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Jeffrey Dunlop

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I. INTRODUCTION

When the San Antonio Spurs captured the 2004–2005 National Basketball Association Championship, one must wonder what went through the mind of young Argentine guard Manu Ginobili. Most likely, it was not the income tax consequences of his latest championship season. However, with an estimated yearly salary of over six million dollars (excluding income from advertising or sponsorships),[1] it is likely that the respective governments of the United States and Argentina were thinking about just that very issue. The United States has an interest in receiving a fair share of Ginobili's income because he enjoyed the benefits of performing services within its borders.[2] On the other hand, Ginobili probably should be concerned about double taxation—both the United States and Argentina imposing a tax on the same income.[3] Any artist or athlete providing services in multiple countries faces the issue of double taxation.

* J.D. Candidate, 2007, Northwestern University School of Law.

[1] Emanuel (Manu) David Ginobili re-signed with the Spurs on July 15, 2004 after an initial two-year contract. While the terms of deal were not announced, media reports stated that the six-year contract was believed to be worth $52 million, of which $6,603,500 was paid for the 2004–2005 season. *See Nets' Martin Dealt to Denver; New Jersey Gets 3 First-Round Picks Bryant Elects to Stay with Lakers*, TORONTO STAR, July 16, 2004, at Sports B08; *see also* USA Today Salaries Database—Pro Basketball, http://www.usatoday.com/sports/front.htm (follow "Pro Basketball home" hyperlink; then follow "Salary Database" hyperlink) (last visited Mar. 10, 2006).

[2] Debra Dobray & Tim Kreatschman, *Taxation Issues Facing the Foreign Athlete or Entertainer*, 9 N.Y.L. SCH. J. INT'L COMP. & L. 265, 279 (1988).

[3] Double taxation is defined as "[t]he imposition of two taxes on the same property during the same period and for the same taxing purpose." BLACK'S LAW DICTIONARY 1500 (8th ed. 2004).

Traditionally, this issue is solved through the "Artiste and Athlete Article" of a bilateral tax treaty.[4] Yet, currently there is no tax treaty in place between the United States and any South American country.

On a separate economic front, thirty-five nations met at Mar del Plata, Argentina to continue discussions about free trade in North and South America at the Fourth Summit of Americas ("SOA") conference on November 3–4, 2005.[5] As the dominant economic power in the hemisphere, the United States stands to benefit substantially from developing free trade. The removal of current tariffs and other entry barriers would significantly expand American exports to the region. However, at the SOA, President Bush's pursuit of a Free Trade Area of the Americas ("FTAA")[6] was overshadowed by protests aimed at highlighting poverty, inequality, and unemployment across South America.[7] The SOA ended without any agreement or commitment from the representative nations to meet again for further discussions.

At first glance, it does not appear that taxation issues facing the international athlete and developing free trade between North and South America are closely related; they represent very different aspects of cross-border transactions and investment. On the other hand, they may be related when viewed as sequential steps in the process toward developing sustained economic relationships. This article will attempt to bridge that gap. First, Part II of this article discusses the current United States approach toward taxation of international athletes. Next, Part III reviews the history and issues facing tax treaty negotiations between the United States and developing countries, with a focus on the negotiation sticking points

[4] *See* Stephanie C. Evans, Note, *U.S. Taxation of International Athletes: A Reexamination of the Artiste and Athlete Article in Tax Treaties*, 29 GEO. WASH. J. INT'L L. & ECON. 297, 304 (1995–1996) (discussing use of bilateral tax treaties and arguing for implementation of a multilateral tax treaty with respect to international athletes). In relieving double taxation, a tax treaty "allocates the primary taxing right to an item of income to one country, and obligates the other country to give up its own right of taxation so the taxpayer does not have to pay tax to both countries on the same income." Daniel Berman, *Tax Treaties—Fundamentals*, 591 TAX L. ESTATE PLANNING COURSE HANDBOOK SERIES 603, 607 (2003).

[5] The first SOA was held in 1994, with the ultimate purpose of setting up free trade in the Americas by 2005. Instead, however, small trade blocs have developed throughout the Americas, such as the North American Free Trade Agreement ("NAFTA"), the Central American Free Trade Agreement ("CAFTA") (*see infra* note 80), and the Southern Common Market ("MERCUSOR"). *See* T.N.C. Rajagopalan, *Summit of Americas: Setback for Free Trade*, BUSINESS STANDARD, Nov. 7, 2005, at 7.

[6] The FTAA would be larger than the European Union, but without its free flow of labor and political integration. *Id.* In addition, an FTAA would "grant U.S. firms preferential treatment—as against, for example, competitors from Europe and Asia." Richard E. Feinberg, *Policy Issues, Regionalism and Domestic Politics: U.S.-Latin American Trade Policy in the Bush Era*, 44 LATIN AM. POL. SOC'Y 127, 132 (2002).

[7] Rajagopalan, *supra* note 5.

between the United States and Brazil. Finally, Part IV of this article argues that a multilateral tax treaty regarding the singular issue of international athletes is a viable tool to help strengthen economic relations in the Americas. Moreover, this initial treaty will open doors to further economic integration resulting in a positive effect on free trade discussions.

II. REVIEW OF CURRENT UNITED STATES TAXATION OF INTERNATIONAL ATHLETES

In order to understand why a multilateral tax treaty in the Americas is feasible, it is important to review the current approach of the United States toward taxing foreign athletes. This part, therefore, will review the treatment of international athletes under three different scenarios: (1) treatment under the U.S. Internal Revenue Code ("I.R.C.") where no tax treaty has been executed with a foreign athlete's home nation, (2) treatment under the U.S.-Canada Tax Treaty for athlete residents of Canada, and (3) treatment under the U.S.-Mexico Tax Treaty for athlete residents of Mexico.

A. Treatment Under the U.S. Internal Revenue Code (No Treaty)

When no tax treaty exists with the home nation of a foreign athlete, the I.R.C. governs the applicable tax treatment of an athlete performing in the United States.[8]

1. Tax Treatment as Resident Alien vs. Nonresident Alien

First, the I.R.C. determines whether the foreign individual is a resident or nonresident alien for purposes of tax treatment. This assessment is critical because the applicable tax rate and tax liability differ depending on this classification.

A *resident* alien (for purposes of taxation) is classified as such by meeting one of two tests.[9] First, under the "Green Card Test" (a/k/a "Permanent Residency Test"), any individual who holds or applies for an alien registration card (a "green card") during the calendar year attains U.S.

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[8] It is well settled that the United States has jurisdiction to tax a nonresident who "does business in the state, but only with respect to income derived from or associated with presence or doing business within the state . . ." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 412(1)(b) (1987).

[9] Under I.R.C. § 7701(b)(1)(A), an alien is a resident alien if the individual: (i) is a lawful permanent resident of the United States at any time during the calendar year in question, (ii) meets the substantial presence test, or (iii) has elected to be treated as such. I.R.C. § 7701(b)(1)(A) (2006). If any of these elements are met, the individual is "treated as a resident alien for federal tax purposes, regardless of the subjective intent concerning the nature and duration of the alien's stay in the United States." JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION—CURRENT THROUGH 2006, ¶ B1.02(2)(c)(i) (2006).

resident status for purposes of tax jurisdiction.[10] Alternatively, under the "Substantial Presence Test," a foreign individual is a resident alien if present in the United States on (1) at least thirty-one days during the calendar year and (2) a total of 183 days during the current year and the two preceding calendar years.[11] If the individual does not meet either the Green Card Test or the Substantial Presence Test (and has not elected tax treatment as a resident alien), then the individual is considered a *nonresident* alien for federal tax purposes. Therefore, it is clear that an alien may qualify as a U.S. resident for tax purposes while simultaneously qualifying as a taxable resident of the individual's home nation as well. This is important because of the U.S. approach to taxing resident aliens.

A resident alien is generally treated in much the same manner as a U.S. citizen for tax purposes: worldwide income (without regard to where it was earned) is subject to U.S. income tax with only a few limited exceptions.[12] On the other hand, a nonresident alien is subject to taxation of income earned in the United States in one of two ways:[13] (1) income from U.S. sources not effectively connected with a trade or business conducted in the United States, without an allowance for deductions, is taxed at a flat rate of thirty percent,[14] and (2) income that is effectively connected with trade or business conducted in the United States[15] is taxable, after allowable

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[10] I.R.C. § 7701(b)(1)(A)(i) states that an alien individual will be considered a permanent U.S. tax resident if the person is "[l]awfully admitted for permanent residence . . . at any time during such calendar year." I.R.C. § 7701(b)(1)(A)(i) (2006). Lawful permanent residence occurs if the individual has been lawfully accorded the privilege of permanent residence under U.S. immigration laws and such status has not been either revoked or abandoned. KUNTZ & PERONI, *supra* note 9, at ¶ B1.02(2)(c)(ii). Possession of a "green card" is traditional proof that a foreigner was lawfully admitted, and hence the name of the test. *See* Bennet Susser, *Achieving Parity in the Taxation of Nonresident Alien Entertainers*, 5 CARDOZO ARTS & ENT. L.J. 613, 620 n.53 (1986).

[11] *See* I.R.C. § 7701(b)(3) (2006). When determining the 183-day requirement, "each day of presence in the United States during the current year counts as a full day, each day in the first preceding year counts as one third of a day, and each day in the second preceding year counts as one sixth of a day." KUNTZ & PERONI, *supra* note 9, at ¶ B1.02(2)(c)(iii).

[12] Relating to individuals, these exceptions allow for (1) a tax credit for foreign taxes paid as discussed in Part II.A.2, *infra*, (2) the exclusion of "foreign earned income" (currently up to $70,000 of such income), such as amounts provided by an employer with respect to housing, (3) the exclusion of extraterritorial income defined as a taxpayer's gross income that is attributable to "foreign trading gross receipts," and (4) an alien individual employed by a foreign government or international organization "to exclude from gross income any wages, fees, or salary received as compensation for official services to such government or international organization if certain conditions are met." *See generally* KUNTZ & PERONI, *supra* note 9, at ¶ B1.03.

[13] *See* KAREN BROWN, 12 MERTENS LAW OF FEDERAL TAXATION § 45.18 (2005), for a more thorough explanation of nonresident alien taxation under the I.R.C.

[14] *See* I.R.C. § 871(a) (2006).

[15] The performance of personal services in the United States is considered engaging in a trade or business. I.R.C. § 864(b) (2006).

deductions, at the graduated rates applicable to U.S. citizens and resident aliens.[16] Salary, fees, wages, compensation, bonuses, and prize winnings are considered paid in connection with the athlete's trade or business in the United States.[17] A nonresident alien, however, is not subject to U.S. taxation on compensation earned for services performed or rendered outside the United States.[18]

Thus, the "tax distinction" between a resident and nonresident alien is critical for determining a foreign athlete's potential tax liability as calculated from the base of (1) worldwide income or (2) only that income earned while in the United States.

2. The Foreign Tax Credit

Based on the concern that double taxation undermines the theories of free market economics, modern tax codes have provisions designed to relieve double taxation.[19] This can be done in three ways: (1) tax credit for foreign taxes paid by the domestic taxpayer (a "foreign tax credit"), (2) exclusion of foreign source income from the domestic tax base, and/or (3) income tax deduction for foreign taxes paid by a domestic taxpayer.[20] The I.R.C. employs the use of a foreign tax credit.[21]

Generally, the I.R.C. foreign tax credit works by "allowing resident taxpayers to credit their foreign taxes paid against their domestic tax liability."[22] In other words, it allows a dollar-for-dollar offset against resident-country income tax liability for respective dollars of foreign income tax paid.[23] A U.S. resident alien may credit the "amount of any

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[16] *See* I.R.C. § 871(b)(1) (2006).

[17] *See id.* However, such income is not taxable if the nonresident alien: (1) has gross income for services performed in the United States that does not exceed $3,000 during the taxable year, (2) was not present in the United States during the taxable year for more than 90 total days, and (3) performs for a nonresident alien individual, foreign partnership, or foreign corporation not engaged in trade or business within the United States or "for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or domestic corporation." I.R.C. § 864(b)(1) (2006). *See also* Evans, *supra* note 4, at 302.

[18] *See* I.R.C. § 864(c)(4)(A) (2006).

[19] JOSEPH ISENBERGH, INTERNATIONAL DOUBLE TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME 3 (1996); *see also* Richard Mitchell, Note, *United States-Brazil Bilateral Income Tax Treaty Negotiations*, 21 HASTINGS INT'L & COMP. L. REV. 209, 216 (1997–1998).

[20] JON E. BISCHEL & ROBERT FEINSCHEIBER, FUNDAMENTALS OF INTERNATIONAL TAXATION 4 (1977); *see also* Mitchell, *supra* note 19, at 216.

[21] *See generally* I.R.C. §§ 901–908 (2006) (assessing the availability of the foreign tax credit under current U.S. domestic tax law).

[22] Mitchell, *supra* note 19, at 216.

[23] Julie Roin, *Rethinking Tax Treaties in a Strategic World With Disparate Tax Systems*,

such taxes paid or accrued during the taxable year to any foreign country."[24] A nonresident alien engaged in trade or business within the United States during the taxable year shall be allowed a credit "for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year . . . to any foreign country . . . with respect to income effectively connected with the conduct of a trade or business within the United States."[25]

Although the I.R.C. foreign tax credit does aid in alleviating double taxation, it "suffers from several imperfections."[26] Most notably, the decision to utilize a foreign tax credit may encourage foreign tax authorities to impose rates on U.S. investors that are at least as high as U.S. domestic rates.[27] The foreign treasury would suffer a revenue loss with no investment gains if they imposed lower rates.[28] Additionally, under the current system, taxpayers with net losses may pay foreign taxes to a country of source income that cannot be credited against domestic tax liability.[29] Finally, the "basket" system employed by the I.R.C. functionally allows for double-taxation of certain income, such as passive income.[30] Under the "basket" system, U.S. residents claiming a foreign tax credit must separate all foreign source income into one or more statutory categories, or "baskets," of income.[31] The taxpayer then computes and applies a separate tax limitation on each "basket."[32] Under the passive income example, any passive income earned in a foreign country and subjected to a high source tax would be allocated to the general income "basket."[33] However, "[i]nstead of being able to credit the full amount of foreign taxes paid on the highly-taxed passive income by combining it with low- or no-taxed passive income . . . the highly-taxed passive income is likely to create additional excess . . . credits in the general income basket" that cannot be fully utilized.[34] Foreign tax credit carryovers expire after five years, and

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81 VA. L. REV. 1753, 1769 (1995).

[24] I.R.C. § 901(b)(3) (2006).

[25] I.R.C. § 906(a) (2006); *see also* I.R.C. § 901(b)(4) (2006) (discussing the application and limitations of the credit for alien nonresidents).

[26] Mitchell, *supra* note 19, at 217. For a more detailed discussion of several flaws in the foreign tax credit with regard to double taxation, *see id.* at 217–20, or *see* Roin, *supra* note 23, at 1772–74.

[27] Roin, *supra* note 23, at 1768.

[28] *Id.* at 1768–69.

[29] Mitchell, *supra* note 19, at 217.

[30] *See id.* at 218. Passive income is income from business activities in which the taxpayer does not materially participate, such as royalties, rents, annuities, interest, and certain dividends. KUNTZ & PERONI, *supra* note 9, at ¶ B4.16(5)(b)(i).

[31] *See* I.R.C. § 904(d)(1) (2006).

[32] *See id.*

[33] *See id.* § 904(d)(1)(I); *see also* Roin, *supra* note 23, at 1773.

[34] Roin, *supra* note 23, at 1773.

therefore, the U.S. taxpayer may be subject to double taxation on this passive income in spite of the foreign tax credit.[35]

B. Treatment Under Tax Treaties

On a broad level, the primary reason for developing a tax treaty is to avoid tax barriers to cross-border transactions and investment through the coordination of potentially disparate tax systems.[36] To facilitate this goal, a tax treaty seeks primarily to relieve double taxation by (1) assigning the primary taxing right to an item of income to one country and (2) requiring the other country to give up its own right of taxation to that same item of income.[37] Thus, one of the fundamental purposes of any tax treaty is "to eliminate double taxation more effectively than unilateral legislation such as foreign tax credit laws."[38]

Procedurally, a tax treaty in the United States is negotiated by the Department of Treasury under authority delegated by the Department of State.[39] Although the Executive Branch negotiates and develops any treaty, the ultimate approval of a tax treaty (as with any other treaty) resides with the Senate.[40] When ratified, the tax treaty overrules the I.R.C.[41] and

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[35] *See* I.R.C. § 904(c) (2006); *see also* Mitchell, *supra* note 19, at 218.

[36] Berman, *supra* note 4, at 607.

[37] *Id.* at 608.

[38] Mitchell, *supra* note 19, at 219. Additionally, tax treaties are important for determining international taxation issues such as "conflicting concepts of taxable income, conflicting rules on the timing of income and deductions, or conflicting source-of-income rules between the United States and its treaty partners." BISCHEL & FEINSCHEIBER, *supra* note 21, at 204.

[39] Berman, *supra* note 4, at 624. The United States is currently party to approximately sixty-four tax treaties, excluding estate and gift tax treaties, or treaties of friendship, commerce, or navigation. *See* Richard Gordon, John Venuti & Diane Renfroe, *Current Status of U.S. Tax Treaties*, 31 TAX MGM'T INT'L J. 266 (2002).

[40] U.S. CONST. art. II, § 2, cl. 2. As Daniel Berman notes, this represents an interesting role reversal between normal tax legislation and the treaty process:

> In legislation, Congress initiates and develops the process while the President reserves the right to sign or veto the ultimate product. The veto threat is an interactive one, however, such that the President often can influence the development of legislation as it works its way through the Congress. These roles are reversed in the case of Treaties. Treaties are prioritized, negotiated, and signed by the Executive Branch, with the Senate (and only the Senate) reserving the right to advise and consent to ratification. Like the President's veto power over legislation, the Senate's ultimate approval power over treaties can influence the content of treaties as negotiated by the Executive.

Berman, *supra* note 4, 632–33.

[41] A validly ratified treaty is equivalent in force of national law to a federal statute. Thus, if the treaty conflicts with another statute or treaty, whichever was enacted later will govern.

governs the tax treatment of any foreign individual determined to be a resident of any nation party to the treaty (the "contracting states").[42] Because an individual may be treated as a resident of multiple countries for purposes of taxation, and therefore subject to worldwide taxation of income by multiple nations,[43] a tax treaty will also employ "tie-breaker" rules to resolve cases of dual residency.[44]

There are two types of tax treaties: bilateral (two countries) and multilateral (multiple countries). Bilateral tax agreements are more common today than multilateral tax treaties,[45] because each nation's tax system is unique and complex; it is not practical to develop or attempt negotiation of general multilateral tax agreements along the lines of such international economic agreements as the General Agreement on Tariffs and Trade ("GATT").[46] On the other hand, it has been argued that bilateral tax treaties "do not represent the ideal resolution but merely serve as a practical response to the double taxation problem."[47] The most glaring problem with bilateral treaties is their lack of uniformity, despite attempts to achieve such uniformity through common starting points.[48] Multilateral tax treaties address this issue by increasing tax uniformity amongst the larger number of contracting states. However, multilateral tax treaties generally work best when applied to discrete or specific issues of taxation.[49]

See PAUL R. MCDANIEL, HUGH J. AULT, & JAMES R. REPETTI, INTRODUCTION TO UNITED STATES INTERNATIONAL TAXATION 178 (5th ed. 2005).

[42] Tax treaties only apply to residents of the countries that are part of the formal agreement—the "contracting states." Residence in a tax treaty is generally defined "by reference to the definition of a resident for tax purposes under the domestic tax laws of the country at issue." Berman, *supra* note 4, at 610–11.

[43] *See supra* Part II.A.1.

[44] Berman, *supra* note 4, at 612.

[45] There are approximately 2000 bilateral tax treaties currently in place around the world. *See* Richard L. Reinhold, *Some Things That Multilateral Tax Treaties Might Usefully Do*, 57 TAX LAW. 661, 662 (2003–2004). In contrast, multilateral tax treaties are limited in number. For further discussion of multilateral tax treaties, *see infra* note 50.

[46] *See* Berman, *supra* note 4, at 631.

[47] Evans, *supra* note 4, at 305. A similar viewpoint is expressed that "[i]n many ways, tax treaties are like dinosaurs in the modern world of international trade. They are bilateral in a world of multilateral trade agreements, and they take just short of forever to conclude." Mitchell, *supra* note 19, at 210.

[48] Mitchell, *supra* note 19, at 210. *See also infra* Part II.B.1 (discussing the three common points of reference for beginning tax treaty negotiations).

[49] Multilateral tax treaties, although rare, include the following: Convention Between the Nordic Countries for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital, Sept. 23, 1996, 98 TAX NOTES INT'L (TA) 9–25 (signed by Denmark, Faroe Islands, Finland, Iceland, Norway, and Sweden); Cartagena Convention for the Avoidance of Double Taxation Among Member Countries, Nov. 16, 1971, 94 TAX NOTES INT'L (TA) 109–34 (signed by Bolivia, Colombia, Chile, Ecuador, Peru, and Venezuela); Agreement on the Avoidance of Double Taxation on the Income and Property of Bodies Corporate, May 19,

1. Starting Points for Tax Treaty Negotiations

All bilateral tax treaty negotiations begin with common points of reference, of which there are generally three: (1) the Organisation for Economic Co-operation and Development Model Tax Convention (the "OECD Model Treaty"), most recently revised in 2005,[50] (2) the United States Model Tax Convention (the "U.S. Model Tax Treaty") published in 1996,[51] and (3) the United Nations Model Double Taxation Convention between Developed and Developing Countries (the "U.N. Model Treaty"), published in 1980.[52]

The United States has been closely involved with the development of the OECD Model Treaty, and thus there are relatively minor differences between that and the U.S. Model Tax Treaty.[53] Generally, the U.S. policy is to favor residence-based taxation.[54] In contrast, the U.N. Model Treaty tends to permit higher levels of taxation by the source country because it was developed as a starting point for negotiations between developed and developing countries.[55] Tax treaties currently in place between the United States and other countries in the Americas vary slightly from these models; however, this variance, even if slight, creates a lack of uniformity amongst

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1978, 1181 U.N.T.S. 131 (signed by Bulgaria, Czechloslovakia, Hungary, Mongolia, and Poland); Agreement on the Avoidance of Double Taxation on Personal Income and Property, May 27, 1977, 1181 U.N.T.S. 117 (signed by Bulgaria, Czechloslovakia, Hungary, Mongolia, and Poland); Agreement Among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, Profits, or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment, July 6, 1994, 95 TAX NOTES INT'L 235–37 (signed by Antigua, Barbados, Belize, Grenada, St. Kitts & Nevis, St. Lucia, St. Vincent, and Trinidad & Tobago). Of these treaties, only the Nordic and Caribbean treaties are comprehensive income tax treaties based on the concepts of the OECD Model Treaty. The others are limited in scope to either personal income or property. *See* Reinhold, *supra* note 45, at 669 n.34.

[50] OECD, ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES OF INCOME AND ON CAPITAL 1 (July 15, 2005), *available at* http://www.oecd.org/dataoecd/50/49/35363840.pdf.

[51] United States Model Income Tax Convention, Convention Between the United States and for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income 1 (Sept. 20, 1996), *available at* http://www.treas.gov/offices/tax-policy/library/model996.pdf (hereinafter U.S. Model Tax Treaty).

[52] U.N. Department of International Economic & Social Affairs, U.N. Model Double for Taxation Convention between Developed and Developing Countries, U.N. Doc. ST/ESA/102 (1980).

[53] Berman, *supra* note 4, at 630–31.

[54] Mitchell, *supra* note 19, at 228.

[55] Berman, *supra* note 4, at 631; *see infra* Part III.A (discussing the reasons why developing countries prefer source-based taxation and developed countries prefer residence-based taxation).

the bilateral tax treaties currently in place.

2. Tax Treaties in North America

The United States currently has separate bilateral tax treaties in place with Canada ("U.S.-Canada Tax Treaty")[56] and Mexico ("U.S.-Mexico Tax Treaty").[57] Both of these treaties function in a similar fashion and in accordance with the U.S. Model Tax Treaty. Under both the U.S.-Canada Tax Treaty and the U.S.-Mexico Tax Treaty, an athlete's income from personal services is attributed to and taxed in the country where the personal services were performed—the source country. The source country taxes in accordance with its domestic law and is not restricted by the tax treaty. The country of residence is then obligated by the treaty to eliminate double taxation for the taxpayer. Thus, both these treaties contain provisions relevant to the tax treatment of international athletes: (1) "tie-breaker" provisions to determine an individual's country of residence,[58] (2) an "Artiste and Athlete Article" attributing the right to tax services performed to the source country,[59] and (3) provisions to relieve the individual from double taxation of the same income.[60]

a. "Tie-Breaker" Provisions for Determining Residency

Both the U.S.-Canada Tax Treaty and the U.S.-Mexico Tax Treaty contain similar language for determining residence, and function in the same manner. Where an individual is a resident of both contracting states, then his status shall be determined as follows: (a) if "he has a permanent home available to him" in a country, "he shall be deemed to be a resident of the [s]tate;" if he has a permanent home in both contracting states or in neither contracting state, "he shall be deemed to be a resident of the [s]tate with which his personal and economic relations are closer (center of vital

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[56] Convention between the United States of America and Canada with respect to Taxes on Income and on Capital, Sept. 26, 1980, 1469 U.N.T.S. 189, *available at* http://www.irs.gov/pub/irs-trty/canada.pdf [hereinafter U.S.-Canada Tax Treaty].

[57] Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 18, 1992, 93 T.N.I. 131-15, *available at* http://www.irs.gov/pub/irs-trty/mexico.pdf [hereinafter U.S.-Mexico Tax Treaty].

[58] *See infra* Part II.B.2.a (discussing tie-breaker provisions of the U.S.-Canada Tax Treaty and the U.S.-Mexico Tax Treaty respectively).

[59] *See infra* Part II.B.2.b.i, (reviewing the Artiste and Athlete Article of the U.S.-Canada Tax Treaty); *see also* Part II.B.2.b.ii (reviewing the Artiste and Athlete Article of the U.S.-Mexico Tax Treaty).

[60] *See infra* Part II.B.2.c.i, (assessing the relief of double taxation under the U.S.-Canada Tax Treaty); *see also* Part II.B.2.c.ii (assessing the relief of double taxation under the U.S.-Mexico Tax Treaty).

interests);" (b) if the individual's center of vital interests cannot be determined, and he does not have a permanent residence in either country, he shall be deemed to be a resident of the state where he has a habitual abode; (c) if he has a habitual abode in both states or in neither of them, he shall be deemed to be a resident of the state of which he is a citizen; (d) "in any other case, the competent authorities of the [c]ontracting [s]tates shall settle the question by mutual agreement."[61]

Again, these "tie-breaker" provisions are important because of the possible overlap of tests for residency among the contracting states.[62] In other words, these provisions ensure resolution of the issue arising when the same individual may be determined to be a taxable resident of more than one nation and therefore subject to taxation on worldwide income.[63]

b. Artistes and Athletes Articles

The U.S.-Canada Tax Treaty and the U.S.-Mexico Tax Treaty are also very similar with respect to the attribution of tax jurisdiction on income earned by an artiste or athlete to the source country. Substantively, both articles are general in discussion and only three paragraphs in length. However, there are some important differences, as discussed below.

i. U.S.-Canada Treaty

Article XVI of the U.S.-Canada Tax Treaty states as follows: "income derived . . . as an entertainer . . . or as an athlete, from his personal activities" exercised in the other contracting state, may be taxed in the source nation, "except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities do not exceed fifteen thousand dollars ($15,000) in the currency of that other State for the calendar year concerned."[64] Therefore, any individual performing the services described, and receiving $15,000 or less in compensation falls outside the scope of this treaty and will be taxed in the country of residence only.

Moreover, this treaty specifically exempts application of Article XVI to the "income of an athlete in respect of an employment with a team which participates in a league with regularly schedule [sic] games in both contracting states."[65] This provision was probably inserted to allow

[61] U.S.-Mexico Tax Treaty, *supra* note 57, art. 4; U.S.-Canada Tax Treaty, *supra* note 56, at art. IV.

[62] *See supra* Part II.A.1.

[63] *See* Berman, *supra* note 4, at 612.

[64] U.S.-Canada Tax Treaty, *supra* note 56, art. XVI, § 1.

[65] *Id.* art. XVI, § 3.

residence-based taxation of professional athletes in basketball, hockey, and baseball who earn substantial sums of money but frequently travel between the United States and Canada for competition.[66]

ii. U.S.-Mexico Tax Treaty

Article 18 of the U.S.-Mexico Tax Treaty states that "income derived . . . as an entertainer, . . . or as an athlete, from his personal activities" may be taxed in the source nation, "except where the amount of the remuneration derived by such entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities does not exceed $3,000 United States dollars or its equivalent in Mexican pesos for the taxable year concerned."[67] Therefore, for example, a resident of Mexico will be exempt from the coverage of this tax treaty if he receives $3,000 or less in compensation for services performed in the United States. Moreover, an artiste or athlete's income is exempt from this Article if the visit to the other contracting state "is substantially supported by public funds" of the athlete's country of residence.[68]

Thus, there are several key differences regarding the tax treatment of athletes covered under these two tax treaties. The first and most glaring is the different minimum thresholds of income required for exemption from coverage: $3,000 for the U.S.-Mexico Tax Treaty and $15,000 for the U.S.-Canada Tax Treaty. In addition, there is a difference in application to professional athletes or those athletes whose visit is supported by public funds of the athlete's resident nation. This, again, highlights the problematic lack of uniformity through the use of bilateral tax treaties.

c. Relief from Double Taxation

In the case of eliminating double taxation for the individual, an individual determined to be a resident of the United States is treated similarly under both treaties. However, the treaties differ with respect to individuals determined to be residents of Canada or Mexico respectively.

i. U.S.-Canada Tax Treaty

According to Article XXIV of the U.S.-Canada Tax Treaty, the United States "shall allow to a citizen or resident of the United States . . . as a credit against the United States tax on income the appropriate amount of

[66] For the respective 2004–2005 seasons, there were the following Canadian professional teams: one in Major League Baseball (Toronto), one in the National Basketball League (Toronto), and six in the National Hockey League (Ottawa, Montreal, Toronto, Vancouver, Calgary and Edmonton).

[67] U.S.-Mexico Tax Treaty, *supra* note 57, art. 18, § 1.

[68] *Id.* art. 18, § 3.

income tax paid or accrued to Canada."[69] This is similar treatment to the I.R.C. foreign tax credit discussed above,[70] but more efficient because of its specific application to income derived in Canada. The article specifically limits the amount of any allowable foreign tax credit paid to Canada to "that proportion of the United States tax that taxable income arising in Canada bears to the entire taxable income."[71]

However, in the case of Canada, double taxation is eliminated as follows: "income tax paid or accrued to the United States on profits, income or gains arising in the United States shall be deducted from any Canadian tax payable in respect of such profits, income or gains."[72] Thus, Canada employs an income tax deduction for taxes paid to the United States. The treaty places further limitations on U.S. citizens who have been determined to be residents of Canada under the "tie-breaker" provisions of Article XXIV: (a) the Canadian deduction for income tax paid or accrued in the United States shall "not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen;"[73] and (b) the U.S. foreign tax credit shall not "reduce that portion of the United States tax that is deductible from Canadian tax."[74]

ii. U.S.-Mexico Tax Treaty

Under Article 24 of the U.S.-Mexico Tax Treaty, the contracting states have agreed to "allow to a resident of that State and, in the case of the United States to a citizen of the United States, as a credit against the income tax of that State . . . the income tax paid to the other Contracting State by or on behalf of such resident or citizen."[75] Moreover, the treaty permits each contracting state to apply domestic law limitations and provisions on credits for income taxes paid.[76] Thus, under the U.S.-Mexico Tax Treaty, both Mexico and the United States agree to use a foreign tax credit.

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[69] U.S.-Canada Tax Treaty, *supra* note 56, art. XXIV, § 1; U.S.-Mexico Tax Treaty, *supra* note 57, art. 24, § 1.

[70] *See supra* Part II.A.2.

[71] U.S.-Canada Tax Treaty, *supra* note 56, art. XXIV, § 1.

[72] *Id.* art. XXIV, § 2(a). The availability of these deductions is "[s]ubject to the provisions of the law of Canada regarding the deduction from tax payable in Canada of tax paid in a territory outside Canada . . ." *Id.*

[73] *Id.* art. XXIV, § 4(a).

[74] *Id.* art. XXIV, § 4(b).

[75] U.S.-Mexico Tax Treaty, *supra* note 57, art. 24, §§ 1, 1(a).

[76] *Id.* art. 24, § 1.

III. TAX TREATY NEGOTIATIONS AND DEVELOPMENTS WITH SOUTH AMERICA

There are certain countries in South America where fundamental differences in political or governmental philosophy (i.e. Columbia[77] and Venezuela[78]) present clear obstacles to the prospect of building long-term economic relationships. However, other developing economies (i.e. Brazil, Argentina and Chile) are viable candidates for the strengthening of U.S. foreign economic relations. These developing economies are the key areas for the potential development of free trade in the Americas.[79] Similarly, the United States is currently in discussions to open up free trade with Central America, which proponents believe reflect the U.S. need to further economic ties in the Americas.[80] To date, however, the United States has

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[77] In 1994, the United States and others in Columbia charged its then current president, Ernesto Samper, with receiving roughly six million dollars of election campaign funds from a drug cartel in Calì. *See* Albert R. Coll, *United States Strategic Interests in Latin America: An Assessment*, 39 J. INTERAMERICAN STUDIES WORLD AFF. (Special Issue: US-Latin American Relations) 45, 50 (1997). The obvious problem of drugs—particularly that over ninety percent of U.S. cocaine came from Columbia—and other issues prompted the U.S. government to formulate a specific policy towards Columbia to battle the drug problem as well as improve democracy and human rights in Columbia. *See* U.S. DEPT. OF STATE, A REPORT TO CONGRESS ON UNITED STATES POLICY TOWARDS COLUMBIA AND OTHER RELATED ISSUES (2003), *available at* http://www.state.gov/p/wha/rls/rpt/17140.htm. As a result, relations have been marked by steady progress in battling Columbian drug trafficking and terrorism, although a continuing an integrated effort is needed to sustain Columbia's stability. *See Plan Columbia: Major Success and New Challenges: Hearing Before the H. Int'l Relations Comm.*, 109th Cong., (2005) (statement of Roger F. Noriega, Assistant Sec'y, Bureau of Western Hemisphere Affairs, Dept. of State), *available at*, http://www.state.gov/p/wha/rls/rm/2005/q2/46564.htm and 2005 WL 1120988.

[78] As recently as December 2005, the U.S. State Department issued a release stating that democracy in Venezuela was in "grave peril" calling for inter-American intervention to address the problems of: "unchecked concentration of power in the executive; politicization of the judiciary, the electoral authorities, and the legal system; political persecution of civil society and the democratic opposition; intimidation of the press; and threats to free association." U.S. DEPT. OF STATE, BUREAU OF PUBLIC AFFAIRS, STATE DEMOCRACY IN VENEZUELA (Dec. 1, 2005), *available at* http://www.state.gov/documents/organization/57714.pdf.

[79] For example, "[a]ccording to one calculation, an FTAA could result in the doubling of U.S. trade with Brazil in the short term alone . . ." Feinberg, *supra* note 6, at 132 (citing Jeffrey Schott & Gary C. Hufbauer, *Whither the Free Trade Area of the Americas?*, WORLD ECON. 22, Aug. 1999, at 778–82).

[80] Proponents of CAFTA argue the agreement will (1) dramatically expand U.S. exports into the growing markets of Central America, (2) support freedom, democracy and economic reform in the United States' own backyard, (3) allow for better competition with Asian markets of textiles and (4) provide better protection of labor and human rights; additionally, CAFTA will have minimal impact on sugar imports, a major area of concern with the agreement. OFFICE OF THE U.S. TRADE REPRESENTATIVE, CAFTA POLICY BRIEF Feb. 2005 http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file235_7178.pdf.

been unable to successfully negotiate and sign a tax treaty with any country in South America.

A. The Traditional Sticking Point of Tax Treaties Between Developed and Developing Countries

The United States adheres to the general economic principle of Capital Export Neutrality, where a "tax system seeks to impose the same tax burdens on the invested capital of its resident companies regardless of whether the capital is invested at home or abroad."[81] In practical terms, this means that the United States seeks to avoid domestic companies setting up investments or operations abroad based simply on tax incentives.[82] The principle of Capital Export Neutrality also underscores why the United States generally prefers residence-based taxation over source-based taxation.[83] Where two developed economies enter into a tax treaty, the income flow between the two countries will be more or less equal, absent any tax incentives encouraging otherwise;[84] attributing the authority to tax to the country of residence is the most equitable mechanism for determining tax jurisdiction.[85]

However, this same analysis reveals opposing interests between developed and developing countries in negotiating tax treaties. Most likely, the developed economy will be a net exporter of capital, goods, and services while the developing country will likely be a net importer.[86] Residence-based taxation presents a perceived unfair flow of tax revenues based on the clear imbalance in the flow of goods and services.[87] More specifically, the tax revenue of the developed country will almost certainly increase at the expense of the developing country's treasury.[88] Thus, developing economies seek tax treaties that "allow for greater source jurisdiction to tax dividends and interest, inculcate minimal permanent establishment thresholds for source-based taxation of trade or business income, and create some incentive for foreign investors to invest in the developing country."[89]

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[81] Berman, *supra* note 4, at 610.

[82] *See id.*

[83] *See id.*

[84] *See* Mitchell, *supra* note 19, at 227.

[85] In these circumstances, "both countries forego roughly equal amounts of source based tax dollars in exchange for roughly equal amounts of residence based tax dollars." Mitchell, *supra* note 19, at 227.

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.* at 228. The term "permanent establishment" is important for use in tax treaties: "[i]ncome attributable to a permanent establishment is not the same as income effectively connected with the conduct of a trade or business in the United States. You need not have a permanent establishment in the United States to be engaged in trade or business in the

Thus far, the United States has been comparatively inflexible when dealing with tax treaty negotiations of developing countries.[90]

B. Negotiations Between the United States and Brazil

Aside from the traditional sticking point between developed and developing countries, each nation's tax system presents unique challenges when developing and negotiating a tax treaty. A detailed analysis of such issues between the United States and every South American country is beyond the scope of this article. However, an exemplary analysis of the issues encountered during the U.S.-Brazil tax treaty negotiations will help shed some light on the subject.

1. Why Brazil is an Important Economic Partner

In recent years, Brazil has shown that it is determined to transform itself into a "true global economic power."[91] It boasts the ninth largest economy in the world and encompasses almost half of the total population, territory and economic output of South America.[92] Looking to the future, it also "possesses large and well-developed agricultural, mining, manufacturing and service" industries.[93] Relations between Brazil and the United States are strong, and "[a]s Brazil lowers trade and foreign investment barriers, more U.S. companies will find Brazil's large and dynamic market an attractive option."[94]

The U.S. government has also identified Brazil as a "Big Emerging Market."[95] This signals a commitment by the U.S. government to assist domestic attempts to invest and enter business in the expanding Brazilian market.[96] Brazil maintains significant economic relationships with other developed countries, where tax treaties already in place may make goods, services and capital from those countries cheaper to Brazil than similar

United States." BISCHEL & FEINSCHEIBER, *supra* note 20, at 208.

[90] Although the United States has been unsuccessful in developing tax treaties, it has designed a program to aid the IRS in enforcing its income tax laws and enhancing compliance in the Americas. These tax information exchange agreements (TIEA's) obligate the signatory nations to cooperate with the United States on civil and criminal tax investigations, with an ultimate goal of concluding tax treaties. *See* Bruce Zagaris, *The Procedural Aspects of U.S. Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?*, 35 GEO. WASH. INT'L L. REV. 331, 331–33 (2003).

[91] Matthew S. Poulter, *My Client's Going to Brazil: A U.S. Practitioner's Guide to Brazilian Limitadas Under the New Civil Code*, 11 SW. J. L. & TRADE AM. 133, 134 (2005).

[92] *Id.*

[93] *Id.*

[94] *Id.* at 134–35.

[95] Mitchell, *supra* note 19, at 226.

[96] *Id.*

exports from the United States.[97] In addition, this is a good time for developing negotiations as Brazil has seen the benefits gained by Mexico and Canada through free trade agreements with the United States.[98]

2. Tax Treaty Issues Between the United States and Brazil

The United States and Brazil first began negotiations over a tax treaty as early as 1949.[99] Yet, despite over fifty years of negotiations, the United States and Brazil have been unable to develop a tax treaty successfully. There are generally two important issues that have yet to be resolved in U.S.-Brazil tax treaty negotiations: (1) the availability of United States tax sparing, and (2) the taxation of fees for technical services.[100]

a. Tax Sparing

Tax sparing grants "domestic taxpayers a foreign tax credit for foreign taxes not actually paid."[101] This occurs through the guarantee that a developed country will give residents (as determined by the treaty) a foreign tax credit for certain taxes, whether or not they are actually paid. This tax credit, in turn, provides an incentive for foreign investment in the developing country.[102] While other developed countries are willing to extend tax sparing to developing countries,[103] the United States is not.[104]

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[97] *Id.* Also, as Mitchell notes, "[n]ot only does this threaten the [U.S.] current market share in Brazil, but it also allows foreign businesses to establish themselves in Brazilian markets for the long term." *Id.* at 226–27.

[98] *See* Poulter, *supra* note 91, at 135.

[99] Mitchell, *supra* note 19, at 222.

[100] *Id.* at 229.

[101] *Id.*

[102] *Id.* As Deborah Toaze notes:

> Developing countries often attempt to attract foreign investors with incentives in the form of reduced rates of taxation or, in some cases, the exemption of certain types of income from tax. In order to preserve the resultant investment revenues to the developing country, the country of residence of the investor (that is, the developed country) "spares" the tax that it would normally impose on the low-taxed or untaxed income earned by its resident abroad by granting foreign tax credits equal to, or possibly greater than, the tax that would otherwise have been exigible in the developing country.

Deborah Toaze, *Tax Sparing: Good Intentions, Unintended Results*, 49 CAN. TAX J. 879, 880–81 (2001).

[103] Mitchell provides the following example to highlight how tax sparing works under the Brazil-Netherlands tax treaty:

> If a Dutch lender receives ten dollars of interest from a Brazilian resident in a taxable year, the income would be subject to Brazil's fifteen percent withholding

The United States has put forth several reasons for refusing to grant tax sparing in tax treaties with developing countries.

First, the United States has taken the paternalistic view that such a provision would "encourage investors to 'shop' for deals, and unwisely erode the developing country's . . . revenue base."[105] Moreover, according to the United States, such tax sparing schemes are irrational, unstable, and "promote[] repatriation of funds by investors rather than the reinvestment of income in business expansion."[106] In this regard, the United States stands by the principle of Capital Export Neutrality: U.S. tax law does not (and thus international tax law should not) favor either domestic or international transactions.[107]

Second, tax sparing runs contrary to the U.S. policy of "using a tax treaty to provide US [sic] benefits to non-residents and foreign tax benefits to US [sic] residents."[108] Correspondingly, tax sparing reduces U.S. control over taxation of its residents because the foreign government is functionally allowed to set tax incentives.[109] The practical effect, therefore, is that foreign governments will determine U.S. tax rates on income earned abroad by U.S. residents.[110] Allowing a foreign government to set U.S. tax rates, whether directly or indirectly, may be unacceptable from both a policy and constitutional standpoint.[111]

And finally, it is likely that granting tax sparing to Brazil "will set an undesired precedent for future negotiations" between the United States and other developing countries.[112] This is unlikely to happen, particularly in light of recent arguments that the OECD Model Treaty is moving closer to

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> tax, which is the maximum percentage permitted under the treaty (with some exceptions). Under the tax sparing provision, the interest is exempt from tax in the Netherlands. In addition, the Dutch lender is allowed a tax credit in the Netherlands equal to a deemed paid tax of twenty percent of the interest. Thus, the taxpayer pays one dollar and fifty cents in tax and receives two dollars in tax credits, netting an extra fifty cents of income at the expense of the Dutch treasury[.]

Mitchell, *supra* note 19, at 229.

[104] *See* Toaze, *supra* note 102, at 883–88 (discussing the changing position of the United States from initial support for tax sparing with developing countries in the 1950s to its current position of opposition).

[105] Mitchell, *supra* note 19, at 230 (quoting David R. Tillinghast, *Tax Treaty Issues*, 50 U. MIAMI L. REV. 455, 474–75 (1996)).

[106] Toaze, *supra* note 102, at 887.

[107] Mitchell, *supra* note 19, at 230.

[108] Toaze, *supra* note 102, at 887.

[109] *Id.*

[110] *Id.*

[111] *Id.*

[112] Mitchell, *supra* note 19, at 230.

the U.S. position and away from tax sparing.[113]

b. Withholding of Fees for Technical Services

Brazilian domestic tax law subjects fees remitted abroad for technical assistance to a source-based withholding tax and seeks for its treaties to preserve this right.[114] Thus, Brazilian tax treaties maintain the right for Brazil to withhold ten to fifteen percent of any kind of payments received for rendering technical assistance and technical services.[115] In practice, "Brazilian tax authorities have interpreted the phrase 'technical services' broadly, to encompass . . . most kinds of services."[116] For example, in February 2005, Brazilian tax authorities ruled that "the concept of Royalties includes (for the application of the Brazil-Spain tax treaty) all services including or not [sic] a transfer of technology or know-how and for which the underlying contracts" are subject to 12.5% withholding tax under the *Brazil-Spain Convention for the Avoidance for Double Taxation.*[117] In contrast, the U.S. Model Treaty requires fees for services to be attributed to

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[113] *See* Toaze, *supra* note 102, at 888–90 (analyzing the OECD's evolution to its current position of no longer granting tax sparing to developing countries on an unquestioning basis).

[114] Mitchell, *supra* note 19, at 231.

[115] *Id.*

[116] *Id.*

[117] Nélio Weiss & Philippe Jeffrey, *Brazil: Tax Treaty with Spain Clarified*, INT'L TAX REV., Feb. 2005, at 44, *available at* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=14050&SID=494272&TYPE=20. In addition, Weiss and Jeffrey note:

> The Brazilian tax authorities have always been very reluctant in applying the business profits principle to exempt income not subject to withholding income tax under a specific article of a treaty (that is, income other than dividends, interest, or royalties). Instead, income such as service fees derived by residents of a treaty country is assumed to be subject to Brazil's withholding income tax under the "Income Not Expressly Mentioned" or "Other Income" article of the treaty and thereby taxable in accordance with domestic law. In this regard, the Brazilian tax authorities had previously issued on January 5, 2000 the Declaratory Act 1/2000, which had unified the official position of the Federal Revenue Department on the proper treatment of withholding taxes for technical service payments remitted outside Brazil.
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> According to the Declaratory Act, payments made abroad for technical services without transfer of technology should be governed by the article in a tax treaty dealing with "Other Income" and accordingly, be subject to a 15% withholding income tax. As a general rule, the latter should remain applicable for service fees paid to a resident of a "treaty country" other than Spain.

Id.

the contracting state of residence for an individual's personal services.[118]

Thus far, neither country has been willing to concede tax jurisdiction on this point for two key reasons. First, as these services typically flow from the United States to Brazil, Brazil stands to lose significant tax revenue from a switch to residence-based taxation; they would not be compensated by a parallel flow of services from Brazil to the United States.[119] This is a similar argument to the traditional sticking point between developed and developing countries discussed above, but the argument carries particular weight in this context. Here, both nations are particularly interested in maintaining the tax revenue of technical services—a growing sector of both economies.[120] Second, as discussed, the U.S. policy of tax treaty neutrality is that tax treaties should eliminate tax-based preferences. Brazil's fee withholding system on technical services essentially creates a double taxation of services remitted abroad, giving Brazilian domestic residents a competitive advantage. Correspondingly, this makes U.S. services artificially more expensive and allows Brazil to keep and create jobs for skilled residents.[121]

IV. WORKING TOWARD FREE TRADE THROUGH TAXING THE INTERNATIONAL ATHLETE

The world is undoubtedly moving toward a greater interconnectivity of national economies through globalization. The benefits of this economic globalization include better allocation of world resources to increase output and standards of living, a greater range of choice in goods and services due to the greater access to foreign goods, the ability to visit far away places due to significantly decreased costs of travel and access to a wider range of information at a lower cost.[122] Correspondingly, since World War II, "a significant part of economic development projects and structural adjustment programs for developing . . . countries" have centered on tax reform.[123] A tax treaty is often seen as the first step in building and sustaining a substantial economic relationship with a foreign nation.[124]

In this regard, a multilateral tax treaty in the Americas will go far in

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[118] *See* U.S. Model Tax Treaty, *supra* note 51, art. 14, 15 (discussing residence-based taxation for both dependent and independent personal services respectively).

[119] Mitchell, *supra* note 19, at 232.

[120] *Id.* at 231–32.

[121] *Id.* at 232.

[122] Miranda Stewart, *Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries*, 44 HARV. INT'L L. J. 139, 140 (2003) (quoting VITO TANZI, GLOBALIZATION, TAX COMPETITION AND THE FUTURE OF TAX SYSTEMS 4 (Int'l Monetary Fund, Working Paper No. 141, 1996)).

[123] *Id.* at 141.

[124] *See id.* at 148. As Stewart notes, a tax treaty with a developing economy "is often presented as an important symbol of international capitalist engagement." *Id.*

developing economic relationships and encouraging continued efforts toward embracing free trade. Addressing the taxation issues facing the international athlete is optimal for application here for several reasons. First, the singular issue of taxing the international athlete is ideal for imposition of a multilateral tax treaty in the Americas.[125] Second, a multilateral tax treaty will address a fundamental tax policy problem produced by the lack of uniformity in today's system of bilateral tax treaties: horizontal tax equity.[126] Third, getting a tax treaty finalized for this discrete issue will likely lead to further agreements through opening the lines of communication between contracting states' "competent authorities."[127] Finally, because of the inherently public nature of international athletes, the United States will benefit from the goodwill created by such an agreement and thereby soften its image as an inflexible country when negotiating tax treaties with developing countries.[128]

A. An Ideal Issue for a Multilateral Tax Treaty

Although the bilateral tax treaty is far more common in today's world of international taxation, the use of multilateral tax treaties organized around an issue (rather than geographical proximity) has proven to be very effective. For example, the European Union's treaty on the Elimination of Double Taxation in Connection with the Adjustment of Profits and Associated Enterprises[129] was concluded specifically for the purpose of settling transfer-pricing issues.[130] Another example is the Multilateral

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[125] *See infra* Part IV.A.

[126] *See infra* Part IV.B.

[127] *See infra* Part IV.C.

[128] *See infra* Part IV.D.

[129] Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, July 23, 1990, 1847 U.N.T.S. 3.

This Convention was subsequently amended twice. When Austria, Finland, and Sweden joined the EU as Member States in 1995, the Arbitration Convention was supplemented by adding a Convention that was signed December 21, 1995. Convention of 21 December 1995 Concerning the Accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, Official Journal, 1996 O.J. (C 26) of 31/01/96, 1–33, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ .do?uri=CELEX:41996A0331(01):en:HTML. Prior to the expiration of the five-year application period of the Arbitration Convention, the Council adopted a Protocol providing for an automatic extension of the Convention for consecutive five year periods unless opposed by a Contracting State. Protocol of 25 May 1999 Amending the Convention of 23 July 1990 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, Official Journal, 1999 O.J. (C 202), 16/07/99, 1–11, *available at* http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:1999:202:SOM:en:HTML (amended by a convention signed Dec. 21, 1995, and a protocol signed May 25, 1999).

[130] This multilateral tax treaty also represents an innovative structure adopting a system

Convention on Mutual Administrative Assistance in Tax Matters signed by the member states of the Council of Europe and the OECD member states in 1988.[131] This treaty was concluded specifically for the purpose of providing administrative assistance in tax collection and service documents through the transfer of information.[132] It is also important because it represents the first multilateral tax treaty to which the United States is a party.[133] Additionally, Richard Reinhold recently argued that the emerging market of e-commerce represents another good environment for the development of a multilateral tax treaty.[134] These previous examples, therefore, lend support to the idea that a multilateral tax treaty can be implemented in other areas.

The narrow area of taxation of international athletes is an ideal singular issue for developing a multilateral tax treaty in the Americas. As discussed above, the "Artiste and Athlete Articles" of both the U.S.-Canada Tax Treaty and U.S.-Mexico Tax Treaty are general in their coverage and short in length.[135] This exemplifies the concern that "although bilateral tax treaties cover a wide gamut of tax issues, the comprehensiveness comes at the expense of accuracy and detail with respect to each article."[136] Yet, the taxation of international athletes deserves more consideration due to its unique position within the realm of international taxation of personal services.[137] The traditional personal service provisions of U.S. tax treaties allow residence-based taxation for the performance of personal services abroad.[138] In contrast, international athletes are subject to source-based taxation.[139] Therefore, it has been argued that the primary reason for the "Artiste and Athlete Article" in bilateral tax treaties is revenue generation and not relief from double taxation.[140] Because this unique set of taxpayers differs from all others in their tax jurisdiction for performance of personal

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for arbitration among tax authorities to resolve issues of transfer pricing. *See* Evans, *supra* note 4, at 318.

[131] Council of Europe-Organisation for Economic Co-operation and Development Convention on Mutual Administrative Assistance in Tax Matters, Jan. 25, 1988, 90 T.N.I. 26–52, Europ. T.S. No. 127, *available at* http://conventions.coe.int/Treaty/en/Treaties/Html/127.htm.

[132] Evans, *supra* note 4, at 318.

[133] *Id.* at 319.

[134] *See generally* Reinhold, *supra* note 45.

[135] *See supra* Part II.B.2.b.

[136] Evans, *supra* note 4, at 328.

[137] *Id.* at 327–28 (discussing in detail why the U.S. Model Tax Treaty allows for source-based jurisdiction of athletes, while other personal services are subjected to residence-based taxation).

[138] *See* U.S.-Canada Tax Treaty, *supra* note 56, art. XIV–XV; *see also* U.S.-Mexico Tax Treaty, *supra* note 57, art. 14–15.

[139] *See supra* Part II.B.2.b.

[140] *See* Evans, *supra* note 4, at 328.

services, more detailed tax provisions will ensure an efficient allocation of tax revenue while better protecting the individual from double taxation.

In addition, the traditional desire of the United States for residence-based taxation[141] will not present the usual barriers to successful negotiation with developing countries. Although the U.S. Model Tax Treaty requires residence-based taxation for all other personal services,[142] artistes and athletes are currently taxed under source-based taxation principles.[143] Both the U.S.-Canada Tax Treaty and the U.S.-Mexico Tax Treaty allow for such an approach. Thus, the United States, Canada, Mexico, and the developing economies of South America are predisposed to agree on fundamental tax policy with regard to taxing the international athlete.

Finally, this category of taxpayers—international athletes—is inherently narrow and discrete.[144] There will be relatively minimal administrative costs because an athlete performing services in multiple countries will be easy to track. The taxation effectiveness and appreciation by countries party to the treaty can be easily measured. Thus, the administrative ease of implementation supports the feasibility of a multilateral tax treaty around this singular issue.

B. Horizontal Tax Equity

Concepts of equity and fairness represent the cornerstone of sound tax policy.[145] In this regard, horizontal tax equity stands for the proposition that similar taxpayers should be taxed alike.[146] Moreover, this principle has been called the "basic yardstick used to gauge whether tax burdens are fairly distributed."[147] Under today's practices, the lack of uniformity between bilateral tax treaties violates this principle.

International athletes from Mexico and Canada are subject to different thresholds for calculating amounts exempt from income generated from their services in the United States.[148] Although these minimal threshold amounts may be of no consequence to professional athletes well beyond exemption, there is the possibility for disparity when applied to lower

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[141] *See supra* Part III.A (discussing why the United States, and most developed countries, prefer residence-based taxation when negotiating treaties with developing economies).

[142] *See* U.S. Model Tax Treaty, supra note 51, art. 14, 15.

[143] *See supra* Part II.B.2.

[144] *See* Evans, *supra* note 4, at 329.

[145] *See* C. EUGENE STEUERLE, *And Equal (Tax) Justice for All? in* TAX JUSTICE: THE ONGOING DEBATE 253, 257–58 (Joseph J. Thorndike & Dennis J. Ventry, Jr. eds., 2002).

[146] *Id.* at 258.

[147] JOSEPH C. CORDES, *Horizontal Equity* in THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 164, 164 (Joseph J. Cordes et al. eds., 1999).

[148] *See supra* Parts II.B.2.b.i, II.B.2.b.ii (discussing the minimum amount of exemption levels for the U.S-Canada Tax Treaty and the U.S.-Mexico Tax Treaty respectively).

income athletes. For example, the United States will treat an athlete who earns ten thousand dollars for athletic services performed in the United States (assuming all else is equal) during a taxable year differently depending only on whether he is defined as a resident of Canada or Mexico. If the athlete were a resident of Mexico, then, under the U.S-Mexico Tax Treaty, the entire amount of income would be taxed according to U.S. law, with the availability of a foreign tax credit to the individual's tax liability in Mexico.[149] However, this same athlete determined to be a resident of Canada under the U.S.-Canada Tax Treaty would not be subject to U.S. tax jurisdiction at all.[150] This represents an inequitable determination of tax liability based solely on country of residence.

A multilateral tax treaty, in which each contracting state would subject individuals to source-based income from athletic services with the same exemption threshold (if any), would remove this lack of uniformity. It would also employ its own "tie-breaker" rules for proper determination of residency, thereby ensuring better predictability of tax jurisdiction for athletes competing in multiple contracting states. Moreover, in doing so, the tax treaty would ensure an equal application of tax jurisdiction, avoiding tax discrimination based solely upon country of residence.[151]

C. Communication Between "Competent Authorities"

An important procedural aspect of tax treaties is that they allow the tax authorities of respective contracting states to establish a direct line of communications.[152] These so-called "competent authority" provisions are created primarily as a mechanism for taxpayers to ensure that their rights under the treaty are respected by the taxing authorities of the contracting states.[153] But the more important element, for purposes of building economic relationships, may be the simple development of open communications. In terms of a bilateral tax treaty, "rather than communicating exclusively through diplomatic channels, the treaty authorizes the 'competent authorities' of the two countries to negotiate with each other and reach binding mutual agreements on the interpretation and application of the tax treaty."[154]

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[149] *See* U.S.-Mexico Tax Treaty, *supra* note 57, art. 18, § 1 (the exemption threshold is $3,000).

[150] *See* U.S.-Canada Tax Treaty, *supra* note 56, art. XVI, § 1 (highlighting, here, that the exemption threshold is $15,000).

[151] According to Cordes, horizontal equity "protects taxpayers against arbitrary discrimination, and also seems consistent with basic principles of equal worth. Some might also argue that horizontal equity comports with the principle of 'equal protection under law' set forth in the United States Constitution." CORDES, *supra* note 147, at 164.

[152] Berman, *supra* note 4, at 623.

[153] *See* MCDANIEL, AULT & REPETTI, *supra* note 41, at 194.

[154] Berman, *supra* note 4, at 623.

This direct communication between each nation's taxing authorities could be very beneficial in working through the current problems faced in tax treaty negotiations between the United States and South American countries.[155] For example, a fundamental disagreement between the United States and Brazil is the Brazilian approach toward withholding fees for technical services.[156] The fundamental concern of U.S. tax authorities is how broadly the Brazilian tax authorities may interpret such services. Opening communications between the taxing authorities may result in a better understanding of each side's opposing position, resulting in a mutually agreeable and beneficial interpretation of technical services.

D. Creation of Goodwill and Lasting Economic Relationships

Finally, it has been argued that the United States needs to develop a more flexible approach toward international tax relationships with developing countries.[157] Formally addressing the taxation issues of international athletes from these countries is an avenue for pursuing a more flexible approach.

Due to escalating salary and endorsement values, it is feasible that tax authorities may become increasingly interested in the issues surrounding the taxation of professional athletes. Domestic professional athletes have already experienced increased tax scrutiny from traveling within the United States, in the form of the so-called "jock taxes."[158] International professional athletes add another element to the equation because of the concerns for double taxation and proper tax jurisdiction. Moreover, the inherently public nature of sports figures puts them constantly at the forefront of public attention and discussion. Thus, the international athlete has potential to represent a high-profile issue of proper taxation.

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[155] As Evans notes, "[a] multilateral agreement would enable several countries to discuss one specific tax issue—the taxation of international athletes. Meetings to negotiate this agreement would foster increased opportunity for discussing issues in depth, solving problems creatively, reaching compromises, and establishing a uniform system of tax treatment." Evans, *supra* note 4, at 328–29.

[156] *See supra* Part III.B.2.b.

[157] *See* Zagaris, *supra* note 90, at 331–32 (arguing that "the inflexible approach of the United States towards developing countries and the emphasis on 'sticks,' or punishment of governments that do not change their policies and laws and conform with U.S. tax enforcement demands, in lieu of 'carrots' or incentives is adversely impacting" the tax environment between the United States and developing countries).

[158] "Jock tax" is the "colloquial expression referring to a state's application of its income tax to visiting professional athletes." David K. Hoffman & Scott A. Hodge, *Nonresident State and Local Income Taxes in the United States: The Continuing Spread of Jock Taxes*, TAX FOUND., SPECIAL REPORT NO. 130 2 (July 2004), *available at* http://www.taxfoundation.org/publications/show/94.html. As Hoffman and Hodge also note, "[p]rofessional athletes make tempting targets for state lawmakers because they represent a highly concentrated pool of wealth that can be taxed with little enforcement." *Id.* at 4.

Directly addressing the taxation issues facing international sports figures is a perfect avenue to increase the positive reputation of international relations while simultaneously building toward an integrated economic future. First, the United States can approach the negotiations with a flexible attitude on this singular issue without fear of setting an undesired precedent of tax agreements with other developing countries.[159] Second, and similarly, signing such a multilateral tax treaty will help bring national and international attention to the issue of building economic relations between the United States and South American countries.

Finally, this approach would also finalize international taxation issues throughout the Americas for at least one issue. This "foot-in-the-door" approach makes sense because it will likely lead to further negotiations down the road. If the representative countries cannot agree on something as straightforward as taxing athletes, there will likely be continued problems with negotiating more substantive tax treaties between the United States and South American countries and ultimately problems in the development of free trade in the Americas. As an example of success, the U.S.-Mexico Tax Treaty was negotiated and signed in conjunction with development of NAFTA.[160] The tax treaty is a critical complement to NAFTA for achieving mutual benefits of investment, even though it generally operates independently.[161] The U.S.-Mexico Tax Treaty has also been perceived as a functional starting point and "model for tax treaties between the United States and other Latin American countries."[162] Thus, if a multilateral tax treaty around one singular issue in the Americas were executed, it would likely lead to sustained economic relationships through continued discussions.

V. CONCLUSION

There is currently no tax treaty in place with any South American country. Similarly, recent attempts at discussion and negotiations toward opening free trade in the Americas seem to have hit a standstill. A multilateral tax treaty in the Americas will move all countries involved closer to developing free trade by removing barriers to cross-border transaction and investment.

Although no tax treaty is currently in place with any South American country, high profile athletes such as Manu Ginobilli of Argentina have

[159] *See supra* Part III.B.2.a (discussing the U.S. resistance to granting tax sparing to Brazil for fear that it will lead to an undesired precedent for tax treaty negotiations with other developing countries).

[160] J.D. Dell & Geoffrey R. Polma, *The New US-Mexico Income Tax Treaty: Overview and Analysis*, 1 NAFTA: L. & BUS. REV. AM. 49, 49 (1995).

[161] *Id.*

[162] *Id.*

raised the level of attention given to the issue of taxing the international athlete. The United States should capitalize on this opportunity by pursuing a multilateral tax treaty in the Americas on the singular issue of taxing the international athlete. In pursuing such an agreement—where the United States and developing countries already agree on the fundamental tax policy of source-based tax jurisdiction—the United States will (1) remove the lack of uniformity currently presented by the various bilateral tax treaties in place, (2) open lines of communication for further development of more substantive tax treaties, and (3) improve goodwill and build a lasting economic relationship with South American economies. All of this will greatly improve the likelihood of achieving free trade in the Americas.