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Manager
Media and Speeches Unit
The Treasury
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By Email: *fameorimage@treasury.gov.au*

Dear Manager

TAXATION OF INCOME FOR AN INDIVIDUAL'S FAME OR IMAGE

1. Thank you for the opportunity to provide comments on the Treasury Consultation Paper titled "Taxation of Income for an Individual's Fame or Image" ("**Consultation Paper**").

2. Pitcher Partners specialises in advising taxpayers in what is commonly referred to as the middle market. Accordingly, we service many taxpayers that would be impacted by any changes to the taxation of celebrities, sportspeople, internet personalities and entertainers (herein refer to as "**high-profile individuals"**).

3. Pitcher Partners acknowledges that the Government's policy, as per the 2018-19 Federal Budget measure, is to ensure that remuneration for the exploitation of an individual's fame or image cannot be effectively alienated for tax purposes to an entity other than that high-profile individual.

4. Rather than answer each of the discussion questions in the Consultation Paper, we have focussed our comments regarding our main areas of concern regarding the implementation of any measures the subject of the Consultation Paper.

Scope of measures

5. The Consultation Paper at page 10 states that the Government is seeking to take a broad approach to the definition of "fame or image" for the purposes of the proposed

measures by extending it to anything and everything that can be attributable to a person's reputation or appearance.

6. We understand the preference for a broad definition over a prescriptive one that may not cover every relevant arrangement. However, we are concerned that an overly broad definition could capture activities that are in the nature of personal services rather than for the exploitation of the high-profile individual's fame or image. For example, a high-profile actor, through a nominated entity, enters into an agreement to perform in a film for a certain number of days for an agreed fee. Depending on how the proposed measures are drafted it may be argued that, due to the high-profile individual's "star power," the income (or a substantial part of the income) is really for their fame or image rather than as mainly a reward for their personal efforts or skill (i.e. personal services income or "**PSI**").

7. The PSI rules already contain measures that are intended to apply to high-profile individuals in relation to income derived as a reward for their performances and appearances. The Consultation Paper does not make clear whether these new measures will fall within the remit of the PSI rules, instead of the PSI rules or in addition to the PSI rules.

8. The PSI regime is long-established and well understood in the industry. We believe that the PSI rules should continue to apply in its present form to such income so that the income so as to able to draw a clear distinction between what is PSI and what is income from the exploitation of an individual's fame or image.

9. We therefore recommend that a broad definition of "fame or image" contain an express exclusion for income that satisfies the definition of PSI in section 84-5.[1]

10. This would go some way to effectively contain the scope of any measures and ensure that the two types of income are dealt with under separate regimes. We also suggest that any exposure draft explanatory materials contain guidance or examples of how any measures are proposed to interact with the current PSI rules.

11. Additionally, we believe that is appropriate that the measures should apply to specific occupations to avoid confusion in situations where a person has a high-profile in their particular industry but are not generally considered "famous". For example, a well-known lawyer, accountant, doctor or other professional may represent their firm at a speaking engagement or publish an article on behalf of their firm – with the firm being paid a fee for this. If the measures had application to all occupations, this could lead to uncertainty in relation to the treatment of such income as it could be considered that the fee is being paid for the "fame or image" of the well-known member of the industry.

12. We believe that the measures are not intended to apply to categories of people mentioned above and is really intended to apply mainly to entertainers and sportspersons.

13. We therefore recommend that any measures should be confined to such occupations accordingly. Most of Australia's double tax agreements have articles that apply specifically to "entertainers and sportspersons". Further, section 405-25 contains

[1] All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

definitions of "performing artist" and "sportsperson". It would make sense for the new measures to leverage terms that already exist under the tax system to minimise uncertainty in application of these new rules.

Relief from double taxation

14. The Consultation Paper notes at page 11:

> *Depending on the structures, arrangements and jurisdictions involved with an individual's fame or image, it is possible that income may be taxed in different entities across different jurisdictions. For example, an individual may be taxed in Australia on their fame or image income and simultaneously be taxed on the same income through a related entity outside of Australia. These types of arrangements may impact relief if double taxation occurs.*

15. We share these concerns as we believe that going forward many high-profile individuals will (for reasons unrelated to tax) continue to enter into and/or be subject to contracts in the name of a related entity rather than in their personal capacity. Some common examples of this would include:

    15.1. Multi-year endorsement deals which may run for many years.

    15.2. Foreign entities (particularly in the US), which will demand to contract with local companies (e.g. US C Corporations ("**C Corps**") and Limited Liability Companies ("**US LLCs**")) for the right to use an individual's fame or image (such rights being recognised under their local laws).

    15.3. Entities in Australia and overseas who will demand to contract with a corporate entity rather than an individual in order to minimise legal obligations which might otherwise be owed to the individual whose fame or image is being exploited.

16. Since the new rules will not change the commercial landscape, Australian residents who derive income from the use of their fame or image in foreign countries may be subject to unrelieved double taxation unless express provision is included within the new legislation to ensure that this does not occur.

Interaction with PSI rules

17. On the basis that such structures will continue to persist for commercial reasons, we would urge Treasury to consider drafting amendments to the foreign income tax offset ("**FITO**") rules in Division 770. There is already uncertainty associated with the interaction of the FITO provisions with the PSI rules. In this regard we note that Taxation Ruling *TR 2005/3* (now withdrawn) provided valuable guidance on the interaction between the PSI rules and the now repealed foreign tax credit system. However, no such public guidance has been published by the Australian Taxation Office on how the FITO regime interacts with the PSI regime (i.e. no reference to the PSI rules in contained in the ATO's *Guide to foreign income tax offset rules*).

18. For example, a C Corp (controlled by a high-profile individual) may enter into a contact with a US film studio for that individual to act in a motion picture. The C Corp derives

income and pays tax in the US. If the PSI rules attribute the net income from the acting work to the high-profile individual, that individual will probably be entitled to a FITO for the US tax paid under subsection 770-130(2).

19. However, if the C Corp instead pays the individual a salary for their services rendered (resulting in a deduction for the C Corp to reduce its taxable income to nil in the US), the US may instead tax the individual on the payment of the salary if it is considered to be derived from US sources. If the salary payment is not made before 14 July for the relevant income year[2] the individual will be assessed under section 86-15 on attributed personal services income rather than ordinary income from wages.[3] We believe that it is unclear whether the individual will be entitled to a FITO in such a situation because the amount they are assessed on (i.e. an amount of attributed personal services income) is not in respect of the same amount or of the same character of the amount they paid foreign tax on (i.e. an amount of salary).

20. The lack of guidance regarding this interaction may result in the same uncertainty regarding any measures dealing with income from the exploitation of an individual's fame or image being attributed to that individual. The introduction of these measures provides Government with an ample opportunity to strengthen the application of sections 770-10 and 770-130 to more effectively provide relief from double taxation to situations where an entity pays foreign tax on income it derives but which is attributed to an individual for Australian tax purposes under a particular domestic regime.

21. For example, section 770-10 could be amended to include a new subsection or note to clarify that foreign income tax is considered to be paid in respect of an amount of assessable income if – in the case where an individual is assessed under a special rule that attributes income to the individual, such as the new measure or the PSI rules – the foreign income tax was paid on an amount that would have been assessable to the individual if that special rule did not exist. This would cover situations such as those mentioned in paragraph 17 where the individual is assessable in both countries on the same amounts but where the character of each amount is different in each country.

22. Additionally, section 770-130 could be expanded to deem an individual to have paid foreign income tax in respect of an amount in situations where the foreign income tax was paid by a member of an entity where that same member would have included the amount in their assessable income if a special rule that attributes income to that person, such as the new measure or the PSI rules did not exist. This would cover situations outlined in the following section involving flow-through structures.

23. We note that section 770-135 operates to provide FITOs to an entity when income is attributed to it (i.e. under the controlled foreign company rules). This type of rule could be expanded to cover attribution under PSI and the new measures to avoid doubt about the ability for the individual to obtain relief from double taxation.

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2 As per subsection 86-40(1).

3 Section 86-35 makes the later salary payment non-assessable non-exempt income.

Flow-through structures

24. In addition to a basic example involving a C Corp set out at paragraph 18 above, in many cases a US LLC will be disregarded as being an entity separate from its owner or, where there is more than one member, taxed like a partnership in the US and Australia under the foreign hybrid rules in Division 830.

25. For example, the US LLC may be owned by an individual and their spouse, each of whom may be required to lodge a tax return in the US and pay tax in respect of their share of the US LLC's income. The individuals may also be assessed in Australia on their interest in the net income of the US LLC where the US LLC is a foreign hybrid company.[4]

26. We suggest that any proposed measures make clear (e.g. through explanatory materials or specific ordering rules) how the law is proposed to apply both in respect of the individual's interest and that of any other member/deemed partner:

    26.1. Will the proposed measures have any operation where the fame or image income derived by another entity flows through to that individual in the same year?

    26.2. Will it matter what the form or manner in which the income flows through (e.g. share of net income of a partnership or trust, dividend from a company, payment of a licence fee by any form of entity)?

    26.3. If the measures do nevertheless apply (i.e. the individual is assessed under the specific attribution rule rather than on a licence payment or distribution from the entity), will the FITO rules operate to allow the individual an offset for foreign tax that individual paid in their capacity as the member of the entity or recipient of the licence fee?

    26.4. Likewise, will the FITO rules attribute any foreign tax paid by another member of the entity to the high-profile individual assessed in Australia (e.g. if the spouse of the high-profile individual is the other member of the LLC and is taxed on their share of the LLC's taxable income in the US)?

Treaty relief

27. The potential inadequacies in the FITO rules would not likely be alleviated by Australia's double tax agreements.[5] Australia's double tax agreements do not generally provide for any relief where the entity seeking a credit or exemption is not the entity which derived an amount of income that is covered by a particular article of the treaty.

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4 In accordance with Division 830.

5 For example, Australia's most recent double tax agreement (with the Federal Republic of Germany) allows an Australian resident a credit for foreign tax under Article 22(1) "subject to the provisions of the laws of Australia which relate to the allowance or credit against Australian tax of tax paid in a country outside Australia…"

28. On this basis, we recommend that the FITO rules are strengthened as it is unlikely that any tax treaties will be able to overcome any deficiencies in Australia's domestic laws in this area.

Availability of deductions

29. We note that the Consultation Paper focuses on the income from the exploitation of a high-profile individual's "fame or image". We believe it is important that any measures also make clear how any expenditure in relation to such income is to be treated given that, in our experience, the entities that would be affected by the measures carry on their affairs as genuine commercial businesses and incur not insignificant expenses.

30. We believe that the measures should only seek to attribute the net rather than the gross amounts derived from the exploitation of "fame or image". Denying the high-profile individual deductions for genuine expenses incurred in deriving that income is unnecessarily punitive.

31. Therefore, we recommend that a rule, similar to section 86-15, be contained in the measures to allow the amount of attributed income to be reduced by deductions the other entity was otherwise entitled to.

Transitional rules

32. We are aware of many pre-existing arrangements involving the licensing of an individual's fame or image, such as multi-year endorsement deals, that were entered into in good faith based on the understanding of the law at that time. Many such arrangements will continue to operate for many years after the proposed 1 July 2019 start date of any new measures.

33. Such arrangements are the product of commercial negotiations between parties dealing at arm's length and will commonly not be able to be varied during their term. Even if the parties were to go to the time and expense to renegotiate their agreements in anticipation of the measures (e.g. to ensure the high-profile individual that is to be taxed on the "fame or image" income from 1 July 2019 will be able to access a FITO to relieve double taxation), without knowing what the detail of what the measures will look like, they would not be able to do so effectively. For this reason, we suggest that income derived from pre-existing arrangements (e.g. those entered into before any draft legislation is made public or alternatively before the Budget Announcement) should not be subject to any new measures unless the terms of relevant agreement are varied by extending the term of the agreement or changing the amounts payable under the agreement. As these agreements related to an individual's fame an image they typically are short or medium term in nature and will not therefore be grandfathered indefinitely.

34. Further, given that the proposed start date is less than six months away and the real possibility of any measures not becoming law until after 1 July 2019, we would recommend that the start date be the first day of the income year commencing after any amending legislation receives the Royal Assent. Given recent experience with retrospective application of legislative amendments (e.g. reduction of the corporate tax rate), we believe that the prospective application of amendments a reasonable

time after they become law provides reduces any confusion for taxpayers and administrators.

Other interactions

35. We suggest that any draft explanatory materials also provide guidance or commentary to taxpayers regarding certain interactions with other areas of tax law:

    35.1. Hybrid mismatch rules – in particular, where foreign income is derived from the exploitation of the individual's fame or image and deductions are claimed in both Australia and the foreign country (potentially by different entities), will there be any consequences under Subdivision 832-G (about deducting hybrid mismatches)?

    35.2. Above-average special professional income – in particular, where the measures apply to attribute income to the high-profile individual that would be covered under Division 405 as if it were actually derived by that individual, will the attributed income be taken into account under that Division? We would also suggest a consequential amendment to Division 405 to make clear that such income can be taken into account so as not to disadvantage those who derive the income via attribution as compared to directly as there would be many commercial reasons to licence the use of fame or image to third parties through related entities.

If you would like to discuss any aspect of this submission, please contact either Leo Gouzenfiter on (03) 8612 9674 or me on (03) 8610 5401.

Yours sincerely

D J HONEY
Executive Director