

International Tax Issues for Athletes and Entertainers: Residency, Tax Treaty Provisions, Mitigating Dual Taxation

THURSDAY, AUGUST 20, 2020, 1:00-2:50 pm Eastern

IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

- **Participate in the program on your own computer connection (no sharing)** - if you need to register additional people, please call customer service at 1-800-926-7926 ext. 1 (or 404-881-1141 ext. 1). Strafford accepts American Express, Visa, MasterCard, Discover.
- Listen on-line via your computer speakers.
- Respond to five prompts during the program plus a single verification code.
- To earn full credit, you must remain connected for the entire program.

WHO TO CONTACT DURING THE LIVE PROGRAM

For Additional Registrations:

-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

For Assistance During the Live Program:

-On the web, use the chat box at the bottom left of the screen

If you get disconnected during the program, you can simply log in using your original instructions and PIN.

Tips for Optimal Quality

FOR LIVE PROGRAM ONLY

Sound Quality

When listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, please e-mail sound@straffordpub.com immediately so we can address the problem.

International Tax Issues for Athletes and Entertainers: Residency, Tax Treaty Provisions, Mitigating Dual Taxation

August 20, 2020

Jeffrey Bowley, CPA, MT
Partner
Joseph W. Bowley & Co.
jeff.bowley@jwbco.net

Patrick J. McCormick, J.D., LL.M.
Partner
Culhane Meadows Haughian & Walsh
pmccormick@cm.law

Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

International Tax for Athletes, Entertainers, and Their Advisors

Patrick J. McCormick, JD, LLM
Jeffrey J. Bowley, CPA, MT

Introduction

- Multinational performers are increasingly common – whether based in the United States and generating income overseas or are nonresidents with income connected to America
 - American-based entertainers are taxed by the United States on worldwide income – but incorporation of foreign activities can create tax savings
 - For nonresident entertainers, scope of tax is dictated by level of United States connection maintained by the nonresident
 - Special tax benefits/exclusions available for nonresidents performers who reside in a tax treaty jurisdiction

Taxpayer Classification

- Which individuals are United States taxpayers?
 - Citizenship – persons born in the United States, naturalized in the United States, or (under specified circumstances) where parents were United States citizens at the time of their birth
 - Classified as a “resident” for United States income tax purposes if:
 - Lawfully admitted for permanent residence (green card holder); or
 - Meet substantial presence requirements
 - Substantial presence test: must be present in the United States for 31 days during the relevant tax year and the sum of days for the last three years (after use of applicable multipliers) exceeds 183
 - Individuals not classified as United States taxpayers termed “nonresident aliens”

Taxpayer Classification

- Who is a U.S. taxpayer?
 - Exceptions exist to resident classification: (1) closer connection to another country and (2) treaty tiebreaker provisions
 - Closer connection exception: look to whether individual's facts and circumstances show a closer connection to another country
 - Available *only* for substantial presence residents!
 - Income tax treaties – individuals classified as residents of both treaty party countries are reclassified as a resident of only the one which contains their permanent abode or (if a permanent abode available in both) their “center of vital interests”
 - Available to *both* substantial presence residents and green card holders – but not citizens!
 - Treaty reclassification **only** for income tax liability purposes
 - information reporting requirements largely unmodified

Taxpayer Classification

- United States citizens/domiciliaries taxable on transfers of worldwide assets, whether during life or at death
 - However, given a lifetime exclusion of \$11.58 million (for 2020fd)
 - Treated as a domiciliary for estate/gift tax purposes when maintaining a United States domicile – domiciliary is a United States resident *with no present intention of leaving*
 - Facts and circumstances determination – look to length of stay, ties to U.S. versus other countries, etc.
 - Imposes an elevated standard for presence-based tax as compared to income tax requirements!
 - Unlimited marital exclusion inapplicable for noncitizen spouses (even if domiciliaries/residents)
 - Bequests to noncitizen spouses typically done through QDOTs

POLL QUESTION #1

- Which of the following is *not* subject to United States tax on their worldwide income?
 - United States citizens
 - United States residents
 - Nonresident aliens

United States Taxpayers – Income from Entertainment Services

- United States generally subjects domestic taxpayers to tax on a worldwide basis
 - Credits applicable to taxes paid to foreign countries on foreign-sourced income
- Numerous options exist for structuring transactions of a United States-domiciled entertainer overseas
 - Where activities are undertaken through a United States corporation, American tax benefits are available

United States Taxpayers – Income from Entertainment Services

Foreign-Derived Intangible Income (“FDII”)

- A deduction is allowed to *domestic corporations* in an amount equal to 37.5% of the FDII of the domestic corporation for the tax year
 - Deduction ONLY available to C-corporations!
 - Effective (American) tax rate is 13.125%
- FDII equals deemed intangible income multiplied by a fraction: foreign-derived deduction eligible income over deduction eligible income.
 - FDII is the portion of intangible income derived from serving foreign markets; it assumes a 10% rate of return on tangible assets
- Drawback – where foreign earned by performer through corporate entity, two levels of American tax (one when income earned, a second where distribution made to performer)

United States Taxpayers – Income from Entertainment Services

Global Intangible Low-Taxed Income (“GILTI”)

- Under Sec. 951A, U.S. shareholders of a controlled foreign corporation (“CFC”) must include their share of global intangible low-taxed income in US tax
 - Wholly-owned American entity will meet U.S. shareholder/controlled foreign corporation requirements
- 50% deduction available for GILTI, but ONLY for C-Corporations!
 - Makes the effective tax rate for corporate shareholders 10.5%
 - Rate reduced when compared to FDII!
- Functionally, GILTI is tax imposed on the excess of an assumed 10% rate of return on tangible business assets of the CFC
 - Must have a CFC for GILTI to apply!

POLL QUESTION #2

- True or False: United States performers can lower American tax consequences by incorporating activities generating foreign income.

Nonresident Athletes/Entertainers

- Under default U.S. rules, nonresident performers are subject to United States tax on:
 - (1) income effectively connected with a United States trade or business, and
 - (2) fixed or determinable annual or periodic income
- Non-U.S. taxpayers are subject to U.S. tax primarily on income items sourced to the United States
 - Royalties sourced to the place of use of the asset
 - Personal services sourced to where services performed
 - Sale of non-inventory property is sourced to the location of the seller
 - Inventory property is sourced based upon where inventory is produced

Nonresidents – Effectively Connected Income

- Income effectively connected to a United States trade or business is subject to tax
 - “Trade or business” undefined in the Code/regulations – but profit-oriented activities carried on in the United States which are regular, substantial, and continuous are properly classified as a trade or business for these purposes
 - Generally, the performance of personal services within the United States constitutes a United States trade or business
 - Macro-level – relatively light requirements to be considered engaged in a U.S. trade or business
 - Effectively connected income taxed by the United States at graduated rates, with deductions/credits available

Nonresidents – FDAP Income

- Fixed or determinable annual or periodic income (“FDAP income”) also subject to tax by the United States (for income items sourced to the U.S.)
 - FDAP income functions as a catch-all for U.S.-sourced income items (aside from capital gains) not otherwise subject to U.S. tax
 - Includes interest (subject to expansive exceptions), dividends, rent, salaries, wages, premiums, annuities, compensation, remuneration, etc.
 - Interplay exists between ECI and FDAP income
 - US-sourced income is classified as effectively connected to a U.S. trade or business rather than FDAP if it satisfies an asset use test or a business activities test
- FDAP income generally subject to a flat 30% rate of tax (with tax collected through withholding by payors)
 - Deductions not permitted for FDAP income

POLL QUESTION #3

- Nonresident performers are subject to American tax on income earned from which of the following?
 - Performances outside the United States
 - Performances in the United States
 - Artistic works produced outside the United States and sold to American customers

United States Income Tax Treaties

- The United States maintains income tax treaties with roughly seventy countries, with each treaty containing distinct terms/articles built around common principles
 - Under treaties, residents of a treaty country can be taxed at a reduced rate, or even exempted from tax, on specified items of income from the other country
 - Savings clause prevents a United States citizen/resident/entity from using a tax treaty to alter tax on US-source income
 - Narrow exceptions are normally provided in treaties to the savings clause, allowing limited modifications to U.S. tax rules for specified foreign income items

United States Income Tax Treaties

- Residency a critical aspect of treaty relief – foreign taxpayers are normally entitled to treaty benefits only when valid residents of a country with which the United States has a tax treaty
 - *Residency* required – citizenship without residency does not qualify an individual for treaty benefits
- Treaty definitions of residence normally include persons liable for tax to a country based on domicile, residence, citizenship, place of management, or place of incorporation
 - Corporations are residents of countries for these purposes if liable for tax based on the country being its place of management
 - Can have conflicts as to residence where place of management and place of incorporation differ
 - Tiebreaker typically is the treaty between those two countries
 - Rules exist to prevent “treaty shopping” – entity creation solely for purposes of treaty benefits

United States Income Tax Treaties

- Tax treaties provide benefits to qualified residents of a treaty party country (normally for income sourced to the other treaty jurisdiction)
 - Threshold question regarding treaty benefits: can residence in a treaty country be established?
 - United States Model Treaty Art. 4(1): taxpayer is a resident of a country for treaty purposes if it “is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature”

United States Income Tax Treaties

- Tax treaties usually contain specific provisions for entertainers and sportsmen)
 - United States Model Treaty Art. 16: income derived by a nonresident “as an entertainer, such as a theater, motion picture, radio, or television artiste, or a musician, or as a sportsman” from personal activities may be taxed by the United States except where the amount of gross receipts derived from such activities does not exceed \$20,000
 - More dated treaties provide lower exemption amounts – the United States-Mexico tax treaty places the exempt amount at \$3,000

United States Income Tax Treaties

- Tax treaties usually contain specific provisions for entertainers and sportsmen
 - United States Model Treaty Art. 16: income derived by a nonresident “as an entertainer, such as a theater, motion picture, radio, or television artiste, or a musician, or as a sportsman” from personal activities may be taxed by the United States except where the amount of gross receipts derived from such activities does not exceed \$20,000
 - More dated treaties provide lower exemption amounts – the United States-Mexico tax treaty places the exempt amount at \$3,000
 - Applicable only with respect to entertainers and sportsmen themselves; others involved in the performance or athletic event are taxed under alternate treaty articles

United States Income Tax Treaties

- Where entertainers/sportsmen article inapplicable, American taxation of a nonresident's non-employee activities traditionally dictated either by a treaty's "Independent Personal Services" or "Business Profits" article
 - Independent Personal Services article (example): performer not taxable by the United States on personal services performed in the United States unless (1) she has a fixed base in the United States available to her which she regularly uses in performing services or (2) she is present in the United States for periods exceeding 183 days within a twelve-month period.
 - Business Profits – taxable where the nonresident maintains a "fixed base" within the United States

POLL QUESTION #4

- True or False: Nonresident performers can obtain tax treaty benefits specifically designed for them.

PLANNING OPPORTUNITIES

- Consider establishing residency in the United States when double taxation is unavoidable or there is the potential result for an overall reduced effective tax rate.
- Closely monitoring days for the purposes of the substantial presence test.
- The characterization of income
 - Royalty (licensing) income vs. personal service income
 - Sale of intangible property vs. personal service income

TCJA CONSIDERATIONS

- SALT cap considerations for state of residency
- Loss of unreimbursed employee business expenses

United States Withholding Requirements

- Persons having control, receipt, custody, disposal or payment of certain income items for foreign persons are normally required to withhold and deduct a tax equal to 30%
 - Imposes requirements on withholding agents for taxes due
 - Withholding agent – generally the last United States person to handle an income item
 - Payor of income items generally must determine whether the recipient is a foreign person
 - Can look to a withholding certificate supplied by the recipient
 - Where payments made to a disregarded entity, must treat payments as made to the DRE's owner for withholding purposes

United States Withholding Requirements

- Withholding requirement generally applies to FDAP income items
 - Withholding exceptions exist for certain income items – i.e. ECI
 - Withholding amounts/rate can be reduced by treaty provisions – however, generally need to be provided a beneficial owner withholding certificate prior to payment to rely on these provisions
 - If source of an item cannot be determined at time of payment it is treated as from U.S. sources for these purposes
 - Amount on which withholding is determined is typically the amount of gross income without deductions
 - Generally the entire amount of a distribution from a corporation is subject to withholding (even amounts which ultimately would not be treated as a dividend), though exceptions can apply

United States Withholding Requirements

- Withholding agent personally liable for amounts required to be withheld
 - Where withholding does not occur and recipient makes tax payments, withholding agent still liable for interest and penalties (though liability for tax is removed)
 - If withholding does not occur and agent instead pays tax from its own funds, the payment can be treated as additional income to the original recipient

POLL QUESTION #5

- True or False: Withholding agents are personally liable for withholding failures.

Nonresident Withholding Options

- Nonresident performers can be subject to substantial withholding requirements for United States activities
 - Overwithheld amounts can be refunded by filing Form 1040-NR; however, refunds not available until long after performance
 - United States filing requirements must also be navigated to obtain refunds
- For performers, central withholding agreements (“CWA”s) can provide a withholding alternative

Nonresident Withholding Options

- Central withholding agreement allows a nonresident artist or entertainer to enter an agreement with the Internal Revenue Service to reduce withholding amounts to match anticipated tax amounts
 - CWA application made by filing Form 13930
 - Included with the filing are copies of American contracts, dates/locations of events, and a proposed budget detailing anticipated revenues and expenses
 - Must be received by the Service 45 days before the first covered event
 - CWAs do not account for tax treaty positions (i.e. exclusions up to set amounts under the “Entertainers and Sportsmen” article of a tax treaty)

Patrick J. McCormick, J.D., LL.M.
pmccormick@culhanemeadows.com
215.630.0861

Jeffrey J. Bowley
Jeff.bowley@jwbco.net
856.228.8006 Ext 104