INTERNATIONAL ASSOCIATION OF YOUNG LAWYERS

Income tax for professional athletes and artists - a cross border story

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Will Johnson

Haynsworth Sinkler Boyd, P.A.
1201 Main Street
Suite 2200
Columbia, SC 29201
USA

+1-803-540-7945

wjohnson@hsblawfirm.com

General Reporters
Pablo Pedrajas Quiles, Abdón Pedrajas Abogados & Asesores Tributarios, S.L.P, Madrid, Spain
Johan Myrén, Advokatfirman Lindahl, Göteborg, Sweden

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1. Introduction

This questionnaire concerns athletes /artists performing missions in countries other than their country of residence, for longer periods or for only short events.

Frequently, athletes / artists' income is arranged in a certain manner for the purpose of tax efficiency. Such arrangements may involve performing the missions under the name of a company owned by the athlete / artist or by performing the mission as an employee. The first issue relevant for this questionnaire is what fiscal impacts such arrangements have.

The fees for athletes / artists' performances often consist of several components. Athletes regularly achieve signing bonuses before any performance is completed, followed by rewards when performance has been completed and incentive bonuses following successful execution. Moreover, athletes /artists regularly have endorsement income in connection to sports or arts events. The second issue addressed in this questionnaire is which of those components are covered by the regulation.

How is the covered income taxed? The third issue to address is how the found income of the athlete/artist is taxed and who is affected by the taxation.

Since the issue involves more than one country, the questionnaire further addresses the issue of double taxation. The final issue concerns how the issue of double taxation generally is handled.

Finally, athletes and artists may have income for their image rights. The last part of the questionnaire is related with the regulation for the image rights in your country.

2. General questions

a) Is there any special tax legislation applying to athletic/artistic performances completed by athletes/artists residing outside the country of performance? Please describe these tax regime(s) briefly.

The United States does not maintain any special tax legislation solely for athletic or artistic performances. The U.S. taxes its citizens and residents on their worldwide income. Outside of the context of an applicable income tax treaty, non-citizen nonresidents are subject to U.S. income tax on U.S.-source income, as well as income from non-U.S. sources that is effectively connected with the active conduct of a U.S. trade or business. Most U.S. income tax treaties provide that foreign athletes and entertainers entitled to treaty benefits are not subject to U.S. income tax unless their gross receipts from such activities exceed a specified threshold amount, generally $10,000 - $20,000 or the foreign equivalent thereof.

While it does not constitute legislation *per se*, the U.S. allows athletes and entertainers to enter into Central Withholding Agreements ("CWAs") with the Internal Revenue Service. Application for a CWA is due at least 45 days before a tour commences in the U.S. and must designate an applicable withholding agent. Such agreements will reduce the otherwise applicable 30% withholding requirement to a lower amount that considers anticipated expenses and the ultimate level of tax the athlete or artist is likely to owe.

b) If so, who is covered by the legislation? (natural/legal persons?)

Central Withholding Agreements are only available for individual athletes or entertainers.

1. Commercial constellations

c) What are the tax implications when payment for an individual athlete / artist 's performance is made to a company owned by him?

Income derived from personal services in the U.S. is subject to U.S. income tax. If payment for such services is to an entity owned by the individual, the result can actually be a higher aggregate tax, as the entity itself is likely subject to corporate income taxes or branch profits taxes in the U.S., and payments to the individual would be subject to U.S. income tax as well due to the performance having occurred within the U.S. Article 17(2) of the U.S.-U.K. income tax treaty provides that "Income in respect of activities exercised by an entertainer or a sportsman in his capacity as such which accrues not to the entertainer or sportsman himself but to another person may, notwithstanding the provisions of Article 7 (Business Profits) or 14 (Income from Employment) of this Convention, be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised, unless that other person establishes that neither the entertainer or sportsman nor persons related to them participate directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions." Most U.S. income tax treaties contain similar language allowing for U.S. taxation in these scenarios.

d) Who is taxed on compensation for an athlete/artist's performance, when it is paid to a company in which the athlete is employed?

Both the company and the athlete would be taxed in this scenario. The company would be taxed on income arising from a U.S. source, which would include income from personal services. Due to the treaty language above, this result would hold true even if the company does not have a

permanent establishment in the U.S. and may not be subject to U.S. taxation under the "Business Profits" provisions of the applicable treaty. In addition, the athlete would be subject to U.S. tax (if the gross receipts are above the relevant threshold amount) on income paid for personal services performed in the U.S. The Internal Revenue Service may scrutinize the agreement as well to ensure that the allocation of the payments is appropriate and reflective of economic reality.

e) Is the company's business as a whole of any relevance for the assessment of the questions above?

No.

f) Is it relevant for the answers above whether the company conducts further activities or has more employees?

No.

g) Would the answer be different if the compensation could be attributed to the performance of an athletic team or an artistic group?

No.

h) Is it of any fiscal significance if the international commitment extends to a long period of time?

No, although a Central Withholding Agreement as described above may be of particular interest in the case of an extended time commitment.

i) **Income covered by the Taxable base**

j) What kind of income is covered by the special tax legislation?

While no special tax legislation applicable for just artists and athletes, the primary types of income triggering U.S. taxation of foreign athletes and artists are personal service income and royalties.

k) Does the legislation limit the taxation to income from the sport /arts practice itself, or does it extend the taxable income to services performed in connection to sports or artistic events and assignments related to the athlete/artist's sports career?

Personal service income may include not only income such as prize money but also appearance fees that are closely intertwined with and therefore largely indistinguishable from payment for individual athletic or artistic performances.

l) Does the income taxable include compensation for performances, endorsements, the sale of merchandise, and royalty, or other income related to the event?

Absent a treaty, the U.S. imposes tax on all such income to the extent attributable to the U.S. Taxation of personal service income depends upon the location where the personal services are performed. Taxation of royalties depends upon the place where the intangible property generating the royalty income is used. For example, in a recent U.S. Tax Court case involving golfer Retief Goosen, the court determined that 92 percent of worldwide royalty income from Upper Deck and 70 percent of worldwide royalty income from Electronic Arts were U.S.-source income. Such income is subject to withholding at a flat rate of 30 percent on the gross amount of the royalties. This determination arose because Goosen was ineligible for benefits that he claimed under the income tax treaty between the U.S. and the United Kingdom (rather than South Africa), because payments were diverted to an account in Liechtenstein and triggered a clause in the U.S.-United Kingdom treaty making its benefits inapplicable.

Treaties generally provide very different results. For example, in a similar case involving golfer Sergio Garcia, the applicable tax treaty (with Switzerland rather than Spain) provided that royalties derived and beneficially owned by a resident of Switzerland could only be taxed in Switzerland, not in the U.S. Consequently, millions of dollars in royalty income escaped U.S. taxation. As one might imagine, the incentive in many such cases is to characterize as much income as possible as royalty income beyond the reach of the U.S. tax regime.

m) Are signing bonuses included in the income covered by the special regulations?

Signing bonuses are a taxable source of income to the athlete or entertainer and constitute personal service income.

n) What is the regulations take on incentive bonuses based on personal or team performance?

Incentive bonuses are a taxable source of income to the athlete or entertainer and constitute personal service income.

o) Is endorsement income considered to be included in the compensation for the athletic /artistic performance and, if so, to what extent?

Endorsement income may be either personal service or royalty income. As stated above, for athletes who are eligible for treaty benefits, the incentive is often to characterize more of the endorsement payment as royalty income.

Courts examine a wide range of factors to determine the proper allocation between personal service income and royalties. Contracts requiring an athlete to compete in a larger number of tournaments tend to suggest personal service income, while provisions basing endorsement income on percentages of apparel sales tend to suggest royalty income.

p) Does the legislation limit the amount that an athlete / artist may receive from his employer in connection with assignment of image rights?

No special legislation limits the amount an athlete or artist may receive from his employer in connection with an assignment of image rights, although the Internal Revenue Service would not be obligated to respect an unreasonable price or allocation methodology. Some of the post-BEPS measures targeted toward abusive transactions involving transfers of intellectual property might actually apply in this situation as well.

q) What is the treatment your national legislation has for image rights in personal income tax?

Image rights generally constitute royalty income and would be taxed as described above.

r) From a tax point of view, are there any differences in the treatment of image rights between a resident athlete / artist and a non-resident athlete/ artist in your country?

For a resident athlete or artist, the U.S. would impose tax on his or her worldwide royalty income, and deductions for ordinary and necessary business expenditures would reduce the amount of tax. For a nonresident athlete or artist, the U.S. would impose a flat 30 percent withholding tax on the gross amount of the royalties, although many treaties would eliminate any U.S. tax on such royalties. In addition, for nonresidents who are subject to U.S. tax on royalty income, the tax would only extend to royalties attributable to the U.S. Thus, the taxpayer must allocate his or her royalty income as between the U.S. and the rest of the world. In the above-referenced case, Retief Goosen allocated his overall royalty income "25% to the UK and 75% to the rest of the world." The U.S. Tax Court held that the U.S. share of the allocated income was not properly specified, and therefore, not subject to the proper level of U.S. taxation. Tax planners should specifically address the proper allocation for U.S.-sourced income in a global royalties contract instead of diluting the taxable income by grouping it within a global, worldwide figure.

1. Tax rates

s) What is the applicable tax rate?

U.S. citizens or residents, including athletes and entertainers, are taxed according to their overall worldwide income at graduated rates, with the highest federal income tax rate for individuals being 39.6 percent (and even higher where investment income is included). State and local governments may also impose taxes over and above the federal income tax (i.e., state income tax and city income tax), in some cases producing an overall tax burden of greater than 50 percent.

Non-resident athletes and entertainers performing independent personal services or participating in events in the U.S. are generally subject to a 30 percent withholding tax on gross income that is not effectively connected with a U.S. trade or business and the same graduated tax rates referenced above for effectively connected income.

t) Does the tax rate differ depending on the sport practiced?

No.

u) And in the case of artistic performances, does it differ?

No.

v) Is the tax rate fixed or progressive?

The tax rate for income not effectively connected with a U.S. trade or business is fixed at 30 percent. Tax rates for effectively connected income are progressive.

w) Does the legislation allow for deduction of costs with regard to the athlete / artist tax?

Costs are deductible, although absent a Central Withholding Agreement as described above, the athlete or artist may be subject to 30 percent withholding and may be required to file a U.S. tax return to claim a refund for overpayments at the end of the year. A Central Withholding Agreement takes into consideration the anticipated expenses and the progressive tax rate that is likely to apply and generally establishes a lower level of withholding that is designed to approximate the ultimate rate of tax the athlete or artist is likely to face.

x) Does the taxed income serve as a basis for social security contributions?

Generally, payments to individuals who are not employees are not subject to social security contributions. In addition, the U.S. is a party to Social Security Totalization Agreements with Australia, Austria, Belgium, Canada,

Czech Republic, Chile, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovak Republic, South Korea, Spain, Sweden, Switzerland, and the United Kingdom. These agreements should be consulted to determine the appropriate social security taxation.

y) Who is responsible for the payment of the tax?

In most cases involving nonresidents, the payor is responsible for withholding, absent the application of a treaty or Central Withholding Agreement (with respect to which the recipient must provide the payor appropriate documentation), although the recipient is ultimately responsible for the tax regardless.

1. Double taxation treaties

z) How is elimination of double taxation regarding athletes / artists generally implemented when there is a double taxation treaty? (exempt/credit/deduction).

As described above, most U.S. treaties provide that foreign athletes and entertainers are not subject to U.S. income tax on income earned from athletic or artistic performances unless their gross receipts from such activities exceed a specified dollar amount (i.e., $20,000 for the United Kingdom, Italy, Germany, Belgium, and Ireland, and $10,000 for Spain, Switzerland, the Netherlands, France).

aa) How is the issue handled when a double taxation treaty does not exist?

U.S. law generally authorizes a foreign tax credit to reduce payments made to foreign jurisdictions. Most developed countries would provide a similar credit against their own income tax for taxes paid to the U.S.

bb) Is there a limit amount for the income to be taxed?

No. The U.S. will happily tax any amount of income that an athlete or artist makes within its borders. In fact, this eagerness to tax unlimited amounts garnered the attention of Phillipino boxer Manny Pacquiao, who fought Chris Algieri in Macau, China in November 2014, causing *Forbes* magazine to note that the bout occurred in a country whose tax system would capture 12% of his earnings from the fight as compared to 39.6% had the fight taken place in the U.S.

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