create greater parity among taxpayers, so that no one group would have an unjustifiably significant advantage over another.¹ Yet, this reform drive is not new. Indeed, there has been a definite movement on the part of the government to put foreigners paying taxes to the United States on more of an equal footing with Americans. This is especially true for a certain class of nonresident aliens²—those in the field of entertainment. These taxpayers have enjoyed an unjustifiably advantageous taxing scheme. Recent trends, however, indicate that nonresident alien entertainers are being brought closer to par with domestic performers.

Various talented individuals share their skills with the world. These include artists, writers, athletes, actors, and musicians. When final products in the form of paintings, books, statues, movies, records, or musical scores are involved, taxation premised on where they are sold presents no significant variation in comparison with a similar creation by a United States citizen.³

However, not all forms of entertainment involve, or are limited to, tangible creations. Many entertainers travel around the world to provide services in the form of athletic prowess, musical proficiency, or great theatrical performances. Their reward, in addition to acclamation, is often a sizeable income—income which is subject to taxation. Since these entertainers earn income in various countries, problems arise regarding the way in which they are taxed.⁴

¹ President's Message to Congress Transmitting Proposed Legislation, 21 WEEKLY COMP. PRES. DOC. 707 (May 29, 1985) (offering President Reagan's tax proposals for fairness, growth, and simplicity).

² For purposes of this Note, the terms "nonresident alien" and "foreigner" will be used interchangeably.

³ See generally M. PETRY, TAXATION OF INTELLECTUAL PROPERTY § 2.03[5] (1985). There are, of course, unique situations which may arise in the taxing of certain artistic and intellectual property creations. See, e.g., McCarthy, *Federal Income Taxation of Fine Art*, 2 CARDOZO ARTS & ENT. L.J. 1 (1983) (discussing the special tax considerations involved in valuing, investing, collecting, and dealing in fine art).

⁴ Worldwide entertainers are subject to complicated, competing, and conflicting tax laws and tax treaty provisions of various countries in which they perform, as well as their "home country's" tax laws. Their tax liabilities are further entangled as often these types of entertainers establish, throughout the year, temporary residence in the various

Until recently, the United States government viewed nonresident aliens quite favorably in regard to income taxation. Some points of this country's taxing scheme are justified. For example, although citizens and residents of the United States pay federal income tax on their worldwide income,⁵ nonresident aliens pay taxes only on income derived from sources within, or from a business or trade effectively connected with, the United States.⁶ Were the taxing scheme to the contrary, traveling foreigners might incur double taxation⁷ and would be hampered from freely moving across jurisdictional lines.⁸

While nonresidents in general require special considerations to avoid double taxation, foreign performers historically have been provided with unnecessary tax advantages. The executive branch of the United States had traditionally opposed the desire of its tax treaty co-partners to include treaty provisions which specifically exclude entertainers from the personal service exemption.⁹ Personal service provisions in tax treaties generally allow the country of the alien's residence to tax the income earned in the host country.¹⁰ With support from the executive branch, most entertainers were able to shield a significant portion of their income from federal taxation.¹¹ The lack of any cognizable standard for determining nonresident alien status added opportunities for certain performers to take advantage of tax treaty

countries where they earn their salaries. See M. MEISELS, *TAXATION OF NONRESIDENT ALIEN ENTERTAINERS* (431 Tax Mgmt. Foreign Income Portfolios (BNA) A-1 (1986)); Ardi, *Tax Planning for Foreign Entertainers Who Perform Within the United States*, 32 *TAX LAW* 349 (1978).

⁵ Residents of the United States are essentially taxed the same way as United States citizens. Treas. Regs. §§ 1.1-1(b) (as amended in 1971), 1.871-1(a) (as amended in 1974); see also *Williams v. United States*, 704 F.2d 1222, 1226 (11th Cir. 1983); *Cinelli v. Commissioner*, 502 F.2d 695, 697 (6th Cir. 1974); *Garzon v. United States*, 605 F. Supp. 738, 744 (S.D. Fla. 1985).

⁶ Damsky, *Significant Tax-Planning Opportunities for Foreign Entertainers Working in the United States*, N.Y.L.J., July 19, 1985, at 4, col. 1.

⁷ I.R.C. § 7852(c) (1982); *Johansson v. United States*, 336 F.2d 809, 813 (5th Cir. 1964). Double taxation would result since the entertainer would be taxed twice on the same income earned; once by the United States, which was the source of income, and once by the home country which has its own domestic tax laws. See D. TILLINGHAST, *TAX ASPECTS OF INTERNATIONAL TRANSACTIONS* 7-8 (2d ed. 1984) (analysis based on taxation of entities). This theory is applicable to personal income taxation as well. Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 *RUTGERS L. REV.* 428 (1963).

⁸ Singer, *Current Issues in Federal Taxation of Nonresident Aliens*, 2 *REV. TAX'N OF INDIVIDUALS* 183, 199 (1978).

⁹ M. MEISELS, *supra* note 4, at A-38.

¹⁰ 3 R. RHOADES & M. LANGER, *INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS* § 13.01[3] (1986).

¹¹ See *infra* notes 87-89 and accompanying text.

benefits.¹²

A nonresident alien musician, actor, or athlete, who had a single contract calling for a worldwide tour or a multinational athletic competition, was able to take advantage of a favorable way of apportioning income subject to tax. Treasury Regulation ("Regulation") section 1.861-4(b) had exclusively provided that where there was no clear way to designate the portion of services actually performed in this country, "an apportionment on the time basis will be acceptable."¹³ Under that basis, income subject to federal tax would be computed by multiplying the nonresident alien's total earnings from services by the percentage of total days spent in the United States over total days of employment required under the contract.¹⁴

While the past federal tax treatment brought a steady flow of foreign entertainers to the shores of the United States, the tide of favorable tax treatment appears to have turned. Congress has enacted a new wave of tax legislation by amending the current Internal Revenue Code ("I.R.C." or "Code"). For the first time, the Code defines nonresident alien status and provides practical tests for determining residence.¹⁵ A new provision in the Treasury Regulations now permits an alternative form of income allocation when "the facts and circumstances will be such that another method of apportionment will be acceptable."¹⁶ New tax treaty provisions regarding entertainers and athletes may likewise reduce favorable tax treatment.¹⁷

This Note will attempt to demonstrate how, consistent with the tax reform movement today, the various branches of government have tried to remedy the disparate tax treatment of nonresident alien entertainers. First, this Note will briefly examine nonresident alien income taxation in general and discuss the new changes affecting a nonresident alien performer.¹⁸ Second, it will analyze tax treaty provisions pertaining to entertainers and athletes and discuss how the United States has yielded to its foreign

¹² See *infra* notes 32-49 and accompanying text.

¹³ Treas. Reg. § 1.861-4(b) (1960) (current version at Treas. Reg. § 1.861-4(b)(i)) (as amended in 1975).

¹⁴ See *infra* notes 131-43 and accompanying text for a complete discussion and description of this type of allocation.

¹⁵ See *infra* notes 50-64 and accompanying text.

¹⁶ Treas. Reg. § 1.861-4(b)(1)(i) (as amended by T.D. 7378, 1975-2 C.B. 272). For an example of the disproportionate tax treatment under the "time basis" allocation method and a discussion of an alternative method, see *infra* 170-85 and accompanying text.

¹⁷ See *infra* notes 96-126 and accompanying text.

¹⁸ See *infra* notes 21-78 and accompanying text.

treaty partners by refusing to grant beneficial tax treatment to performers.¹⁹ Finally, this Note will examine the implications of the time basis allocation method, and the way the Regulations have left an "open door" for the application of other methods in cases involving foreign performers.²⁰

II. LEGISLATIVE CHANGES TO THE INTERNAL REVENUE CODE

Before discussing the corrective measures which remove unjustified tax advantages for foreign entertainers, it is necessary to define exactly who is a nonresident alien. The fact that the I.R.C. only recently has been amended to provide a practical way to determine nonresident alien status is itself an indication that Congress has attempted to prevent foreigners from unduly qualifying for the existing tax advantages. Congress has thus provided the Internal Revenue Service ("I.R.S.") with clearer guidelines for imposing United States tax upon an individual whose status was formerly questionable.

A. *Determining Nonresident Alien Status*

To facilitate the imposition of tax upon individuals whose status as a nonresident alien was formerly uncertain,²¹ Congress, in 1985, enacted a new Code provision to define, for the first time,²² the term "nonresident." I.R.C. section 7701(b)(1)(B) provides that a nonresident alien is an individual who "is neither a citizen of the United States nor a resident of the United States" Although this definition describes nonresidence in the negative,²³ it contains a practical and objective guideline for determining a taxpayer's status. To determine if the taxpayer qualifies as a nonresident, certain requisites which would classify one

¹⁹ See *infra* notes 79-126 and accompanying text.

²⁰ See *infra* notes 127-94 and accompanying text.

²¹ The determination of nonresident alien status has historically posed many problems. Prior to 1985, the Code did not define the term "nonresident alien." The accompanying Regulations always referred to the term confusingly in the negative. Povell & Granwell, *Regulations Affecting Individuals*, in REGULATION OF FOREIGN INVESTMENTS IN THE UNITED STATES (209 Corporate Law and Practice Handbook Series (PLI)) 237, 241 (1976). It has been noted that "[u]nfortunately, a concise definition of nonresident alien does not exist nor can one be formulated given the many interrelated factors that are relevant to making the determination." Navarro, *Do's and Don'ts in Tax Planning for Nonresident Aliens*, 117 TRS. & ESTS. 484, 485 (1978). Notwithstanding this viewpoint, Congress' enactment of a definition of nonresidency seems to provide an accurate determination of this status.

²² 1 R. RHOADES & M. LANGER, *supra* note 10, at § 1A.01; see also Langer, *The New Residency Rules for United States Income Tax Purposes*, in FIFTEENTH ANNUAL INSTITUTE ON INTERNATIONAL TAXATION (PLI) 195, 197 (1984).

²³ The accompanying Treasury Regulations also define "nonresident alien" in the negative. Treas. Reg. § 1.871-2(a) (1957).

as a United States citizen or resident must *not* be met.²⁴

Although the Code does not define the term "citizenship," the Treasury Regulations provide that "[e]very person born or naturalized in the United States and subject to its jurisdiction is a citizen."²⁵ This wording conforms to that contained in the United States Constitution²⁶ and is commonly referred to as "constitutional citizenship."²⁷ The Regulation further states that all other rules determining citizenship are governed by the first two chapters of title III of the Immigration and Nationality Act.²⁸ With respect to foreigners who are not United States expatriates,²⁹ the question of citizenship is not usually a difficult one under immigration law.³⁰ Once a foreign entertainer establishes that he is not a United States citizen, he must further prove that he is a nonresident. The determination of residence has important consequences. If deemed a United States resident, an alien entertainer would be taxed in generally the same manner as a United States citizen.³¹

B. *Determining Residence—The Two Tests*

Prior to 1985,³² the legislative guidelines for determining residence were extremely vague.³³ The applicable Treasury Regulations were considered archaic; they had remained virtually un-

²⁴ For a discussion of the term "resident," see *infra* notes 32-67 and accompanying text.

²⁵ Treas. Reg. § 1.1-1(c) (as amended in 1971).

²⁶ U.S. CONST. amend. XIV, § 1.

²⁷ See, e.g., Karp, *Definition of Citizenship, Residence and Domicile for United States Income, Gift and Estate Tax Purposes*, 43 N.Y.U. INST. ON FED. TAX'N § 13.02[1] (1985). This is distinguished from "statutory citizenship," which is determined only by the citizenship status of one or both of the individual's parents. *Id.* at 13-4. These provisions are found within 8 U.S.C. § 1401 (1982).

²⁸ 8 U.S.C. §§ 1401-1459 (1982). For example, "statutory citizenship" and all forms of naturalization are adopted by the Internal Revenue Service as criteria to determine citizenship. This is one of the few areas of tax law that relies significantly on a non-tax statute. Karp, *supra* note 27, at § 13.02[2].

²⁹ There are special rules governing cases where a United States citizen or resident changes his nationality, particularly to avoid income taxation. See I.R.C. §§ 877, 2107 (1982); Treas. Reg. § 1.871-13(a)(1) (as amended in 1980). A discussion of expatriation is beyond the scope of this Note.

³⁰ 2 J. SPIRES, *DOING BUSINESS IN THE UNITED STATES* § 12.02[1] (1983). For an excellent source for interpretation of these rules, see 2 C. GORDON & H. ROSENFELD, *IMMIGRATION LAW AND PROCEDURE* (rev. ed. 1986).

³¹ 2 J. SPIRES, *supra* note 30, at § 12.02.

³² It is important to look to the legislative history with regard to how residence and citizenship were viewed. The enactment of I.R.C. § 7701(b) (Supp. III 1985) shows that Congress is trying to repair an area of law which is subject to a great deal of manipulation and is quite difficult to enforce. See Langer, *supra* note 22, at 223.

³³ Karp, *supra* note 27, at § 13.03.

changed for almost fifty-five years.³⁴ Moreover, the terms “resident” and “nonresident” were considered “slippery” words, whose meanings in given situations were not easy to grasp.³⁵ Justice Ross of the Ninth Circuit wrote:

Residence . . . has an evasive way about it, with as many colors as Joseph’s coat. . . .

It appears . . . that the courts in reaching divergent conclusions . . . have, more times than even they realize, been caught out on the shifting meaning of the word residence. If we can lock that word down and view it in its proper perspective and context . . . then we have mastered its unruly spirit, halter broken it, so to speak.³⁶

Courts were forced to consult the Treasury Regulations, which, prior to the Code’s recent amendments, probably provided the “best definition”³⁷ of these evasive terms. The Regulations stated in part then, as they currently do:

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. . . . If he lives in the United States and has no definite intention as to his stay, he is a resident. . . . An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.³⁸

Rather than providing a true definition, the Regulation, as used as the sole definition, merely listed criteria which were to be subjectively construed³⁹ on a case-by-case basis, contingent upon the particular taxpayer’s intent.⁴⁰ An important factor which courts looked to in determining intent was the nature of the foreigner’s stay in this country.⁴¹ A foreigner’s intention not to remain indefinitely in this country, or a foreigner’s lack of action comporting with an intention

³⁴ Langer, *When Does a Nonresident Alien Become a Resident for Tax Purposes?*, 44 J. TAX’N 220 (1976).

³⁵ *Commissioner v. Swent*, 155 F.2d 513, 515 (4th Cir.), *cert. denied*, 329 U.S. 801 (1946), *cited in Commissioner v. Nubar*, 185 F.2d 584, 587 (4th Cir. 1950), *cert. denied*, 341 U.S. 925 (1951).

³⁶ *Weible v. United States*, 244 F.2d 158, 163 (9th Cir. 1957).

³⁷ 8 J. MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 45.08 (1986).

³⁸ *Treas. Reg. § 1.871-2(b)* (1960).

³⁹ M. MEISELS, *supra* note 4, at A-4.

⁴⁰ *Jamvold v. Commissioner*, 11 T.C. 122, 125 (1948); *Constantinescu v. Commissioner*, 11 T.C. 37, 42-44 (1948), *acq.* 1948-2 C.B. 1.

⁴¹ M. MEISELS, *supra* note 4, at A-4.

to remain in the United States, were important considerations to be examined.⁴²

In the case of an alien entertainer who, because of international travels, may have had no "home" to be away from,⁴³ determining the nature of one's stay was a difficult task. In these instances, the courts had to deal with the complicated question of whether the entertainer was something more than "a mere transient or sojourner."⁴⁴

Due to the difficulties encountered in proving a taxpayer's residence status, the Regulations created a legal assumption that a foreigner, "by reason of his alienage, is presumed to be a nonresident alien."⁴⁵ Although the Commissioner of Internal Revenue could rebut this presumption,⁴⁶ he rarely did so,⁴⁷ most likely due to the tremendous burden of gathering all of the information necessary to show that a foreign taxpayer intended to become a United States resident.⁴⁸ Thus, "the subjective test of residence . . . was easy to manipulate and difficult to enforce."⁴⁹ Foreign performers could easily manipulate their status by including in their contracts words to the effect that their visit to the United States would be brief and limited during the tax year—an assertion that may not have been true.

In response to this potential for manipulation, Congress enacted an "objective"⁵⁰ and "exclusive"⁵¹ standard to determine resi-

⁴² 2 J. SPIRES, *supra* note 30, at § 12.02[1].

⁴³ See, e.g., *Boyer v. Commissioner*, 36 T.C.M. (CCH) 1329, 1332 (1977). In *Boyer*, the tax court was forced to consider whether a married pair of professional ice skaters who traveled throughout the United States and Canada with the "Ice Follies," but maintained a home in Austria, should be considered "itinerants who had no home to be away from." *Id.*

⁴⁴ Treas. Reg. § 1.871-2(b) (1960); 36 T.C.M. (CCH) at 1332-33. In *Boyer*, the tax court acknowledged that:

The matter is not free from doubt, and a number of the factual considerations stressed by the Government support its position. Nevertheless, we are persuaded by the record as a whole [and find for the taxpayer]. It would serve no useful purpose to review the various factors pro and con that lead us to this factual conclusion.

36 T.C.M. (CCH) at 1333.

⁴⁵ Treas. Reg. § 1.871-4(b) (1957).

⁴⁶ *Id.* § 1.871-4(c).

⁴⁷ Langer, *supra* note 22, at 223.

⁴⁸ *Park v. Commissioner*, 79 T.C. 252 (1982), *aff'd mem.*, 755 F.2d 181 (D.C. Cir. 1985). One authority cites this case to support the proposition that the I.R.S. and the courts had a relatively easy time to find "exceptional circumstances" to rebut the presumption of nonresidence. See Karp, *supra* note 27, at § 13.03. Another expert believes the Commissioner won this case solely through the enormous amount of information he had to collect. See Langer, *supra* note 22, at 223.

⁴⁹ Langer, *supra* note 22, at 223.

⁵⁰ *Id.* at 197; see also 1 R. RHOADES & M. LANGER, *supra* note 10, at § 1A.01.

⁵¹ Karp, *supra* note 27, at § 13.03[1].

dence. Effective as of January 1, 1985, I.R.C. section 7701(b)(1)(A) created two tests to be used in determining United States residence: the "green card" test,⁵² alternatively called the "permanent residency" test,⁵³ and the "substantial presence" test.⁵⁴

The "green card" test is briefly described in I.R.C. section 7701(b)(1)(A)(i); the Code relies on, and refers to, the procedural details contained in immigration law. The test determines whether the individual was a "lawfully permanent resident,"⁵⁵ by inquiring whether he was legally admitted into the United States, and if so, whether that admission had been revoked.

Beginning in 1984, any alien lawfully admitted as a permanent resident, or physically present in the United States and accorded that status *at any time* during that year, is considered a United States resident for federal income tax purposes.⁵⁶ A holder of a "green card"⁵⁷ is automatically considered a lawfully admitted resident and therefore is susceptible to United States taxation on his entire income.⁵⁸ The green card is a registration receipt card⁵⁹ given to a foreigner in exchange for an immigration visa received through a United States consul.⁶⁰ A foreign performer will not acquire a "green card," but instead will apply for either an H-1 visa⁶¹ or a B-1

⁵² Although not identified as such, the provision contained in I.R.C. § 7701(b)(1)(A)(i) (Supp. III 1985) briefly provides that an individual will be considered a permanent United States resident if the person is "[l]awfully admitted for permanent residence . . . at any time during such calendar year." Since possession of a "green card" has traditionally been proof that a foreigner was lawfully admitted as a resident, *see* I R. RHOADES & M. LANGER, *supra* note 10, at §§ 1A.03, 1A.06[2], it is the standard envisioned to be used. *See also* Langer, *supra* note 22, at 208-09; Oliver, *U.S. Taxation of Foreign Nationals*, 43 N.Y.U. INST. ON FED. TAX'N § 16.02[3][a] (1985); 1986 MASTER FEDERAL TAX MANUAL (RIA) ¶ 4613(1) (identifying this test as the "green card test").

⁵³ *See* Karp, *supra* note 27, at § 13.03[2]; Note, *United States Activities of Foreigners and Tax Treaties*, 38 TAX LAW. 1093, 1096 (1985).

⁵⁴ Identified as such by I.R.C. §§ 7701(b)(1)(A)(ii), 7701(b)(3) (Supp. III 1985).

⁵⁵ *Id.* at § 7701(b)(5) (Supp. III 1985). A foreigner is considered a "lawfully permanent resident" if:

(A) such individual has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, and

(B) such status has not been revoked (and has not been administratively or judicially determined to have been abandoned).

⁵⁶ *Id.* § 7701(b)(3) (Supp. III 1985).

⁵⁷ The term "green card" is somewhat of a misnomer. Although at one time the card was green, the present form is now white and blue. Nevertheless, it is still recognized and identified as a "green card." *See* I R. RHOADES & M. LANGER, *supra* note 10, at § 1A.06[2].

⁵⁸ Langer, *supra* note 22, at 209.

⁵⁹ Formerly labeled Immigration Form I-151, it has now been replaced by a machine-readable card identified as Immigration Form I-551. 2 C. GORDON & H. ROSENFELD, *supra* note 30, at § 6.10d.

⁶⁰ I R. RHOADES & M. LANGER, *supra* note 10, at § 1A.06[2].

⁶¹ 8 U.S.C. § 1101(a)(15)(H)(i) (1982); 8 C.F.R. § 214.2(h)(2)(ii) (1973).

visa⁶² for temporary employment in the United States.⁶³ Athletes and actors would normally obtain temporary work permits allowing them to work in the United States for up to one year.⁶⁴ Therefore, another residence test, the "substantial presence" test, provides a more appropriate means of determining whether the foreign entertainer should nevertheless be considered a United States resident.

The "substantial presence" test is outlined in significant detail in section 7701(b)(3) of the Internal Revenue Code. It is designed to determine whether aliens who do not possess "green cards," but who spend a significant amount of time in this country, should be considered United States residents.⁶⁵ An individual is a resident if: 1) present in the United States for at least thirty-one days in the calendar year; and 2) the total days spent in this country during the past two calendar years, reduced by an applicable multiplier, and the current calendar year is greater than or equal to 183 days.⁶⁶

The 1986 Tax Reform Act⁶⁷ slightly modifies the substantial presence test. On August 29, 1986 the Joint Committee on Taxation title XII(F)(11),⁶⁸ contained the following change in the definition of a resident alien:

In determining whether an alien individual is a U.S. resident for U.S. income tax purposes under the 1984 Act's substantial presence test, days in which a professional athlete is present in the United States competing in certain charitable sports events will not be counted. This provision applies to periods after the bill's date of enactment.⁶⁹

⁶² 8 U.S.C. § 101(a)(15)(B) (1982); 8 C.F.R. § 214.2(b)(1) (1973).

⁶³ Glucoft, *Temporary Employment in the United States of Foreign Entertainers: Immigration Principles*, 5 ENT. & SPORTS LAW. 1 (1986). While foreign entertainers had been afforded special tax benefits when they performed in the United States, getting to this country was, and still is, not always easy. They face special immigration problems. See generally *id.*; Rey, *U.S. Immigration Procedures and the Employment of Alien Performers and Sports Personalities*, J. COPYRIGHT, ENT., & SPORTS L. 119 (1982); Fraade, Gardner, & Stewart, *The IRS, the INS and the Foreign Entertainer*, 5 COMM/ENT 191 (1982).

⁶⁴ Gallagher, *The Freedoms—and Limits—For Aliens Working in U.S.*, U.S. NEWS & WORLD REPORT, July 1, 1985, at 69.

⁶⁵ Oliver, *supra* note 52, at § 16.02[3][b].

⁶⁶ I.R.C. § 7701(b)(3)(A) (Supp. III 1985).

The multiplier referred to in I.R.C. § 7701(b)(3)(A)(ii) (Supp. III 1985) is determined according to the following table:

In the case of days in:	The applicable multiplier is:
Current year	1
1st preceding year	1/3
2nd preceding year	1/6

⁶⁷ Tax Reform Act of 1986, Pub. L. No. 99-514, § 1810(l)(5)(A), 100 Stat. __, __ (1986).

⁶⁸ H.R. CONF. REP. NO. 3838, 99th Cong., 2d Sess. (Aug. 29, 1986), *reprinted in*, 69 FED. TAX REP. (CCH) (extra stand. ed. 47) (1986).

⁶⁹ *Id.* at 63. Surprisingly, this provision did not appear in the September 24, 1986

The final enacted version of the Tax Reform Act of 1986 provides that “[f]or purposes of [the substantial presence] subsection [a]n individual is an exempt individual for any day if, for such day, such individual is . . . a professional athlete who is temporarily in the United States to compete in a charitable sports event described in section [274(l)(1)(B)].”⁷⁰ Because this special provision is only applicable to foreign athletes who, during at least part of their stay, participate in the noble activity of helping a charitable organization in the United States, a “tax break” of this kind is probably an incentive for their involvement.⁷¹ Nevertheless, the “substantial presence” test remains a mathematical test⁷² that is designed to prevent foreigners from earning nontaxable income while commuting back and forth to this country, maintaining an illusion of nonresidence. The rule, however, provides for a number of exceptions which detract from the effectiveness of its purpose.

For most nonresidents, there is a justification for allowing an alien to be exempt from the provisions of the substantial presence test. Altruistic, diplomatic, and educational desires have motivated Congress to allow foreigners to enter this country without worrying

Joint Committee report. H.R. CONF. Rep. No. 3838, 99th Cong., 2d Sess., 132 CONG. REC. H7490-H7493 (daily ed. Sept. 24, 1986).

⁷⁰ I.R.C. § 7701(b)(5)(A)(iv) (1987), *reprinted in* INTERNAL REVENUE CODE 1987 U.S. CODE CONG. & ADMIN. NEWS 1861. The actual cross-reference is mistakenly to I.R.C. § 274(k)(2), which refers to business meals. Section 274(l)(1)(B) defines a charitable sports event as an event:

- (i) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),
- (ii) all of the net proceeds of which are contributed to such organization, and
- (iii) which utilizes volunteers for substantially all of the work performed in carrying out such event.

An I.R.C. § 501(c)(3) organization consists of:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Id. § 501(c)(3).

⁷¹ Indeed, the Code appears not only to provide a special tax deduction and exemption for charitable athletic competitions, but it also expressly seeks to encourage organizations which “foster national or *international* amateur sports competition” I.R.C. § 501(j)(2) (emphasis added). This identical language appears in I.R.C. § 501(c)(3).

⁷² Langer, *supra* note 22, at 211.

about paying taxes. Examples of such exemptions are: 1) where an individual stays in this country for an excessive period of time due to medical reasons;⁷³ 2) where an individual is employed in a job related to a foreign government; and 3) where an individual is a visiting teacher, trainee, or student.⁷⁴ Another exemption is needed for those individuals who: 1) stays in the United States for under six months; 2) maintain a foreign tax home;⁷⁵ and 3) can show a greater relationship to a foreign nation than to the United States.⁷⁶ A foreign entertainer typically falls within this exception.

Therefore, by stating in an entertainer's contract that the United States is a "touring country," and by spending less than half a year in this country, the performer would probably qualify under this exemption. Use of this exemption converts the test for residence back to a subjective factual determination,⁷⁷ since a court will have to look to the circumstances of the entertainer's stay. To prevent foreign entertainers from taking advantage of this legislative flaw, the executive branch, through tax treaties, has restricted the use of this "loophole." Most new tax treaties either subject an entertainer to taxation if earnings exceed a specified monetary amount, or provide for taxation of an entertainer's entire income earned within, or effectively connected with, the United States.⁷⁸

III. TAX TREATY CHANGES

The many tax treaties the United States has with other countries provide an important source of tax law for nonresident alien

⁷³ I.R.C. § 7701(b)(3)(D) (Supp. III 1985).

⁷⁴ See *id.* § 7701(b)(4) (Supp. III 1985).

⁷⁵ For this exception "tax home" is defined by I.R.C. § 911(d)(3) (1982) as the "individual's home where traveling expenses while away from that home are claimed . . ." which is governed by I.R.C. § 162(a)(2) (1982). It is important to note that reference in I.R.C. § 7701(b)(3)(B)(ii) (Supp. III 1985) to § 911(d)(3) (1982) does not include the latter section's last sentence. I.R.C. § 911(d)(3) denies a taxpayer the ability to claim a tax home in a foreign country when he makes his abode in the United States.

⁷⁶ I.R.C. § 7701(b)(3)(B) (Supp. III 1985) provides, in relevant part:

An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current [calendar] year if—

- (i) such individual is present in the United States on fewer than 183 days during the current year, and
- (ii) it is established that for the current [calendar] year such individual has a tax home . . . in a foreign country and has a closer connection to such foreign country than to the United States.

⁷⁷ Cf. *Garzon v. United States*, 605 F. Supp. 738, 742 (S.D. Fla. 1985) (the Southern District of Florida, considered all relevant facts and circumstances, including Garzon's affidavit to the I.R.S. that he had no intention to reside in the United States, when it found that Garzon was a nonresident alien).

⁷⁸ United States Department of Treasury, *Structure and Parts of an Income Tax Treaty*, in THE EXCHANGE OF INFORMATION UNDER TAX TREATIES (Proceedings of the 19th Technical Conference of the Inter-American Center of Tax Administrators (C.I.A.T.)) 105, 112 (1978).

entertainers.⁷⁹ The purpose of tax treaties is to avoid the uncoordinated taxation of an individual's income by two different

⁷⁹ The United States currently has income tax treaties with thirty-eight nations. They are, in their most current form and in alphabetical order:

- 1) Australia: Convention for the Avoidance of Double Taxation, Aug. 6, 1982, United States-Australia, — U.S.T. —, T.I.A.S. No. 10773;
- 2) Austria: Convention for the Avoidance of Double Taxation, Oct. 25, 1956, United States-Austria, 8 U.S.T. 1699, T.I.A.S. No. 3923;
- 3) Barbados: Convention for the Avoidance of Double Taxation, Dec. 31, 1984, United States-Barbados, S. TREATY DOC. NO. 3, 99th Cong., 1st Sess. (1985); — U.S.T. —, T.I.A.S. No. —;
- 4) Belgium: Convention for the Avoidance of Double Taxation, July 9, 1970, United States-Belgium, 23 U.S.T. 2687, T.I.A.S. No. 7463;
- 5) British Virgin Islands: Convention for the Avoidance of Double Taxation, February 18, 1981, United States-British Virgin Islands, S. TREATY DOC. NO. 6, 97th Cong., 1st Sess. (1981); — U.S.T. —, T.I.A.S. No. —;
- 6) Canada: Convention with Respect to Taxes on Income, Sept. 26, 1980, United States-Canada, S. EXEC. DOC. 2, 96th Cong., 1st Sess. (1980), — U.S.T. —, T.I.A.S. No. —, amended by Protocol Amending the Convention with Respect to Taxes, June 14, 1983, United States-Canada, S. Treaty Doc. 7, 98th Cong., 1st Sess. (1983), — U.S.T. —, T.I.A.S. No. —, amended by Second Protocol Amending the Convention with Respect to Taxes as Amended, Mar. 28, 1984, United States-Canada, S. TREATY DOC. NO. 22, 98th Cong., 1st Sess. (1983); — U.S.T. —, T.I.A.S. No. —;
- 7) China: Agreement for the Avoidance of Double Taxation, Apr. 30, 1984, United States-China, S. TREATY DOC. NO. 30, 98th Cong., 2d Sess. (1984); — U.S.T. —, T.I.A.S. No. —;
- 8) Cyprus: Convention for the Avoidance of Double Taxation, Mar. 19, 1984, United States-Cyprus, S. TREATY DOC. NO. 32, 98th Cong., 2d Sess. (1984); — U.S.T. —, T.I.A.S. No. —;
- 9) Denmark: Convention for the Avoidance of Double Taxation, May 6, 1948, United States-Denmark, 62 Stat. 1730, T.I.A.S. No. 1854;
- 10) Egypt: Convention for the Avoidance of Double Taxation, Aug. 24, 1980, United States-Egypt, — U.S.T. —, T.I.A.S. No. 10149 (Pursuant to an understanding subject to a reservation. United States Department of State, *Treaties in Force* 52 (1986));
- 11) Finland: Convention for the Avoidance of Double Taxation, Mar. 6, 1970, United States-Finland, 22 U.S.T. 40, T.I.A.S. No. 7042;
- 12) France: Convention with Respect to Taxes on Income, July 28, 1967, United States-France, 19 U.S.T. 5280, T.I.A.S. No. 6518, amended by Protocol with Respect to Taxes on Income and Property, Oct. 12, 1970, United States-France, 23 U.S.T. 20, T.I.A.S. No. 7270, amended by Protocol to the Convention with Respect to Taxes on Income of July 28, 1967, as Amended, Nov. 24, 1978, United States-France, 30 U.S.T. 5109, T.I.A.S. No. 9500, amended by Protocol to the Convention for the Avoidance of Double Taxation, Jan. 17, 1984, United States-France, S. TREATY DOC. NO. 21, 98th Cong., 2d Sess. (1984); — U.S.T. —, T.I.A.S. No. —;

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- 13) (West) Germany: Convention for the Avoidance of Double Taxation, July 22, 1954, United States-Germany, 5 U.S.T. 2768, T.I.A.S. No. 3133, amended by Protocol for the Avoidance of Double Taxation, Sept. 17, 1965, United States-Germany, 16 U.S.T. 1875, T.I.A.S. No. 5920;
- 14) Greece: Convention for the Avoidance of Double Taxation, Feb. 20, 1950, United States-Greece, 5 U.S.T. 47, T.I.A.S. No. 2902;
- 15) Hungary: Convention for the Avoidance of Double Taxation, Feb. 12, 1979, United States-Hungary, 30 U.S.T. 6357, T.I.A.S. No. 9560;
- 16) Iceland: Convention for the Avoidance of Double Taxation, May. 7, 1975, United States-Iceland, 26 U.S.T. 2004, T.I.A.S. No. 8151;
- 17) Ireland: Convention for the Avoidance of Double Taxation, Sept. 13, 1949, United States-Ireland, 2 U.S.T. 2303, T.I.A.S. No. 2356;
- 18) Italy: Convention for the Avoidance of Double Taxation, Apr. 17, 1984, United States-Italy, S. TREATY DOC. NO. 28, 98th Cong., 2d Sess. (1984); — U.S.T. —, T.I.A.S. No. — (Pursuant to an understanding. United States Department of State, *Treaties in Force* 96 (1986));
- 19) Jamaica: Convention for the Avoidance of Double Taxation, May 21, 1980, United States-Jamaica, — U.S.T. —, T.I.A.S. No. 10206, amended by Protocol for the Avoidance of Double Taxation, July 17, 1981, United States-Jamaica, — U.S.T. —, T.I.A.S. No. 10206;
- 20) Japan: Convention for the Avoidance of Double Taxation, Mar. 8, 1971, United States-Japan, 23 U.S.T. 967, T.I.A.S. No. 7365;
- 21) Korea: Convention for the Avoidance of Double Taxation, June 4, 1976, United States-Korea, 30 U.S.T. 5253, T.I.A.S. No. 9506;
- 22) Luxembourg: Convention with Respect to Taxes on Income and Property, Dec. 18, 1962, United States-Luxembourg, 15 U.S.T. 2355, T.I.A.S. No. 5726;
- 23) Malta: Agreement with Respect to Taxes on Income, Mar. 21, 1980, United States-Malta, — U.S.T. —, T.I.A.S. No. 10567;
- 24) Morocco: Convention for the Avoidance of Double Taxation, Aug. 1, 1977, United States-Morocco, — U.S.T. —, T.I.A.S. No. 10194;
- 25) Netherlands: Convention with Respect to Taxes on Income, Dec. 30, 1965, United States-Netherlands, 17 U.S.T. 896, T.I.A.S. No. 6051;
- 26) Netherlands Antilles: Protocol for the Avoidance of Double Taxation, Oct. 23, 1963, United States-Netherlands Antilles, 15 U.S.T. 1900, T.I.A.S. No. 5665 (On January 1, 1986, this treaty was applicable to Aruba as a separate entity. United States Department of State, *Treaties in Force* 129 (1986));
- 27) New Zealand: Convention for the Avoidance of Double Taxation, July 23, 1982, United States-New Zealand, — U.S.T. —, T.I.A.S. No. 10772 (Excludes Tokelau or the Associated Self Governing States of the Cook Islands and Niue. United States Department of State, *Treaties in Force* 131 (1986));
- 28) Norway: Convention for the Avoidance of Double Taxation, Dec. 3, 1971, United States-Norway, 23 U.S.T. 2832, T.I.A.S. No. 7474, amended by Protocol for the Avoidance of Double Taxation, Sept. 19, 1980, United States-Norway, — U.S.T. —, T.I.A.S. No. 10205 (Pursuant to an understanding. United States Department of State, *Treaties in Force* 136 (1986));

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- 29) Pakistan: Convention for the Avoidance of Double Taxation, July 1, 1957, United States-Pakistan, 10 U.S.T. 984, T.I.A.S. No. 4232;
- 30) Philippines: Convention with Respect to Taxes on Income, Oct. 1, 1976, United States-Philippines, — U.S.T. —, T.I.A.S. No. 10417 (Pursuant to reservations and understandings. United States Department of State, *Treaties in Force* 150 (1986));
- 31) Poland: Convention for the Avoidance of Double Taxation, Oct. 8, 1974, United States-Poland, 28 U.S.T. 891, T.I.A.S. No. 8486;
- 32) Romania: Convention with Respect to Taxes on Income, Dec. 4, 1973, United States-Romania, 27 U.S.T. 165, T.I.A.S. No. 8228;
- 33) South Africa: Convention for the Avoidance of Double Taxation, Dec. 13 1946, United States-South Africa, 3 U.S.T. 3821, T.I.A.S. No. 2510, amended by Protocol Supplementing Convention for the Avoidance of Double Taxation, July 14, 1950, United States-South Africa, 3 U.S.T. 3821, T.I.A.S. No. 2510;
- 34) Sweden: Convention for the Avoidance of Double Taxation, Mar. 23, 1939, United States-Sweden, 54 Stat. 1759, T.S. 958, amended by Supplementary Convention Relating to Income and other Taxes, Oct. 22, 1963, United States-Sweden, 15 U.S.T. 1824, T.I.A.S. No. 5656;
- 35) Switzerland: Convention for the Avoidance of Double Taxation, May 24, 1951, United States-Switzerland, 2 U.S.T. 1751, T.I.A.S. No. 2316;
- 36) Trinidad and Tobago: Convention for the Avoidance of Double Taxation, Jan. 9, 1970, United States-Trinidad and Tobago, 22 U.S.T. 164, T.I.A.S. No. 7047 [hereinafter U.S.-Trinidad & Tobago Tax Treaty] (Pursuant to reservation. United States Department of State, *Treaties in Force* 180 (1986));
- 37) Union of Soviet Socialist Republics: Convention on Matters of Taxation, June 20, 1973, United States-U.S.S.R., 27 U.S.T. 1, T.I.A.S. No. 8225;
- 38) United Kingdom (and Northern Ireland): Convention for the Avoidance of Double Taxation, Dec. 31, 1975, United States-United Kingdom, 31 U.S.T. 5668, T.I.A.S. No. 9682 (amending agreement of Apr. 13, 1976; and protocols: Aug. 26, 1976; Mar. 31 1977; Mar. 15, 1979).

Please note that for several of the citations, references to *United States Treaties* ("U.S.T.") and *United States Treaties and Other International Agreements* ("T.I.A.S.") are left blank. This is due to the fact that the "[o]fficial publication of a treaty, even in pamphlet form, can take quite a while." Questions and Answers, 78 LAW LIBR. J. 593 (1986). Therefore, where the official cite is non-existent, reference is made to the appropriate Senate Treaty Document Number ("S. TREATY DOC. NO.").

The United States is also close to completing tax treaties with the following six countries:

- 1) Argentina: Convention for the Avoidance of Double Taxation, May 7, 1981, United States-Argentina, S. TREATY DOC. NO. 10, 97th Cong., 1st Sess. (1981);
- 2) Bangladesh: Convention for the Avoidance of Double Taxation, Oct. 6, 1980, United States-Bangladesh, S. EXEC. DOC. Y, 96th Cong., 2d Sess. (1980);
- 3) Denmark: Protocol for the Avoidance of Double Taxation, Aug. 23, 1983, United States-Denmark, S. TREATY DOC. NO. 12, 98th Cong., 1st Sess. (1983);
- 4) Israel: Protocol with Respect to Taxes on Income, May 30, 1980, United States-Israel, S. EXEC. DOC. M, 96th Cong., 2d Sess. (1980);

countries.⁸⁰ In avoiding double taxation consequences, income tax treaties encourage the development of international trade and business,⁸¹ while preventing "fiscal evasion."⁸² A country's self-interest in encouraging foreign professionals to bring their skills into the nation often facilitates the creation of treaty provisions which provide an exemption for an individual's personal services. These provisions generally permit an alien to provide services in a host country without being subjected to the country's taxation system; only the alien's resident country will have the taxing power over their citizens.

Recognizing the important role tax treaties serve, the Code states that its sections will not override treaty provisions and exemptions.⁸³ The Code's deference to treaties is significantly different from the judicial doctrine that statutes and treaties are to

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| 5) Sri Lanka: | Convention with Protocol for the Avoidance of Double Taxation, Mar. 14, 1985, United States-Sri Lanka, S. TREATY Doc. No. 10, 99th Cong., 1st Sess. (1985); |
| 6) Tunisia: | Convention for the Avoidance of Double Taxation, June 17, 1985, United States-Tunisia, S. TREATY DOC. No. 13, 99th Cong., 2d Sess. (1986); |

The United States has cancelled tax treaties with the following nineteen nations (considering them to be extensions of the United Kingdom) as of July 1, 1983:

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| 1) Anguilla; | 11) Rwanda; |
| 2) Barbados; | 12) St. Christopher-Nevis; |
| 3) Belize; | 13) St. Lucia; |
| 4) Burundi; | 14) St. Vincent; |
| 5) Dominica; | 15) Grenadines; |
| 6) Falkland Islands; | 16) Seychelles; |
| 7) the Gambia; | 17) Sierra Leone; |
| 8) Grenada; | 18) Zambia; |
| 9) Malawi; | 19) Zaire. |
| 10) Montserrat; | |

Of these nineteen countries, the United States has renegotiated, signed, and ratified a new income tax treaty with Barbados. See M. MEISELS, *supra* note 4, Corrections & Additions 4. The United States is also currently negotiating a tax treaty with Turkey and Zambia. Telephone interview with Mordecai Feinberg, International Economist, United States Treasury Department, Office of Tax Policy (Sept. 2, 1986); see also M. MEISELS, *supra* note 4, Corrections & Additions 4.

⁸⁰ Henriquez, *Objectives of Tax Treaties*, in THE EXCHANGE OF INFORMATION UNDER TAX TREATIES (Proceedings of the 19th Technical Conference of the Inter-American Center of Tax Administrators (C.I.A.T.)) 10 (1978).

⁸¹ *Id.*

⁸² Maximov v. United States, 373 U.S. 49, 54 (1963); 3 R. RHOADES & M. LANGER, *supra* note 10, at § 9.01[2].

⁸³ I.R.C. § 894(a) (1982). Specifically, it states that "[i]ncome of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle." See 8 J. MERTENS, *supra* note 37, at § 45.69. I.R.C. § 7852(d) (1982) further provides that "[n]o provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

be given equal weight, with the latest enacted instrument resolving any inconsistencies.⁸⁴

In the area of personal services, the treaties encourage talented foreigners to share their skill and knowledge in many fields to help develop industry and education.⁸⁵ However, personal services also include those of traveling entertainers. Most countries believe that entertainers should not be included within the purview of this tax treaty exemption.⁸⁶ Only within the past decade has the United States followed that path.

A. *Prior United States Tax Treaty Policy*

Prior to 1970, the United States government had consistently favored worldwide performers and had rejected any tax treaty provisions containing an anti-entertainer bias.⁸⁷ Although these tax treaties provided alien performers with liberal tax treatment, the I.R.S. frequently attempted to tax the earnings of foreign entertainers and athletes who performed in the United States, regardless of the nature of the arrangements for the performances.⁸⁸ The I.R.S. had little success because the courts gave great deference to the treaties.⁸⁹ The courts allowed taxation only if they found that the entertainer was not within the purview of a given treaty.

In *Johansson v. United States*,⁹⁰ Swedish citizen and onetime heavyweight boxing champion, Ingemar Johansson, claimed Swiss residence in order to avoid payment of United States tax on income earned in the United States. He attempted to use the personal services exclusion provided under the United States-Switzerland tax treaty.⁹¹ However, the Commissioner proved that the tax treaty was inapplicable to Johansson's situation. The evidence showed that Johansson spent only 79 days of the tax

⁸⁴ The landmark case regarding the equal authority of statutes and treaties is *Whitney v. Robertson*, 124 U.S. 190, 194 (1888). See also *Chae Chan Ping v. United States*, 130 U.S. 581, 600 (1889) ("The Chinese Exclusion Case").

⁸⁵ See generally Kubasiak, *U.S. Income Tax Planning for a Nonresident's Personal Service Income*, 16 INT'L LAW. 397, 403-04 (1982).

⁸⁶ Singer, *supra* note 8, at 199-200.

⁸⁷ 8 J. MERTENS, *supra* note 37, at § 45.69.

⁸⁸ J. BISCHEL & R. FEINSCHREIBER, *FUNDAMENTALS OF INTERNATIONAL TAXATION* 20-21 (2d ed. 1985).

⁸⁹ Indeed, courts have liberally construed treaties. *Jordan v. Tashiro*, 278 U.S. 123, 127 (1928); see *Maximov v. United States*, 373 U.S. 49, 56 (1963).

⁹⁰ 336 F.2d 809 (5th Cir. 1964).

⁹¹ Convention for the Avoidance of Double Taxation, May 24, 1951, United States-Switzerland, art. X(1), 2 U.S.T. 1751, 1758, T.I.A.S. No. 2316, at 8, governing personal services, provides the following exemption:

An individual resident of Switzerland shall be exempt from United States tax upon compensation for labor or personal services performed in the United

year in Switzerland, compared with 218 days in the United States and 120 days in Sweden.⁹² Although the United States-Switzerland treaty did not define residence,⁹³ Johansson could not be considered a Swiss resident during the tax year in question.⁹⁴ The Fifth Circuit found that Johansson did not fall within the scope of the United States-Switzerland tax treaty; therefore, he was required to pay income tax at the place where his services were rendered—the United States.⁹⁵ The lack of Swiss residence was critical; since Johansson could not invoke the personal services exclusion provided by the treaty, he could not avoid United States taxation.

B. *The Addition of Restrictive Tax Treaty Provisions for Entertainers*

After 1970, United States tax treaties began to contain more restrictive provisions, particularly with regard to entertainers.⁹⁶ New treaties designate the amount of income earned by performers differently from that of other forms of personal service income.⁹⁷ The most probable reason for this may be that countries which provide entertainers and athletes with a place to earn a significant amount of income want to claim a potentially sizeable share of tax.⁹⁸ Tax treaties which have no monetary limit for other types of personal service income now contain special provisions for entertainers and athletes that place a ceiling on the amount of the performer's income earned within a designated time span which may be exempt.⁹⁹ This amount is designed to snare those performers who quickly earn a significant amount of compensation.¹⁰⁰ Because other providers of personal services,

States . . . if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the taxable year and . . .

(a) his compensation is received for such labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Switzerland

⁹² 336 F.2d at 812.

⁹³ Indeed, at the time, there was little authority which provided a workable definition of "residence." See *supra* notes 50-66 and accompanying text.

⁹⁴ 336 F.2d at 812.

⁹⁵ *Id.* at 813-14.

⁹⁶ M. MEISELS, *supra* note 4, at A-38. It is observed that January 1970 became a turning point in the way entertainers were treated, because the United States-Trinidad and Tobago Tax Treaty, *supra* note 79, "became effective on that date [and] was the harbinger of other treaties and protocols which put serious restrictions on tax treaty benefits available to entertainers." M. MEISELS, *supra* note 4, at A-38.

⁹⁷ 3 R. RHOADES & M. LANGER, *supra* note 10, at § 13.01[3].

⁹⁸ *Id.*; see also Burge, *The New United States-United Kingdom Income Tax Treaty*, in INCOME TAX TREATIES 683, 714 (J. Bischel ed. 1978); Singer, *supra* note 8, at 200.

⁹⁹ 3 R. RHOADES & M. LANGER, *supra* note 10, at § 13.02[3].

¹⁰⁰ Below is a compilation of United States tax treaties with various countries which contain a special provision for entertainers and athletes:

such as teachers, earn substantially less income, tax treaty nations have been willing to grant them liberal exemptions.¹⁰¹

The United States Model Tax Treaty¹⁰² evidences the executive branch's tendency to include "Artistes and Athletes" provisions in future tax treaties. This model treaty, created in 1977, provides that a performer in the entertainment industry, "such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete . . . may be taxed in"¹⁰³ the country where

<u>Country</u>	<u>Provision</u>	<u>Taxed if exceeds:</u>
Australia	Article 17	\$10,000/year
Barbados	Article 17	\$250/day or \$4,000/year
Belgium	Article 14	90 days & \$3,000/year
Canada	Article XVI	\$15,000/year
China	Article 16	ALL INCOME TAXED
Cyprus	Article 19	\$500/day or \$5,000/year
Egypt	Article 17	\$400/day
France	Article 15A	\$10,000/year
Iceland	Article 18	90 days & \$100/day
Italy	Article 17	\$12,000/year or 90 days
Jamaica	Article 18	\$400/day or \$5,000/year
Japan	Article 17	90 days & \$3,000/year
Malta	Article 18	90 days or \$500/day or \$5,000/year
Morocco	Article 16	ALL EARNINGS TAXED
New Zealand	Article 17	\$10,000/year
Norway	Article 13	90 days or \$10,000/year
Philippines	Article 17	\$100/day or \$3,000/year
Romania	Article 14	90 days & \$3,000/year
Sweden	Article XI	ALL EARNINGS TAXED
Trinidad	Article 17	\$100/day
U.K.	Article 17	\$15,000/year

Below is a compilation of United States tax treaties not yet in force, which contain a special provision for entertainers and athletes:

<u>Country</u>	<u>Provision</u>	<u>Taxed if exceeds:</u>
Argentina	Article 17	\$400/day or \$12,000/year
Bangladesh	Article 17	\$100/day or \$3,000/year
Denmark	Article 18	\$3,000/year
Israel	Article 18	\$400/day
Sri Lanka	Article 18	\$6,000/year
Tunisia	Article 17	\$7,500/year

For a listing of the citations to these tax treaties, see *supra* note 79.

It is the policy of the United States Treasury Department to include special provisions for artists and athletes. Any new income tax treaty convention, agreement, or protocol proposed by the United States therefore will contain a separate taxing scheme for entertainers, with the limitation figure, if any, varying subject to negotiations with the treaty partner. Therefore, all of the proposed income tax treaties pending with Belgium, Finland, India, Ireland, Netherlands, Pakistan, Sweden, Switzerland, Trinidad and Zambia, contain an entertainer clause. Feinberg, *supra* note 72. It is interesting to note, however, that South Africa has deleted the special provisions for "Artistes and Athletes."

¹⁰¹ 3 R. RHOADES & M. LANGER, *supra* note 10, at § 13.01[3].

¹⁰² United States Treasury Department, *Proposed New Model Income Tax Treaty* in MODEL INCOME TAX TREATIES (K. van Raad, ed. 1983).

¹⁰³ Article 17(1), United States Model Income Tax Treaty (1977), *reprinted in* 3 R.

services are rendered if gross receipts, including reimbursed expenses,¹⁰⁴ exceed \$15,000.¹⁰⁵ If the amount earned is greater than \$15,000, then the *entire* amount is subject to tax.¹⁰⁶ Furthermore, the United States Model Tax Treaty prevents a performer's earnings from accruing in the name of a straw man.¹⁰⁷ If such a ruse is used, the straw man will be taxed to the same extent as the performer. Similarly, an entertainer is prevented from using a sham holding company to avoid the full tax treaty obligations by creating the illusion that the performer is a salaried employee, rather than an independent contractor.¹⁰⁸ However, if the performer can demonstrate that he will not in any way participate in the profits, this provision will not apply.¹⁰⁹

As restrictive as these new provisions may seem, the United States still maintains a \$15,000 allowance for entertainers' in-

RHOADES & M. LANGER, *supra* note 10, at § 15.02[17]. Labeled "ARTISTES AND ATHLETES," this provision provides:

Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his or her personal activities as such exercised in the other Contracting State, may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or her or borne on his or her behalf, from such activities do not exceed fifteen thousand United States Dollars (\$15,000) or its equivalent in _____ for the taxable year concerned.

¹⁰⁴ TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM, Article 17, reprinted in 3 R. RHOADES & M. LANGER, *supra* note 10, at § 15.07[17] [hereinafter U.K.-U.S. TECHNICAL EXPLANATION].

¹⁰⁵ Article 17(2), United States Model Income Tax Treaty (1977), reprinted in 3 R. RHOADES & M. LANGER, *supra* note 10, at § 15.02[17]. Labeled "ARTISTES AND ATHLETES," this provision provides:

Where income in respect of activities exercised by an entertainer or an athlete in his or her capacity as such accrues not to that entertainer or athlete but to another person, that income may, notwithstanding the provisions 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 or athlete are exercised. For purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

A new United States Model Tax Treaty, proposed in 1981 would raise the exclusion figure found in Article 17 to \$20,000. See *id.* at § 15.09[17].

¹⁰⁶ U.K.-U.S. TECHNICAL EXPLANATION, *supra* note 104, at § 15.02[17].

¹⁰⁷ A straw man is defined as a person who acts as a "front" by being a nominal party to a transaction, without having any real part of the deal. BLACK'S LAW DICTIONARY 1274 (5th ed. 1979).

¹⁰⁸ Rev. Rul. 74-330, 1974-2 C.B. 278; 3 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 66.2 (1981); Singer, *supra* note 8, at 200-01.

¹⁰⁹ U.K.-U.S. TECHNICAL EXPLANATION, *supra* note 104, at § 15.07.

come. This is in sharp contrast to the practice of many European nations, which claim an unrestricted right to tax entertainers' entire gross receipts earned in their respective countries.¹¹⁰ Indeed, the Organization of Economic Cooperation and Development¹¹¹ has written into its 1977 Model Tax Treaty¹¹² an "Artistes and Athletes" provision which subjects *all* income earned by performers to taxation by the country where the services were rendered.¹¹³ The United Nations Guidelines and Model Income Tax Treaty of 1979¹¹⁴ also allows the country where the performer is employed to tax all income earned in that country. Japan, a large "importer" of foreign entertainers, has been considered a "leader in [drafting treaty provisions] denying public performers tax benefits."¹¹⁵ In comparison to other forms of tax treaties, the United States Treasury Department has observed that the United States Model Tax Treaty:

reflects the view that cultural exchanges should be encouraged, and that in the absence of international tax avoidance, entertainers and athletes should not be singled out for special adverse tax treatment. The U.S. Model does recognize, however, the ability of those performers to earn very high remuneration in very short periods, and, for that reason, includes the \$15,000 threshold.¹¹⁶

Although the United States has sought to use income tax treaties to establish a fair way of taxing entertainers, many problems still

¹¹⁰ *Id.* at § 13.06[1].

¹¹¹ The Organization for Economic Cooperation and Development is the successor of the Organization for European Economic Cooperation. *Id.* at § 9.01[4][a].

¹¹² Organization of Economic Cooperation and Development, *Model Double Taxation Convention on Income and Capital* in MODEL INCOME TAX TREATIES (K. van Raad, ed., 1983) [hereinafter OECD Model].

¹¹³ *Id.* This provision provides:

Notwithstanding the provisions of Articles 14 [Independent Personal Services] and 15 [Dependent Personal Services], income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

Note that with the major exception of the inclusion of a second sentence of the United States Model Tax Treaty, the two Model provisions read very much alike. *See supra* note 103.

¹¹⁴ United Nations, *Model Double Taxation Convention Between Developed and Developing Countries*, in MODEL INCOME TAX TREATIES (K. van Raad, ed., 1983) [hereinafter U.N. Model].

¹¹⁵ J. HUSTON, T. MIYATAKE, & G. WAY, JAPANESE INTERNATIONAL TAXATION § 1.02[2][iv] (1985); Huston, *Working with the Japanese Treaty* in INCOME TAX TREATIES 563, 610 (Bischel ed. 1978).

¹¹⁶ United States Treasury Department, *The United States Model Tax Treaty*, in THE EXCHANGE OF INFORMATION UNDER TAX TREATIES (Proceedings of the 19th Technical Conference of the InterAmerican Center of Tax Administrators (C.I.A.T.)) 80, 86 (1978).

exist. The United States has consistently sought to provide some sort of monetary figure which would further cultural exchanges. However, monetary limits are inconsistent from country to country. Only two nations, Canada and the United Kingdom,¹¹⁷ have agreed to use the United States Tax Treaty Model figure in treaties with the United States by taxing performers who earn more than \$15,000 per year. Three countries, Sweden, Morocco, and China, have included in their tax treaties with the United States an "Entertainers and Athletes" provision¹¹⁸ which follows both the Organization of Economic Cooperation and Development Model and the United Nations Model. For the most part, the United States tax treaties with other nations fall somewhere between these two extremes, but most allow only a minor exemption.¹¹⁹

Another problem exists in the way tax treaties exclusively list those entertainers not entitled to full exemption from tax of the personal service income. For example, these provisions usually do not apply to motion picture directors, whose skills arguably fall within the category of artistry. Indeed, it has been pointed out that serious anomalies exist in taxing an actor differently from those who travel and work with actors and are responsible for production of motion pictures in foreign countries.¹²⁰

The post-1970 treaties show the executive branch's specific intent to provide separately for artists and athletes, as well as to distinguish "independent" personal services from "dependent" personal services.¹²¹ This prevents aliens from unduly taking advantage of privileges which were not intended for them. To foster cultural exchanges without the obstacle of potential tax disputes, musicians, athletes, dancers, or other entertainers who are employees of a foreign entity, such as a foreign government performing group¹²² or a foreign national team,¹²³ will be entitled to a federal tax exemption.¹²⁴ These treaties show the executive branch's intent to tax the

¹¹⁷ See *supra* note 100.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ Burge, *supra* note 98, at 715.

¹²¹ Kubasiak, *supra* note 85, at 401-02.

¹²² Examples of foreign government performing groups are the Soviet Union's Bolshoi Ballet and the Vienna Boys Choir.

¹²³ Examples of foreign government national teams are the Soviet Union National Hockey Team and the Italian National Soccer Team.

¹²⁴ New tax treaty agreements not yet ratified with China and Sri Lanka specifically contain special provisions to give a tax exemption to these types of performers. Article 16 of the United States-China agreement provides, in pertinent part:

[I]ncome derived by a resident of a Contracting State as an entertainer or athlete from activities exercised in accordance with a special program for cul-

substantial amount of performer's income earned absent foreign government's sponsorship.

While tax treaties provide monetary guidelines that indicate the extent to which an entertainer will be taxed, they do not describe the way in which an individual has reached these limits. The treaties do not identify a way to compute the amount of the performer's salary that was actually earned in each country. Without specific authority to the contrary, courts were obliged to allow foreigners to favorably allocate earnings so as to create manipulation for the avoidance of United States federal income taxation.¹²⁵ However, here too, foreign performers are losing an advantage.

IV. POTENTIAL CHANGES IN INCOME ALLOCATION OF NONRESIDENT ALIEN ENTERTAINERS

While the Treasury Regulations had at one time provided only one method for allocating the income of nonresident aliens, an amendment will likely snare most entertainers. The time basis allocation method¹²⁶ allowed for significant abuse, as evidenced by several cases.¹²⁷ This method, when used by foreign entertainers, resulted in disproportionate tax treatment in comparison with a performer in the United States.¹²⁸ With the Regulations now explicitly allowing any other type of income allocation which would better represent the location of the earning activity, a box office method would likely be the best method for determining the tax liability of most performers,¹²⁹ although athletes may still be allowed to use the time basis allocation method.¹³⁰

A. *The Time Basis Allocation Method*

In determining federal income tax liability, United States cit-

tural exchange agreed upon by the governments of both Contracting States shall be exempt from tax by the other Contracting State.

Agreement for the Avoidance of Double Taxation, Apr. 30, 1984, United States-China, art. 16, S. TREATY DOC. NO. 30, 98th Cong., 2d Sess. (1984); — U.S.T. —, T.I.A.S. —. Sri Lanka has a similar provision. Convention with Protocol for the Avoidance of Double Taxation, March 14, 1985, United States-Sri Lanka, art. 18, S. TREATY DOC. NO. 10, 99th Cong., 1st Sess. (1986).

¹²⁵ See, e.g., *Hanna v. Commissioner*, 763 F.2d 171 (4th Cir. 1985); *Stemkowski v. Commissioner*, 690 F.2d 40 (2d Cir. 1982); *Tipton & Kalmbach, Inc. v. United States*, 480 F.2d 1118 (10th Cir. 1973); *Linseman v. Commissioner*, 82 T.C. 514 (1984); see *infra* notes 149-69 and accompanying text.

¹²⁶ Treas. Reg. § 1.8641-4(b)(1) (1975); see *infra* notes 131-48 and accompanying text.

¹²⁷ See *infra* notes 149-69 and accompanying text.

¹²⁸ See *infra* notes 174-86 and accompanying text.

¹²⁹ See *infra* notes 174-86 and accompanying text.

¹³⁰ See *infra* notes 187-94 and accompanying text.

izens and residents must include in their gross income¹³¹ the amounts received from sources within *and* without the United States.¹³² Although American citizens and residents are entitled to a foreign tax credit¹³³ for taxes paid to another country on foreign income, that credit does not relieve the obligation to pay United States tax on their remaining income.¹³⁴

In contrast, when determining their United States income tax, nonresident aliens include in their gross income¹³⁵ the compensation received for services performed *only* within, or "effectively connected with the conduct of a trade or business in the United States."¹³⁶ They will be taxed in relationship to their source of income.¹³⁷ The apparent reason for taxing income earned only from sources within the United States is that foreigners should "pay" for the benefits received while staying in the United States for a limited period of time.¹³⁸ Failure to tax these

¹³¹ I.R.C. § 61 (1982 & Supp. III 1985) lists fifteen items which are specifically to be included in gross income for United States citizens and resident aliens. However, sources of income subject to tax is not to be limited by this list. *Id.*

¹³² *Id.* Section 861 defines, particularly for alien residents, what income should be treated as derived from sources within the United States.

¹³³ *Id.* §§ 27, 901-905 (1982 & Supp. III 1985). This would thereby avoid double taxation. See *United States v. Woodmansee*, 388 F. Supp. 36, 43-44 (N.D. Cal. 1975), *rev'd on other grounds*, 578 F.2d 1302 (9th Cir. 1978). The Northern District of California cited *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 7-8 (1932); *Rinehart v. United States*, 429 F.2d 1286, 1288 (10th Cir. 1970); *Associated Tel. & Tel. Co. v. United States*, 306 F.2d 824, 832 (2d Cir. 1962), *cert. denied*, 371 U.S. 950 (1963); *Federated Mutual Implement & Hardware Ins. Co. v. Commissioner*, 266 F.2d 66, 69 (8th Cir. 1959); *Duke v. Commissioner*, 34 T.C. 772, 775 (1960); *Marsman v. Commissioner*, 18 T.C. 1, 12 (1952), *aff'd in relevant part, rev'd in part*, 205 F.2d 335 (4th Cir. 1953); see also *supra* note 7 for a brief discussion on double taxation.

¹³⁴ 388 F. Supp. at 44. Therefore, whatever the foreign government does not tax, the United States Treasury Department will.

¹³⁵ I.R.C. § 872(a) (1982) contains a definition of gross income which is only applicable to nonresident aliens. Such gross income only includes:

- (1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and
- (2) gross income which is effectively connected with the conduct of a trade or business within the United States.

For the definition of gross income of United States citizens or residents, see I.R.C. § 61 (1982 & Supp. III 1985).

¹³⁶ Treas. Reg. § 1.861-4(a)(1)(i) (as amended by T.D. 7378, 1975-2 C.B. 272). The nonresident alien, must prepare a special income tax return, titled Form 1040NR. The I.R.S., in addition to publishing a 21 page booklet of instructions for Form 1040NR also publishes a 32 page booklet entitled "United States Tax Guide for Aliens," Pub. No. 519 (Rev. Nov. 1985).

¹³⁷ I.R.C. § 871(a)(1)(A) (1982 & Supp. III 1985) lists sources of income on which a nonresident alien must pay United States income tax, if acquired from sources within this country. They include: "interest[,] dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income."

¹³⁸ Aliens are not entitled to enjoy *all* the benefits and advantages afforded United States citizens. *Mathews v. Diaz*, 426 U.S. 67, 78-80, 82-83 (1976). However, the

earnings would be discriminatory against United States residents and citizens.¹³⁹

To determine a nonresident alien entertainer's United States income tax liability, the "source" of the income must be ascertained. If a nonresident alien's income is not connected with a United States business,¹⁴⁰ the tax rate will be thirty percent.¹⁴¹ If the income is deemed to be so connected, a graduated rate of taxation will apply¹⁴² so that the more money the foreigner earns in the United States the greater the tax rate.¹⁴³ This taxing scheme is premised on the theory that a nonresident alien involved with a United States trade or business has made a significant level of "economic penetration" by becoming a direct participant in United States economic life.¹⁴⁴

Occasionally, as a result of the absence of specific income designation language in a foreigner's personal service contract, there may be no apparent means by which to precisely segregate income actually earned in the United States from that earned elsewhere. Recognizing this problem, the I.R.S. provided a sin-

Supreme Court has held that aliens are protected under the fifth and fourteenth amendments of the Constitution from deprivation of life, liberty, or property without due process of law. *Id.* at 77, citing *Wong Yang Sung v. McGrath*, 339 U.S. 33, 48-51, *modified*, 339 U.S. 908 (1950); *Wong Wing v. United States*, 163 U.S. 228, 238 (1896); *Russian Volunteer Fleet v. United States*, 282 U.S. 481, 489 (1931).

Moreover, the Court historically has struck down statutes which deny an alien the right to do business in the United States. See *Truax v. Raich*, 239 U.S. 33 (1915); *Yick Wo v. Hopkins*, 118 U.S. 356 (1886); and more recently in *In re Griffiths*, 413 U.S. 717 (1973); *Sugarman v. Dougall*, 413 U.S. 634 (1973).

For a brief review governing an alien's right to work in this country, see 4 J. SPIRES, *supra* note 30, at § 54.09.

¹³⁹ The Supreme Court, in *Commissioner v. Wodehouse*, 337 U.S. 369 (1949), observed:

No suggestion appears that Congress intended or wished to relieve from taxation the readily accessible and long-established source of revenue to be found in the payments made to nonresident aliens . . . in the United States To have exempted these nonresident aliens from these readily collectible taxes derived from sources within the United States would have discriminated in their favor against resident citizens of the United States who would be required to pay their regular income tax on such income No such purpose to discriminate can be implied.

Id. at 390-91. The Court found that nonresident aliens are subject to United States tax on copyrights. *Id.* at 371.

¹⁴⁰ I.R.C. § 864(b) (1982) defines a "trade or business" as it relates to foreigners. The term, with certain exceptions inapplicable to entertainers' performance income, "includes the performance of personal services within the United States at any time within the taxable year." *Id.*

¹⁴¹ *Id.* at § 871(a)(1)(A). The tax rate may be less than 30% if a lower treaty rate applies. See 20 FEDERAL TAX COORDINATOR 2d (RIA) O-10120 (1986).

¹⁴² I.R.C. § 871(b) (1982).

¹⁴³ *Id.* The taxpayer will be taxed according to the individual's status provided under I.R.C. §§ 1, 55, or 402(e)(1) (1982 & West Supp. 1986).

¹⁴⁴ P. McDANIEL & H. AULT, INTRODUCTION TO UNITED STATES INTERNATIONAL TAXATION 49 (1977).

gle way to match income to the country where it is earned. The governing Treasury Regulation¹⁴⁵ stated only that in "many circumstances," allocation of income through a time basis apportionment would be acceptable. Under this method of apportionment, a foreigner's total receipts under a personal service contract is multiplied by the fraction of days spent within the United States over the total number of days covered in the contract.¹⁴⁶ The result of this equation represents United States taxable income earned within this country.

Although considered a "reasonable, convenient and expeditious method of allocating income,"¹⁴⁷ the time basis method cannot always accurately designate United States income. This is particularly true in the case of some nonresident alien entertainers, whose earnings, unlike those of other workers, are not contingent upon the time spent on the job. Case histories expose situations where foreign performers were able to use this method for significant tax advantages.¹⁴⁸

B. *Case History Illustrating Nonresident Aliens' Favorable Tax Treatment by Using the Time Basis Allocation Method*

Prior to 1976, courts were bound to the exclusive use of the time basis allocation method because there was no authority for any other standard.¹⁴⁹ In *Stemkowski v. Commissioner*,¹⁵⁰ the tax-

¹⁴⁵ Treas. Reg. § 1.861-4(b)(1)(i) (as amended by T.D. 7378, 1975-2 C.B. 272). More specifically it provides, in pertinent part:

If no accurate allocation or segregation of compensation for labor or personal services . . . can be made . . . when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case. In many cases the facts and circumstances will be such that an apportionment on the time basis will be acceptable, that is, the amount to be included in gross income will be that amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. In other cases, the facts and circumstances will be such that another method of apportionment will be acceptable.

Note, however, that prior to 1976, the last sentence of the Regulation did not exist.

¹⁴⁶ Mathematically, the equation will be:

$$\begin{array}{rcl} \text{Income under} & & \text{Days Within the U.S.} \\ \text{Multinational} & \times & \hline \text{Contract} & & \text{Total Contracted Days} \end{array}$$

¹⁴⁷ See *Tipton & Kalmbach, Inc. v. United States*, 480 F.2d 1118, 1121 (10th Cir. 1973).

¹⁴⁸ See *infra* text accompanying notes 149-66.

¹⁴⁹ Since 1976, the amended Regulations untied the courts' hands. See *infra* notes 172-85 and accompanying text.

payer was a professional National League Hockey player¹⁵¹ and a resident of Canada. He signed a National Hockey League Standard Player's Contract which did not differentiate between payments for services performed within and without the United States.¹⁵² In addition, the contract required participation in play-off games and training camp services. Stemkowski was also obligated, under the contract, to be physically fit to play upon arrival at the training camp as well as throughout the playing season.¹⁵³ The court held that the income earned exclusively in the United States was to be determined by the proportion of games played in the United States.¹⁵⁴ Income from games played in Canada would not be subject to United States tax.¹⁵⁵ Furthermore, Stemkowski's physical conditioning expenses that were incurred in Canada and needed to keep him fit for play in the United States were deductible.¹⁵⁶ The result indicates that foreign athletes are able to exclude a significant portion of playing contract revenue from taxable income. No reference was made to the Canadian tax treaty. This decision was followed in a similar case in the Fourth Circuit.¹⁵⁷

Another hockey player case involved a sign-on bonus payment. In *Linseman v. Commissioner*,¹⁵⁸ the Tax Court found that because the Canadian resident's sign-on bonus was an incentive to play hockey games both in the United States and in Canada, the sign-on bonus was subject to apportionment based on the amount of time played in each country. As a result, Linseman was able to "divert" a portion of his bonus out of United States gross income and have it taxed under a more favorable Canadian tax rate.¹⁵⁹

Utilization of the time basis allocation method has not been limited to athletes. In *Boulez v. Commissioner*,¹⁶⁰ the taxpayer was a

¹⁵⁰ 690 F.2d 40 (2d Cir. 1982) (applying the pre-1976 Regulations).

¹⁵¹ Players in the National Hockey League are required to play games both in the United States and in Canada.

¹⁵² 690 F.2d at 44.

¹⁵³ *Id.* at 43, 46.

¹⁵⁴ *Id.* at 44. It has been observed that the Tax Court erroneously included Stemkowski's 1970 activity when determining the amount of his 1971 compensation. See Harwood, *Recent CA-2 Decision Focuses on Computing U.S. Source Income for Nonresident Alien*, 58 J. TAX'N 266, 267 (1983).

¹⁵⁵ See 690 F.2d at 46.

¹⁵⁶ The Second Circuit thus differed from the Tax Court's decision on this point. See *Stemkowski v. Commissioner*, 82 T.C. 854 (1984).

¹⁵⁷ *Hanna v. Commissioner*, 763 F.2d 171 (4th Cir. 1985).

¹⁵⁸ 82 T.C. 514 (1984).

¹⁵⁹ See generally MATERIALS ON CANADIAN INCOME TAX 146-47 (W. Grover & F. Iacobucci ed. 2d ed. 1974).

¹⁶⁰ 83 T.C. 584 (1984).

resident of Germany during the tax year in question. As a "world-renowned music director and orchestra conductor,"¹⁶¹ he entered into a contract with a record company to perform with the New York Philharmonic and to produce phonograph records.¹⁶² The Tax Court concluded that the ambiguous contract was for personal services, not for a sale or lease of property rights.¹⁶³ Viewing Boulez as an "independent contractor" rather than a common law employee,¹⁶⁴ and holding that he had no copyrightable property interest in the recordings, he would be subject to taxation in accordance with Article X of the United States-Germany tax treaty.¹⁶⁵ Therefore, the country in which he made the recordings, not the recordings themselves, determined the taxing scheme.

The ramifications of *Boulez* are tremendous. The Tax Court established a precedent by going beyond the product whose source was in question, and looking to the place where the entertainer engaged in the income earning activity. The court found as fact that the performance and not the product was the material taxing issue. Moreover, the Tax Court found the place of the musician's performance the controlling factor in determining how much of his activity was taxable. This case could be interpreted to suggest that if a German conductor made a studio recording in a "tax haven"¹⁶⁶ rather than in New York, he would not have had to pay any tax on the recording sales within the United States.¹⁶⁷ For example, if he had entered into a contract to record in the Bahamas, any income received on a percentage of sales in the United States would not be considered derived from United States sources.¹⁶⁸

It is arguable that use of the time basis allocation method by a nonresident alien entertainer yields a result that is disproportionate to the tax obligation of a United States citizen or resident who is also a performer. In light of this inequitable result, it is questionable whether a foreign musician or actor will be able to

¹⁶¹ *Id.* at 585.

¹⁶² *Id.* at 587.

¹⁶³ *Id.* at 592.

¹⁶⁴ *Id.* at 595.

¹⁶⁵ *Id.* at 596.

¹⁶⁶ See *supra* note 72.

¹⁶⁷ This case is similar to *Ingram v. Bowers*, 47 F.2d 925 (S.D.N.Y. 1931), *aff'd*, 57 F.2d 65 (2d Cir. 1932) (the court held that since the famed tenor Enrico Caruso, as a nonresident alien contracted with Victor Talking Machine Company to record in the United States, any money earned by way of royalties on foreign sales of his records were subject to United States tax).

¹⁶⁸ *Damsky*, *supra* note 6, at 4, col. 5.

continue to use the time basis method, given an amendment to Treasury Regulation section 1.861-4(b)¹⁶⁹ which now calls for other methods of allocation where the circumstances so merit. Before an analysis can be made regarding the utilization of a different method, it is necessary to look at examples of situations illustrating the potential unjustified disparity in the taxing treatment.

C. *Illustrative Examples of Disproportionate Tax Treatment*

A comparison of the tax treatment accorded to a nonresident alien entertainer and a United States citizen or resident alien entertainer illustrates that use of the time basis allocation method may result in unwarranted inequitable treatment. Consider the following hypothetical taxpayers. *N*, a foreign "rock & roll" star,¹⁷⁰ wishes to enter the American "musical market." If his promoter were to give him a \$1,000,000 contract for all United States performances, the entire amount would be taxed as United States income. However, if the promoter were to sign him on a tour of the United States as well as several other countries, *N* would be able to apportion only that percentage of his performance contract agreement which is based upon the total days spent in the United States over the total days of the tour.

Assume that the promoter has booked *N* on a tour of only two foreign countries: the Bahamas and the United States. *N* will perform a total of sixty days of concerts, divided by an equal thirty days in each country, with a salary, under the United States-Bahamas tour contract, of \$1,000,000. The amount of income taxable by the United States would be divided in half, since his performances in the United States totalled only thirty days out of the sixty contracted days of performances. Therefore, only \$500,000 of his salary would be subject to United States tax, and the remaining \$500,000 would be subject to the Bahamian taxing scheme. The time apportionment technique does not take into consideration how much of his income was realistically earned in the United States. For example, box office receipts of each country would be ignored. It is tautological that the actual total "take" from United States concert attendance greatly exceeded the amount earned in the Bahamas. Most of *N*'s earnings from the tour were probably attributable to United States fans,

¹⁶⁹ Treas. Reg. § 1.861-4(b) (as amended in 1975).

¹⁷⁰ Although this hypothetical uses a "rock & roll" performer, this illustration could have used any other type of entertainer.

but as the contract does not contain a provision describing salary apportionment, *N* is able to use time apportionment to save a substantial amount in United States taxes. Moreover, since the Bahamas is a tax-free nation,¹⁷¹ *N* shifts money otherwise earned in one nation to another without having to pay United States tax on that portion. This is, of course, subject to the tax law provisions of the country where *N* makes his home.

Now assume that *C*, a United States citizen, also performs thirty days in both the United States and the Bahamas for a total of \$1,000,000. As a United States citizen, he is obligated to pay taxes on the *entire* \$1,000,000. Since a United States citizen derives benefits and protection from this country, he is obligated to pay taxes on income earned worldwide. The only factual dissimilarity between *N* and *C* is nationality. Yet, this factor has resulted in a significantly different tax treatment.

Although *C* would avoid being taxed twice on the same income through a "foreign tax credit"¹⁷² if the Bahamas had a tax law that required him to pay a foreign tax, *C* still would not have the advantages *N* does in diverting income. Another method for income allocation must be used in order to create an equitable parity in tax treatment of these two individuals.

D. Another Available Allocation Alternative: The Box Office Allocation Method

When dealing with the allocation of deductions of expenses and costs for tangible goods, a variety of techniques are available: allocation premised on sales, expenses, asset-uses, company/office space, and time.¹⁷³ However, where the taxable occurrences are not founded on the sale of goods but are instead based on the performance of services, an allocation based on time, at first glance, appears to be the proper method. Utilization of time basis apportionment to nonresident alien entertainers, however, raises serious questions of equity.¹⁷⁴

Prior to the 1975 amendment to Treasury Regulation 1.8614(b), the government had opposed judicial application of the time basis allocation method irrespective of the taxpayers' sit-

¹⁷¹ M. LANGER, PRACTICAL INTERNATIONAL TAX PLANNING 61-8 (3d ed. 1986). Indeed, the Bahamas are considered "one of the bestknown tax havens in the world." *Id.* at 61-1; see also A. STARCHILD, TAX HAVENS 108 (1979) (the islands are a very traditional and central tax haven).

¹⁷² I.R.C. §§ 901-905 (1982 & Supp. III 1985).

¹⁷³ Kalish & Bodner, *Allocation and apportionment of deductions between U.S. and foreign source income*, 2 TAX ADVISER 534, 536 (1971).

¹⁷⁴ See *supra* notes 152-53 and accompanying text.

uations.¹⁷⁵ In lieu of the time basis allocation, the government advocated a “payroll cost method”¹⁷⁶ because it more accurately reflected income allocation. However, in *Tipton & Kalmbach, Inc. v. United States*,¹⁷⁷ the court specifically rejected that argument by upholding the express statutory provision of Treasury Regulation section 1.861-4(b), stating that the “Internal Revenue Service is . . . not free to apply an *ad hoc* method of allocation when [the Regulation] does not abuse the allocation issue in this case.”¹⁷⁸ However, when the case was decided, time basis apportionment was the only method available in the Regulations to apportion income.

In 1975, the Regulation was amended to incorporate that the use of the time basis allocation method as valid in some instances, while in other situations, “another method of apportionment will be acceptable.”¹⁷⁹ Income apportionment is therefore contingent upon the particular circumstances of a specific taxpayer. In some cases, the amount included in gross income *may* be determined by allocating the total compensation for labor and services based upon the number of days of contractual performance within the United States.

The Regulation likely envisions that application of the time basis allocation method is appropriate only when the rate of income earned in the United States would not be different from income earned elsewhere. In the case of a nonresident alien who is not an entertainer, salary is computed by the amount of days engaged in employment. The time basis allocation method is the appropriate measure used to determine the portion of income effectively earned in the United States. However, in cases involving nonresident alien entertainers, computation of contractual salary amounts are usually determined by other standards. However, the Regulations fail to list examples of situations involving entertainers whose respective contracts call for performances in the United States and in other nations.

The government may attempt to use a method predicated upon the box office receipts earned in each country, which can be

¹⁷⁵ See, e.g., *Le Beau Tours Inter-America, Inc. v. United States*, 415 F. Supp. 48 (S.D.N.Y.), *aff'd*, 547 F.2d 9 (2d Cir. 1976), *cert. denied*, 431 U.S. 904 (1977).

¹⁷⁶ The United States argued that since *Tipton & Kalmbach, Inc.*, paid their employees not by the amount of time they spent, but instead by contract, the better way to allocate would be to use the corporation's payroll costs. Appellee's Brief at 17-20, *Tipton & Kalmbach, Inc. v. United States* (10th Cir. 1973) (No. 72-1563).

¹⁷⁷ 480 F.2d 1118 (10th Cir. 1973).

¹⁷⁸ *Id.* at 1121.

¹⁷⁹ Treas. Reg. § 1.861-4(b)(1)(i) (as amended in 1975).

appropriately labeled the box office allocation method. The box office allocation method is designed to take into account the way in which a performer's contractual salary amount is determined. Promoters, agents, and entertainers usually make calculations and estimations as to the amount to charge for admission prices in each country. Seeing the potential lump sum figure, they negotiate the salary to be earned by the entertainer. It is likely that more income will be derived in certain countries than in others, despite an equal number of performances given in each nation. After a performer has engaged in a worldwide tour, including a stop in the United States, box office receipts should be examined to determine how much the public paid to see the performer. The amounts of money received in other countries will have to be valued in American dollars at the time earned.¹⁸⁰ Once currency is converted, the total United States box office "take"¹⁸¹ will be divided by the total worldwide box office take. The resulting figure would then be multiplied by the entertainer's income provided under the multinational contract to produce the actual amount of money earned through United States turnstiles.¹⁸² This method more accurately reflects that the portion of an entertainer's income was "effectively earned" in a given country, disregarding the number of days spent in each nation. Thus, the box office allocation method is a more precise way to allocate income to its source in these situations rather than the time basis method. Ultimately, it prevents a foreign entertainer from sheltering income earned in the United States through utilization of a tax haven.

To support an argument for the use of another method like the box office allocation method, one may refer to the Regulation's illustrations of the application of the time basis allocation method.¹⁸³ The Regulations provide no examples involving per-

¹⁸⁰ This should not be a difficult process, as the "Currency Exchange" keeps records on the value of foreign currency on a daily basis. Indeed, this is the method applied in determining the earnings and profits of foreign corporations. *See generally* Treas. Reg. § 1.964-1(d) (as amended in 1983).

¹⁸¹ "Take" represents the sum total of all the box office revenue received. United States box-office take would therefore include all money earned in box offices in all of the United States and possessions. World-wide "take" would include the entire total of admissions fans paid throughout the world.

¹⁸² Mathematically, the equation would look like this:

$$\begin{array}{rcl} \text{Income under} & & \text{U.S. Box Office Take} \\ \text{Multinational} & \times & \hline \text{Contract} & & \text{Total Box Office Take} \end{array}$$

¹⁸³ Treas. Reg. § 1.861-4(b)(ii) (as amended in 1975).

formers. In one example, a nonresident alien employee under an employment contract was on call at all times—payment to be made on a seven-day work week basis with a stipulated salary regardless of the number of days actually worked. Some employment required a presence in the United States. The Regulation states that “[u]nder these circumstances the amount of compensation to be included in gross income as income from sources with the United States will be [computed on the time basis allocation method].”¹⁸⁴ The only other example envisions a United States citizen, residing in a foreign country and employed by a United States corporation.¹⁸⁵

Although the box office allocation method may be effective for musicians and actors, it does not work for all types of performers. Athletes playing for professional teams cannot use the box office allocation method since their contracts are not negotiated based upon the team’s earnings from admissions to the same extent it is for musicians and actors.¹⁸⁶ The box office allocation method is inaccurate if a non-United States team plays poorly and does not attract many fans in its home country; yet while playing against successful teams in the United States, the games draw large attendance. Therefore, barring the creation of another method of income allocation, nonresident alien athletes may still plan to use time basis allocation of their salaries to their advantage.

E. *Athletes Using Time Basis Allocation*

For the purpose of illustration, consider the following example. *J*, a citizen and current resident of Canada, is a promising baseball prospect for the “General League.”¹⁸⁷ He is offered

¹⁸⁴ *Id.*, Example (1) (emphasis added).

¹⁸⁵ *Id.*, Example (2). Here, the employee is paid a yearly salary for a five day work-week. His job also required him to work some days in the United States. Once again, the regulation provides, “[u]nder these circumstances the amount of compensation for personal services performed in the United States is [computed on the time basis allocation method].” *Id.* (emphasis added).

Other authorities who explain and describe the application of this Regulation also phrase example fact patterns which do not involve the unique situation of entertainers. See, e.g., P. POSTLEWAITE & M. COLLINS, INTERNATIONAL INDIVIDUAL TAXATION 60 (1982).

¹⁸⁶ This is not to say that teams will hire an athlete without considering the amount of fans a particular player will draw. However, when compared to other entertainers, such as musicians and athletes, this is a small part of the consideration in reaching a salary amount.

¹⁸⁷ The “General League” is a fictitious analogy to Major League Baseball. Actual games played and contract term specifications may or may not parallel between the two. Furthermore, the “General League” does not play “double-headers” so that the number of games played correspond exactly to the number of days played.

identical year long contracts¹⁸⁸ with two teams of equal ability—one whose home is in a United States city, and the other in a Canadian city. Each contract pays *J* a fixed salary of \$100,000 as compensation for one “year’s” play.

Both contracts envision a ballplayer’s “year” as consisting of four main activities. First, he would be required to be available to play 162 regular season games. He would also have to participate in Spring training which includes playing twenty exhibition games in Florida. In addition, he would be obligated to play in any post-season games if the team is fortunate enough to do well. Finally, he would have to play winter ball¹⁸⁹ during part of the “off season” in the “Mexican League,”¹⁹⁰ which consists of sixty games played in Mexico. During the rest of the “off-season,” *J* is required to stay in top physical shape in the event his contract is renewed for the next season.¹⁹¹ Assuming that his decision will be motivated solely by how much money is left after taxes,¹⁹² *J* will make the following analysis. First, *J* will consider the total number of games played in the United States and the number played in Canada. If half of the 162 regular season games are played at the team’s own ballpark, *J* will play eighty-one days in the United States if he joins the Canadian team. In contrast, if *J* joins the United States team, he would be playing a total of 153 regular season games in this country.¹⁹³ With the twenty addi-

¹⁸⁸ The hypothetical contracts are patterned after the National Hockey League player’s standard contract as reproduced in part in *Stemkowski v. Commissioner*, 690 F.2d 40, 43 (2d Cir. 1982).

¹⁸⁹ In professional Major League Baseball, a player signs a separate contract with a team in the Winter League. Telephone interview with Stephanie Vardavas, Assistant Counsel for Major League Baseball (Oct. 30, 1986).

¹⁹⁰ The “Mexican League” is a hypothetical league which for purposes of this example should be considered the same as the leagues which play winter ball. Also, for purposes of this illustration, assume that both General League teams own a Mexican League team. Note, however, that in Major League Baseball, Winter League clubs are not affiliated with the Major League clubs. Vardavas, *supra* note 189.

¹⁹¹ The Uniform Player’s Contract of both the American League and the National League provide the following clause:

The Player agrees to perform his services hereunder diligently and faithfully, to keep himself in first-class physical condition and to obey the Club’s training rules, and pledges himself to the American public and to the Club to conform to high standards of personal conduct, fair play and good sportsmanship.

¹⁹² Although in real life it is unlikely that tax consequences would be a *sole* motivating factor in determining which team to play for, astute athletes and entertainers will give considerable attention to the tax consequences involved. See 3 A. LINDEY, LINDEY ON ENTERTAINMENT, PUBLISHING AND THE ARTS 1855 (2d ed. 1986).

¹⁹³ Like Major League Baseball, the “General League” is composed of two divisions, an “East” and a “West”, with a team playing eighteen games against each of the teams in its division. Furthermore, half of the games, nine in total, will be played in the visiting stadium. Therefore, *J*’s team would be the visiting team in Canada for only nine games.

tional days required to be spent in the United States for spring training exhibition games, plus sixty days in Mexico for winter ball, the total proportion of days spent in different countries can be broken down into the following charts:

IF J WERE TO JOIN THE CANADIAN TEAM			
Days spent in:			
<u>U.S.</u> 101	<u>Canada</u> 61	<u>Mexico</u> 60	<u>Total</u> 222
Salary amounts considered, based on time apportionment, earned in:			
<u>U.S.</u>	<u>Canada</u>	<u>Mexico</u>	
$\frac{101}{222} \times \$100,000$	$\frac{61}{222} \times \$100,000$	$\frac{60}{222} \times \$100,000$	
=\$45,496	=\$27,477	=\$27,027	

IF J WERE TO JOIN THE UNITED STATES TEAM			
Days spent in:			
<u>U.S.</u> 153	<u>Canada</u> 9	<u>Mexico</u> 60	<u>Total</u> 222
Salary amounts considered, based on time apportionment, earned in:			
<u>U.S.</u>	<u>Canada</u>	<u>Mexico</u>	
$\frac{153}{222} \times \$100,000$	$\frac{9}{222} \times \$100,000$	$\frac{60}{222} \times \$100,000$	
=\$68,919	=\$ 4,054	=\$27,027	

After compiling these charts, *J* will determine which nation has the more favorable income tax rates. *J* will calculate the income tax consequences of joining each team by computing the total tax liability for both Canada and the United States. For each day *J* spends in his homeland of Canada rather than playing in the United States, he will be able to "divert" approximately \$450 of his salary away from his United States taxable income. This figure is derived by multiplying $1/222$ by \$100,000.¹⁹⁴ Regardless of which team he chooses, *J*

¹⁹⁴ If this were Major League Baseball, and *J* were to join a Western Division team (Canadian baseball teams are in the Eastern Division), he would play a total of 156 games in the United States, while playing only 6 games in Canada. This is because the Major League Baseball schedule structure calls for teams to play against other teams

will be able to exclude \$27,027 from his United States income—the amount attributable to play in Mexico—by using the time basis allocation method.

On the other hand, the United States citizens or residents who are *J*'s teammates, having identical contracts, are not afforded similar tax treatment. Instead, they must pay United States income tax on the entire \$100,000 salary. No apportionment is made for games played in Canada or Mexico. They are subject, by virtue of their status as United States citizens or residents, to pay United States tax on their worldwide income. Since there appears to be no way to limit a nonresident alien athlete's tax advantage, perhaps a special provision should be given to United States citizens and residents to avoid inequitable treatment.

V. CONCLUSION

For most nonresident alien entertainers, the significant tax advantages once afforded to them may no longer be available. Both the executive and legislative branches, while still welcoming foreign entertainers to do business in the United States, are now beginning to tax the sizeable performance income that is earned here. The recent amendments to the Code regarding classification of nonresident alien status and determination of residence signify a reform movement which attempts to "crack-down" on nonresident aliens in general. New tax treaties specifically designate a section for "Artistes and Athletes" so as to distinguish them from other foreign income earners and place a monetary limit on how much income should be excluded from federal income tax. Finally, the addition to the Regulations of an alternative means available to apportion income, most likely a box office allocation method, may untie courts' hands to further erase the tax benefits foreign entertainers formerly received.

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within their same division more often. In this case, *J*'s income allocation would place \$70,270 as earned in the U.S., while only \$2,703 of income would be considered connected to Canadian revenue.

