

Key US Tax Rules For Foreign Athletes And Entertainers

By **Jason Dimopoulos and Thomas Linguanti** (September 11, 2019, 3:31 PM EDT)

When Canadian women's tennis player Bianca Andreescu defeated Serena Williams in a stunning upset in the 2019 U.S. Open, she probably wasn't thinking about how that affected her taxes. But she should.

Given the growth of the sports industry not only within North America, but also internationally, it is increasingly critical that foreign athletes and entertainers become educated regarding the United States' taxation of their income.[1]

U.S. Taxation of Foreign Athletes and Entertainers

Taxation of Foreign Athletes and Entertainers as Resident Aliens

The first step in determining the U.S. taxation of a so-called "foreign" athlete or entertainer (namely an athlete that is not a U.S. citizen) is residency for tax purposes — specifically, whether the athlete or entertainer is a "resident alien" or a "nonresident alien." [2]

Resident aliens, as opposed to nonresident aliens, are subject to U.S. tax on their worldwide income.[3] Nonresident aliens, by contrast, are typically subject only to tax on income that can be "sourced" in the U.S.[4]

If a foreign athlete or entertainer is not a U.S. citizen, the athlete or entertainer is considered a resident for purposes of U.S. income tax if the athlete is (1) a lawful permanent resident or (2) satisfies the substantial presence test.[5]

Under the first test, a foreign national is a "resident alien" for taxation purposes if the individual is a "lawful permanent resident of the United States at any time during such calendar year."

Under the second test, an athlete or entertainer is deemed to satisfy the substantial presence test if they (1) were present in the United States on at least 31 days during the calendar year, and (2) the sum of the number of days on which the athlete was present in the United States during the current year and the two preceding calendar years equals or exceeds 183 days.

A lawful permanent resident of the United States is also known as a green card holder.

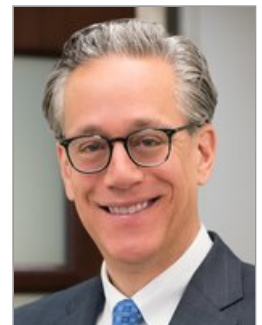
Taxation of Foreign Athletes and Entertainers as Nonresident Aliens

While U.S. citizens and resident aliens are taxed on their worldwide income, nonresident aliens are only subject to the U.S. federal income tax on certain U.S.-source income.[6] In the United States, nonresident athletes and entertainers are treated in the same manner as other nonresidents on income they earn, or is "sourced," from the United States.

The source of an athlete or entertainer's income — U.S. or otherwise — is, thus, of critical significance to nonresident aliens. While compensation for personal services conducted within the United States is generally considered U.S.-source income,[7] as a practical matter these personal



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services are frequently split between U.S. activities and foreign activities, or U.S.-source and foreign-source.

In those cases, only the percentage of income earned in the United States is U.S.-source.[8] Accordingly, a nonresident alien must determine how much of their business occurs in the United States in order to calculate what percentage of their income is taxable by the Internal Revenue Service.[9]

Pursuant to Section 861(a)(4) of the Code, gross income from U.S. sources includes, further, royalties from property located in the United States or any interest in such property, including for the use of U.S. goodwill, trademarks, trade brands and like property.

Nonresident aliens can deduct from U.S.-source gross income expenses, losses, other deductions properly apportioned or allocated thereto, and a ratable portion of deductions that cannot be definitely allocated.

Royalties paid in exchange for the license of an athlete or entertainer's name or likeness are generally not considered effectively connected with a US trade or business unless the activities of the athlete or entertainer's U.S. trade or business are a material factor in the realization of the royalty income. Thus, such royalties are typically subject to withholding at a rate of 30%.

A nonresident athlete or entertainer's income is also subject to tax if that income is considered to be effectively connected with a U.S. trade or business. Pursuant to Section 871(b) of the Internal Revenue Code, a nonresident alien engaged in a U.S. trade or business is taxable under either Section 1 or Section 55 on their taxable income that is effectively connected with the conduct of a U.S. trade or business.

Planning Opportunities for Athletes and Entertainers

With careful planning, certain foreign athletes may be able to save on taxes. One such opportunity involves foreign citizens who are currently residents of a foreign country and play a professional sport (baseball, for example) in the United States. Such athletes are potentially subject to double taxation.

These athletes, however, may be able to address this "unfair" outcome, by establishing residency in the United States and relinquishing residency in the foreign country (subject to applicable immigration laws, of course), as many foreign countries only levy taxes on their own residents. In so doing, then, they would eliminate their foreign income tax obligations and the potential for double taxation.

A second strategy, of course, is for the foreign athlete to minimize the amount of time they spend performing personal services in the United States. An athlete should take pains not to spend more than 183 days in the United States and become subject to the substantial presence test.[10]

A third means by which such an athlete (or entertainer) can minimize their taxable income arises in the context of endorsement agreements. The characterization of income earned in exchange for the performance of personal services versus income characterized as royalty income pursuant to an endorsement agreement is critical.

Athletes and entertainers can attempt to minimize the amount of tax they pay by bifurcating the portion of the income they receive pursuant to endorsement agreements in exchange for the performance of personal services from the royalty income they receive, by contrast, in exchange for the license of intangible property, which is taxed at a lesser rate.

Foreign athletes should, further, take heed of the Dec. 22, 2017, passage of the Tax Cuts and Jobs Act which affects athletes, entertainers, and owners and coaches of sports teams in several ways. While the TCJA affected athletes in several ways, a few examples follow.

First, the enactment of Code Section 199A will have implications on the taxation of pass-through partnerships, including sports teams.[11] While the new 20% deduction implemented by Section 199A is unavailable to owners of businesses that provide certain types of services, including lawyer and physician services, final regulations promulgated by the U.S. Department of the Treasury in

January clarified that partnerships that own sports franchises will be generally unable to take the Section 199A deduction.

Second, Code Section 4960, newly enacted as part of the TCJA, imposes a 21% excise tax on both "remuneration paid by an applicable tax-exempt organization for the taxable year with respect to employment of any covered employee in excess of \$1 million" and on excess parachute payments paid by such organizations.[12]

In recently promulgated interim IRS guidance, however, the IRS made clear that a state college or university that is not an applicable tax-exempt organization under Section 4960 and which employs a football or basketball coach earning more than \$1 million per year does not have to pay the 21% excise tax, provided that the college or university has not received a determination letter recognizing its tax-exempt status.

Third, the reduction of the top tax bracket from 39.6% to 37% could exacerbate the divide between the taxation of athletes, entertainers and artists in no-income tax and high-income tax states. Specifically, athletes and entertainers who are residents of high-income tax states, such as New York, will not be able to offset their lost state and local tax deductions completely. Thus, such individuals may save tens of thousands of dollars by establishing residency in a no-income tax state, such as Texas, Florida or Nevada, as opposed to a high-income tax state, such as New York.

Fourth, the new \$10,000 cap on state and local tax deductions may significantly affect the amount that athletes can deduct. While teams located in no-income tax states had an advantage in signing certain athletes over states such as California or New York even prior to the enactment of the TCJA, the cap on the state and local tax deduction only increases that advantage.

Fifth, the lost deduction for unreimbursed employee business expenses may dramatically affect athletes. Many athletes who had previously, for example, deducted their agent fees — often among athletes' biggest expenses — are now prohibited from doing so.

Takeaways

The following constitute a few key takeaways for foreign athletes and entertainers:

- Determine whether you are a resident or nonresident alien. Resident aliens are subject to U.S. tax on their worldwide income, whereas nonresident aliens are only subject to U.S. tax on their U.S.-source income.
- If you are a nonresident alien, determine what portion of your income may be U.S.-sourced considering, in part, what percentage of your business occurs in the US or is effectively connected with a US trade or business;
- Consider certain planning opportunities, including, for example, relinquishing residency in your home country to minimize taxation; and
- Consider the effects of the TCJA on the taxation of your income.

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[1] Note that this article refers only to the rules governing U.S. federal income taxation. State and local governments in the United States, by contrast, may have different rules. For example, U.S. state and local governments may have lower thresholds for the triggering of taxation and are not parties to U.S. taxation treaties.

[2] See [Internal Revenue Code Section 2\(d\)](#).

[3] See [Internal Revenue Code Section 871](#).

[4] See *id.*

[5] See [Internal Revenue Code Sections 7701\(b\)\(1\)\(A\)\(i\)-\(ii\)](#), [\(b\)\(3\)](#).

[6] See [Internal Revenue Code Section 871](#).

[7] See [Internal Revenue Code Section 861\(a\)\(3\)](#).

[8] See [Treas. Reg. Section 1.861-4\(b\)](#).

[9] [Internal Revenue Code Section 861\(a\)\(4\)](#).

[10] For U.S. tax purposes, a "day" is defined as any portion of a day. Thus, if an athlete spends one hour in the U.S. on a given day, that one hour spent constitutes a "day" for U.S. tax purposes.

[11] [Internal Revenue Code Section 199A](#).

[12] [Internal Revenue Code Section 4960](#).

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