



THE PRICE OF SUCCESS: CROSS-BORDER TAXATION FOR PROFESSIONAL ATHLETES

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The free agency season is upon us in various sports and it's a great excuse to impress everyone with your tax knowledge. This is one of the few times a year when the cross-border professional can shine in everyday media. Decisions based on jurisdiction and rates may play a pivotal role in the decision making for an athlete and their agents.

Background on Cross-Border Taxation

To understand the issues we will go through the basics of cross border taxation. In the most general sense, people pay tax to a jurisdiction when they are standing there doing the work. So if a Canadian does work standing in United States (U.S.), they may have a tax liability in the United States. The currency that they are paid in is entirely irrelevant.

Of course, they are also liable for taxes in the country that they are resident in, or a citizen of, if the athlete is also a citizen of the U.S. So, a Canadian resident who works in the U.S. for some time would be liable for worldwide taxation in Canada and the U.S., based off of the allocation of their income to the time standing in the U.S. To minimize any double taxation a credit would be permitted in Canada for the amount of taxes paid to the U.S. on that U.S. income.

What makes it a little more confusing is that each State (and possibly cities) in the U.S. is a different jurisdiction, so income earned while standing in those states is possibly taxable in those states, as well. There are a number of states with no personal income tax and some states with substantial income tax. California, for example, imposes one of the highest state tax rates, and New York has a state tax and an additional city tax for any income earned while resident in Manhattan and some other cities. Ohio also has a city tax which may be an additional tax depending on where the services are performed. Some states won't tax non-residents and some states and cities have a tax only for non-resident athletes. Preparing tax returns for athletes can be time consuming and difficult by navigating through all of the rules.

The tax treaty between Canada and the U.S. provides an exemption from the above rules. If someone from the U.S. is in Canada less than 183 days and is paid from a U.S employer, they may be exempt from Canadian tax. The same goes if a Canadian resident works in the U.S. for less than 183 days in a year and is paid from a

Canadian employer. For some States this rule also applies, and for others tax must be still paid on any income allocated for services performed in their jurisdiction (California, for example).

Cross-Border Taxation Specific to Sports

In some sports the athlete is an employee of an organization, and in others they are self-employed and earn money from prize winnings or other methods. The sports that are in the news regarding free agency are ones where the athletes are an employee of the club or league (NHL, NBA, MLB, MLS, etc.).

The Canada-US tax treaty also says that athletes and entertainers are taxed differently than other individuals. There is much discussion on what is an athlete or entertainer, which is an article in itself. That Treaty says that notwithstanding that exception given to employees who are less than 183 days and their salary is paid from their country of residency, if one is an athlete or entertainer then income is back to being allocated to where you stood (or skated) when you performed your services.

However, like every good tax rule, there is an exception to the exception. If the athlete plays for a team that has regularly scheduled games in both countries (such as MLB, NHL, MLS, NBA) then that original exemption given to other salaried employees is available.

Example:

Let's say a baseball player is resident in Cleveland (not a resident of Canada) and plays for the Indians. They travel to play the Toronto Blue Jays for a certain number of days a year. The assumption is that this player is not in Canada for more than 183 days (19 inning games still count for just one day). They would normally be subject to tax allocated to their income for the days in Canada, however because they play for a team with the regularly scheduled games in Toronto, then they can use the employee exemption and as they were paid from a U.S. team they could be exempt from tax in Canada. Likewise, a Canadian resident player on the Edmonton Oilers who plays against teams in the U.S. would be exempt from taxation on their dates in the U.S., though they may be liable for state tax for some of the games. Again, this assumes the player is in the U.S. for less than 183 days so meticulous records must be kept, especially if the Oilers go very deep into the playoffs.

Where it gets more complicated is situations where, a U.S. player (not a resident of Canada) plays for a Canadian team, or a Canadian player plays for a U.S. team. For example, a U.S. player on the Toronto Raptors cannot use the exemption given to other U.S. players who play games in Canada because their pay comes from a Canadian team. So they would pay tax based on the income allocated to the days they are in Canada and worldwide tax to the U.S. (with a credit in the US for the taxes paid in Canada, to the limit of the tax in the U.S. on that same income). A Canadian resident player who plays for a U.S. team would again allocate their income for their U.S. days to the U.S. and the appropriate states/cities. They would then pay tax on their worldwide income to Canada and have a credit for the U.S. taxes paid subject to normal limitations.

This is where the planning on which contract to accept takes shape. Let's say a U.S. resident of Florida (not resident in Canada) plays on a team in Florida. They would pay tax on worldwide income to the U.S. and the state where they are resident (Florida has no personal income tax). They then allocate the income to the games/days in the other states, and are exempt for any games played in Canada by that Treaty exemption. Since half of their games would be home in Florida and they are exempt from Canadian tax on any Canadian games, they are concerned with just the allocation to the individual states such as for games played in California and New York.

Now take that same Florida resident player and say they now play for a Toronto team. There would be no exemption under the treaty and they'd allocate to Canada at least half the income for all the home games, and any other games played in Canada, and then would still play worldwide tax to the US and the various states (in this instance only a few games would be allocated to Florida for those away games)

The Canadian Tax Foundation and Americans for Tax Reform released a joint publication where they calculated for each hockey team the relative tax rate based on 2015 and some 2016 rates using a hypothetical salary. They assumed each player is resident where their team is based. Of course, that is a bold assumption and the residence of the player could mitigate or exacerbate the rates, but that would make an unwieldy number of possible rates. The chart did not take into account state taxes other than the state of residence, which could substantially affect a player's total tax obligation. Other data that may skew the results is the change in schedule from year to year, tax rates from year to year, the amount of deductions a player may have and, of course, the actual amount of their salary.

Using the above assumptions, the states with no personal income tax (Florida, Texas, Tennessee) had the lowest average rate. The California teams have the highest rate of tax, and the Canadian teams are in the top, as well. The chart is good as a baseline, but a resident of Florida playing for the Montreal Canadiens has a different worldwide tax liability than a resident of Quebec playing for the same team.

The report goes into much depth at the relative salaries that would be computed for players of various teams to equalize the net pay on a trade from a former team. The report makes note of how many limited trade clauses in contracts restrict trades to high tax teams (though that may not be the only or any reason those teams are on the list).

So when a player is choosing a number of options for their next team and if the salary is the same for all of their choices, then they may end up with more pay at a team with in a lower tax jurisdiction. If the team in the higher jurisdiction wants that player, they may have to pay more than a competing offer.

If it is a factor to the player, planning for changes in tax rates when changing teams is important in addition to the planning of their residence. One more factor affecting their net pay is how much of the deal is salary and how much is a signing bonus. Bonuses may be taxed differently than the above rules, but that is a topic for a different day.

For more information, please contact:

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