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LEVELING THE PLAYING FIELD: A SEPARATE TAX REGIME FOR INTERNATIONAL ATHLETES

Andrew D. Appleby*

INTRODUCTION

Taxation of international athletes is a failure. The lack of a single, consistent regime results in substantial enforcement difficulties for tax administrators as well as a massive compliance burden and potential double taxation for athletes. International athletes' unique characteristics necessitate a separate tax regime. Athletes are extremely mobile and transient taxpayers and are often among the most highly compensated individuals in the world. They can earn substantial sums of money during very short periods in a particular country. And athletes often have vast freedom to decide where to reside and where to perform. The difficulties associated with international taxation of athletes receives heightened attention every couple of years due to the publicity and broad participation of the Olympics or the World Cup.¹ However, the implications of this broken tax system run very deep due to the increasing commercialization and popularity of professional sports around the globe.

The majority of high-paying professional sporting events take place in the United States and Western Europe, although several quickly-growing countries, such as Brazil and China, will likely play a larger role in the near future.² As most sports fans may expect, the New York Yankees—the evil empire—are the highest paying team in the world, with its starting players averaging \$7 million per year.³ Surprisingly, however, the second and third highest paying sports teams in the world are Spanish soccer teams—Real Madrid and Barcelona—whose starting players average over \$6 million.⁴ The British soccer team, Chelsea, is next, fol-

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1. The tax implications resurface for tax professionals and serious sports fans, at least.

2. See discussion *infra* Parts VI and VII.

3. Chris Chase, *The 10 Highest-Paid Sports Teams in the World*, Y! SPORTS BLOG (Mar. 29, 2010 11:48 AM), <http://sports.yahoo.com/blogs/post/The-10-highest-paid-sports-teams-in-the-world?urn=top,230688>.

4. *Id.*

lowed by five U.S. basketball teams rounding out the top ten.⁵ Importantly, players on these teams are citizens and residents of many different countries.

Independent athletes pose even greater tax difficulties, and their earnings can be even higher than team athletes. In 2009, Tiger Woods reached a record \$1 billion in career earnings and is a perfect example of an athlete with diverse character and sources of income.⁶ He has income “from prize money, appearance fees, endorsements, bonuses, and his golf course design business.”⁷ Further, his income comes from sources in dozens of countries. And top earning athletes are not just American. Rivaling Tiger Woods is the German Formula One driver Michael Schumacher, who had career earnings of over \$700 million by 2009.⁸

Despite the high stakes, each country has struggled to apply and adapt its own tax regime to international athletes. The tangled web of disparate and inconsistent tax systems is a nightmare for tax administrators and athletes alike. Even among countries with a treaty provision addressing athletes, there is still a crucial lack of uniformity in taxing international athletes.⁹

This Article begins in Part I with an overview of international taxation of athletes, focusing generally on bilateral tax treaties and the characterization of an athlete’s income. Parts II–VII examine how six significant countries tax international athletes: the United States, the United Kingdom, Germany, Spain, Brazil, and China. This examination principally compares each country’s withholding regimes and characterization of income.¹⁰ Part VIII presents the justifications for, and benefits of, a separate international tax regime for athletes. This Part concludes with a proposal for a regime that is simple, effective, efficient, and extremely beneficial for both tax administrators and athletes.

5. *Id.*

6. Kurt Badenhausen, *Sports’ First Billion-Dollar Man*, FORBES (Sept. 29, 2009), <http://www.forbes.com/2009/09/29/tiger-woods-billion-business-sports-tiger.html>. Due to his recent transgressions, it appears Tiger Woods’s net worth may be cut in half. But he is still young.

7. *Id.*

8. *Id.*

9. See discussion *infra* Parts II–VII.

10. Many countries require payors to withhold tax when they make a payment to ensure that the tax is collected. Countries often use withholding when it is difficult to enforce a tax liability, such as when the taxpayer is a non-resident in that country for a very short time. Thus, withholding becomes an important part of an international athlete tax regime. See discussion *infra* Parts II–VII.

I. OVERVIEW: INTERNATIONAL TAXATION OF ATHLETES

Any discussion of an international tax regime for athletes centers on bilateral tax treaties and the characterization of income. The first step, though, is to define the term “athlete.”¹¹ The terms “sportsmen” and “athlete” are effectively interchangeable and defined very broadly.¹² An athlete is “an individual who engages in some physical or mental activity which is exercised as an end in itself, usually in line with certain rules and in certain forms of organization designed specifically for it.”¹³ An athlete must actually be involved in a public performance.¹⁴ In addition to “participants in traditional athletic events,” the term athlete also covers golfers, jockeys, soccer players, cricketers, tennis players, and racing drivers.¹⁵ Thus, the broad definition of “athlete” allows countries to address these taxpayers in bilateral tax treaties.

A. *Bilateral Tax Treaties*

The taxation of athletes and entertainers is so important that most bilateral tax treaties include a provision specifically addressing them. Despite established model treaties, there is still a significant lack of uniformity amongst bilateral tax treaties. Further, the treaty network for most

11. Although athletes are often grouped with entertainers for tax treaty purposes, this Article addresses solely the taxation of athletes. Entertainers can be more difficult to define and present a different set of challenges. Further, sports are a common thread throughout the world and can unite nations unlike other forms of entertainment.

12. See ORG. FOR ECON. COOPERATION & DEV. (OECD), THIN CAPITALISATION, TAXATION OF ENTERTAINERS, ARTISTES AND SPORTSMEN ¶ 70 (1987).

13. KLAUS VOGEL ET AL., KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS: A COMMENTARY TO THE OECD, UN, AND U.S. MODEL CONVENTIONS FOR THE AVOIDANCE OF DOUBLE TAXATION OF INCOME AND CAPITAL 976, n.14 (3d ed. 1997). There is no level of professionalism required to qualify as an athlete. *Id.*

14. U.S. DEP'T OF THE TREASURY, UNITED STATES MODEL TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOV. 15, 2006, 51 (2006) [hereinafter U.S. MODEL TECHNICAL EXPLANATION]; COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV. [OECD], MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, at 224 para. 9 (2008) (condensed version) [hereinafter OECD MODEL TAX CONVENTION 2008], available at http://www.oecd.org/document/37/0,3343,en_2649_33747_1913957_1_1_1_1,00.html. The OECD is an international organization of thirty-four economically developed countries, including the United States, that focuses on economic policy matters. See OECD, *Secretary General's Report to Ministers* (2010), available at <http://www.oecd.org/dataoecd/62/12/45342482.pdf>.

15. OECD MODEL TAX CONVENTION 2008, *supra* note 14, at 223. Also included in Article 17 are those who participate in billiards, chess, and bridge. *Id.* Generally, those employed by governments will be included in the “athlete” definition. *Id.* at 226.

countries—even global trade leaders—is not comprehensive.¹⁶ Nevertheless, the core concepts underlying most bilateral tax treaties are sufficiently similar regarding the international taxation of athletes.

1. OECD Model Convention

The most widely-accepted model income tax treaty is the Organisation for Economic Co-operation and Development (“OECD”) Model Convention.¹⁷ In addition to a provision directly addressing the income of athletes, the OECD model also addresses two other pertinent income classifications: business profits and dependent personal services.¹⁸ Athletes that are not employed by a team—such as golfers—provide “independent personal services,” which treaties classify as business profits.¹⁹ Athletes that are employed by a team—such as baseball players—provide “dependent personal services.” Income from independent and dependent personal services inherently requires different treatment.²⁰ Thus, treaties utilize separate provisions to comprehensively address the taxation of business and employment income.

a. Article 7: Business Profits

Article 7 addresses the taxation of an individual’s or company’s business income. A business is subject to taxation only in its country of residence, unless it has a permanent establishment in another country.²¹ A permanent establishment is a fixed place of business or an agent acting on behalf of a nonresident.²² If a nonresident has a permanent establishment in the source country, the country in which the income is earned, the nonresident is subject to tax in that source country to the extent of business profits attributable to the permanent establishment.²³ Therefore,

16. For instance, the U.S. only has income tax treaties with approximately sixty countries, and Brazil is not one of them. See *United States Income Tax Treaties—A-Z*, IRS.GOV (May 3, 2010), <http://www.irs.gov/businesses/international/article/0,,id=96739,00.html>.

17. See Stephanie C. Evans, Note, *U.S. Taxation of International Athletes: A Re-Examination of the Artist and Athlete Article in Tax Treaties*, 29 GEO. WASH. J. INT’L L. & ECON. 297, 305–07 (1996).

18. OECD MODEL TAX CONVENTION 2008, *supra* note 14.

19. Essentially, individuals performing independent personal services are “self-employed.”

20. For example, it is much easier for an employer to withhold tax for employees performing dependent personal services because of their regular, often long-term, employment and availability of employee information.

21. OECD MODEL TAX CONVENTION 2008, *supra* note 14, art. 7.

22. *Id.* art. 5. An agent generally must have authority to bind the business as well. *Id.*

23. *Id.* art. 7, para. 2.

in the absence of an athlete-specific provision, athletes that provide independent personal services—such as golfers, runners, and tennis players—would only be taxed in the source country if they had a permanent establishment in that country.

b. Article 15: Dependent Personal Services

Article 15 addresses the taxation of an individual's employment income. In the absence of an athlete-specific provision, Article 15 would apply to athletes that perform services as employees, generally as a part of a team—such as soccer, baseball, football, and basketball players.²⁴ Employment income is taxable in the source country if the employment occurs in the source country, unless: (1) the employee is in the source country no more than 183 days in any twelve-month period; (2) the salary is paid by or on behalf of a nonresident employer; and (3) the salary is not borne by a permanent establishment or fixed base of the employer in the source country.²⁵ Therefore, many employees can avoid taxation in a foreign country even if they perform services in that country, as long as they satisfy the above requirements.

c. Article 17: Artistes and Sportsmen

Unfortunately for athletes, Article 17 eliminates most of the benefits provided in Articles 7 and 15. Under Article 17, paragraph 1, "Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as . . . a sportsman, from his personal activities as such exercised in the [source country], may be taxed in that [source country]."²⁶ Thus, non-athletes can often avoid being subject to taxation in the source country, however athletes' performance-related income will be subject to taxation in the source country.

Article 17 also has a provision that attempts to prevent "loan-out" corporations, or entities that furnish athletes' services and collect their compensation, from undermining the Article's intention.²⁷ In that regard, paragraph 2 states:

"[w]here income in respect of personal activities exercised by . . . a sportsman in his capacity as such accrues not to the . . . sportsman him-

24. *Id.* art. 15.

25. *Id.*

26. *Id.* art. 17.

27. Debra Dobray & Tim Kreatschman, *Taxation Issues Facing the Foreign Athlete or Entertainer*, 9 N.Y.L. SCH. J. INT'L & COMP. L. 265, 286–88 (1988). This Article does not focus on loan-out companies. Although they are still utilized, most countries strictly scrutinize loan-out arrangements and there is a great deal of commentary on the subject.

self but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the [country] in which the activities of the . . . sportsman are exercised.”²⁸

Regardless of whether the athlete is compensated directly or through a “loan-out” corporation, Article 17 governs and explicitly overrides Articles 7 and 15.²⁹ Therefore, an athlete’s personal service income, “whether accruing to the athlete or to another entity, is attributed to and taxed in the country where the personal services were performed or exercised—the source country.”³⁰

The source country can tax only the athlete’s “earnings derived from performances in the source country.”³¹ For example, if an athlete receives a salary, the source country may only tax the income that is properly allocable to that source country.³² There are a variety of allocation methods and imperfect information exchange, which makes allocation difficult in many situations. Whether an athlete’s income is related to his athletic performance and falls under Article 17 or is not related to his athletic performance and falls under a different Article depends on the characterization of the income. Thus, characterization of income is crucial for athletes in the treaty context, and for several other reasons discussed in Part I.B.

2. United States Model Income Tax Convention

In 1945, the U.S. first adopted an “Artiste and Athlete” provision in a tax treaty with the U.K.³³ However, the U.S. dropped the provision due to the Senate Foreign Relations Committee’s concerns that the “Athlete” provision discriminated against a small group of individuals.³⁴ Eventually, the U.S. overcame these concerns and included an “Artiste and Athlete” provision in a subsequent U.S.-U.K. Treaty and in the U.S. Model Income Tax Convention, now Article 16.³⁵ The adoption of an “Artiste

28. OECD MODEL TAX CONVENTION 2008, *supra* note 14, art. 15, para. 2.

29. *Id.* at 223, para. 1; *see also* Evans, *supra* note 17, at 309.

30. Evans, *supra* note 17, at 309 (citing OECD MODEL TAX CONVENTION 2008).

31. *Id.* (citing OECD MODEL TAX CONVENTION 2008).

32. As another example, if an American golfer were to win a tournament in the U.K., and earned no other income in the U.K., the U.K. could tax only the golfer’s winnings from that tournament.

33. Dennis Ardi, *Tax Planning for Foreign Entertainers Who Perform Within the United States*, 32 TAX LAW 349, 372–73 (1978–1979).

34. *Id.* Congress thought the “Athlete” provision was discriminatory because it treated a small group of taxpayers differently than taxpayers at large. *Id.*

35. Convention, Income Tax, U.S.-U.K., Dec. 31, 1975, 31 U.S.T. 5668; *see also* Ardi, *supra* note 33, at 374. The first U.S. treaty to incorporate an “Athlete” provision was between the U.S. and Trinidad & Tobago in 1970. Evans, *supra* note 17, at 311–12.

and Athlete” provision that specifically denies athletes favorable tax treatment reflects the U.S. belief that some athletes “took advantage of the interaction of the treaty and domestic tax rules to avoid taxation” in both the source and residence countries.³⁶

The U.S. overcame the aforementioned discrimination concerns by implementing an income threshold for the Article 16 “Artiste and Athlete” provision.³⁷ Thus, Article 16 only applies to an athlete if he earns above the threshold amount, which differs depending on the other contracting country, but is currently \$20,000 in the U.S. Model Treaty.³⁸ Aside from the income threshold, Article 16 in the U.S. Model Treaty functions in essentially the same way as Article 17 in the OECD Model Treaty.

3. Multilateral Tax Treaties

A global, multilateral tax treaty is the ideal resolution of the double tax problem.³⁹ Although multilateral tax treaties are exceedingly rare, the OECD recognizes that such an agreement may be possible for “particular purposes.”⁴⁰ In the past, multilateral tax treaties have either focused on a region with common interests or a specific area of taxation. For example, five Scandinavian countries formed the Nordic Convention on Income

36. Evans, *supra* note 17, at 313 (citing Bennett Susser, Note, *Achieving Parity in the Taxation of Nonresident Alien Entertainers*, 5 CARDOZO ARTS & ENT. L.J. 613, 614–15 (1986)).

37. The threshold “reflects the view that cultural exchanges should be encouraged, and that . . . athletes should not be singled out for special adverse tax treatment.” Bennett Susser, Note, *Achieving Parity in the Taxation of Nonresident Alien Entertainers*, 5 CARDOZO ARTS & ENT. L.J. 613, 632 (1986).

38. U.S. DEP’T OF THE TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF NOV. 15, 2006, 1. Tax Treaties (CCH) art. 16 (2006). For threshold calculation purposes, income includes all expenses that are reimbursed such as travel and lodging. Further, once the threshold is met, all income falls under the “Artiste and Athlete” provision, not just the income above the threshold. U.S. DEP’T OF THE TREASURY, TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS art. 17 (Dec. 1, 1983), available at <http://www.irs.gov/pub/irs-trty/uktech.pdf>.

39. See DANIEL SANDLER, THE TAXATION OF INTERNATIONAL ENTERTAINERS AND ATHLETES 347 (1995); Evans, *supra* note 17, at 305 (citing David M. Hudson & Daniel C. Turner, *International and Interstate Approaches to Taxing Business Income*, 6 NW. J. INT’L L. & BUS. 562, 563 (1984)). The double tax problem arises when two or more countries each tax the same income.

40. OECD MODEL TAX CONVENTION 2008, *supra* note 14, at I-12. Multilateral tax treaties are rare because it is extremely difficult for countries with conflicting interests and policies to reach an agreement.

and Capital, and eight Caribbean countries formed a broad multilateral income tax convention.⁴¹ In contrast, the countries of the European Union have entered into an agreement addressing transfer pricing, and the countries of the EU and OECD—including the U.S.—have entered into an agreement for mutual administrative assistance, called the Convention on Mutual Administrative Assistance in Tax Matters (“MAAT”).⁴² Thus, a multilateral tax treaty is feasible if it focuses on a targeted area of taxation.

B. Characterization of Income

Athletes often earn many different types of income, “the characterization and source of . . . [which] can pose considerable difficulties.”⁴³ Characterization of income is crucial for athletes because different types of income are taxed differently under treaties and often at very different rates depending on the taxing country. Further, the definition of domestic-source income varies from country to country and is affected by the characterization of the income.⁴⁴

Before comparing how various countries characterize income, it is useful to begin with general treaty characterization principles. Whether an athlete’s income falls under the Athlete provision, Article 16 in the U.S. Model Treaty and Article 17 in the OECD Model Treaty, depends on the extent to which the income is connected with the athlete’s actual performance.⁴⁵ Each model treaty uses a different standard to determine when income is sufficiently connected with the athlete’s actual performance. Under the OECD Model, Article 17 applies if there is a “direct link” be-

41. Convention Between the Nordic Countries for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital, Mar. 22, 1983, 135 U.N.T.S. 245 (amended Sept. 23, 1996, 98 TAX NOTES INT’L (TA) 9–25); Agreement Among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, Profits, or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment, July 6, 1994, 95 TAX NOTES INT’L 235–37.

42. Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises 1990 O.J. (L 225) 10; Council of Europe—OECD Convention on Mutual Administrative Assistance in Tax Matters, June 28, 1989, S. Treaty Doc. No. 6, 101st Cong., 1st Sess. (1989).

43. See Ralph Winnie Jr., *A Separate International Tax Regime for Nonresident Athletes*, 95 TAX NOTES INT’L 69, 70 (2005).

44. See *id.* at 70.

45. OECD MODEL TAX CONVENTION 2008, *supra* note 14, art. 17; U.S. DEP’T OF THE TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION, 1 Tax Treaties (CCH) art. 16 (Nov. 15, 2006).

tween the income and the athlete's public exhibition.⁴⁶ Under the U.S. Model, Article 16 will apply if the income is "predominantly attributable to the performance itself."⁴⁷ However, determining whether an athlete's income is connected with the athlete's performance is only the first step. The income must also be characterized, generally as personal service income or royalty income.⁴⁸

1. Actual Performance Income

The first classification of income covers compensation for an athlete's actual performance of personal services. This classification includes "all income connected with a performance by the entertainer, such as appearance fees, award or prize money, and a share of the gate receipts."⁴⁹ The text of both model treaties limits Article 16/17 to an athlete performing services in his capacity as an athlete.⁵⁰ Thus, if an athlete were performing personal services as a banker or security guard, for instance, Article 16/17 would not apply. Likewise, if an event organizer cancels the event, any cancellation fee paid to the athlete falls outside Article 16/17 and instead falls under the personal services provisions in Articles 7 or 14/15.⁵¹ Additionally, where an individual is performing a dual-role, such as a player-coach, both the OECD and U.S. Models apportion the income from the activities.⁵²

2. Endorsement, Image Rights & Sponsorship Income

In addition to income from actually performing in athletic events, athletes usually receive endorsement or image rights income and sponsorship income.⁵³ An athlete earns endorsement income when a manufacturer pays the athlete to use his name or image to promote or advertise the manufacturer's products.⁵⁴ Outside the U.S., endorsement income is generally referred to as image rights income.⁵⁵ An athlete earns sponsorship

46. OECD MODEL TAX CONVENTION 2008, *supra* note 14, at 224 para. 9.

47. U.S. MODEL TECHNICAL EXPLANATION, *supra* note 14, at 51.

48. *See id.*

49. *Id.*; OECD MODEL TAX CONVENTION 2008, *supra* note 14, 224 para. 9.

50. *See* sources cited *supra* note 49.

51. OECD MODEL TAX CONVENTION 2008, *supra* note 14, at 224 para. 9; U.S. MODEL TECHNICAL EXPLANATION, *supra* note 14, at 52.

52. *See* sources cited *supra* note 51. If one of the roles is negligible, it will be disregarded. *Id.*

53. *See* OECD MODEL TAX CONVENTION 2008, *supra* note 14, 224 para. 9.

54. BIM50610—Athletes: Athlete's Sources of Income, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/manuals/bimmanual/BIM50610.htm> (last visited Feb. 25, 2011); *see also id.*

55. *See* sources cited *supra* note 54.

income when a company pays the athlete to display the company's name or logo while the athlete is performing.⁵⁶

Under the OECD, endorsement, image rights, or sponsorship income, "which is related directly or indirectly to performances or appearances" in a given country, falls within Article 17 as income derived from personal activities as a sportsman.⁵⁷ If the income is not directly or indirectly related to a performance but is still considered personal service, the income will fall under Articles 7 or 15.⁵⁸ If the income is simply from licensing intellectual property, these royalties generally fall under OECD Article 12, which allocates all the income to the country of residence.⁵⁹

Regarding the U.S. Model, its Technical Explanation provides two examples of endorsement and sponsorship income that are predominantly attributable to the performance itself. First, a "fee paid to a performer for endorsement of a performance in which the athlete will participate . . . [is] so closely associated with the performance itself that it normally would fall within Article 16 [of the U.S. Model]."⁶⁰ Second, "a sponsorship fee paid by a business in return for the right to attach its name to the performance would be so closely associated with the performance that it would fall under Article 16 as well."⁶¹ However, as with the OECD, if the endorsement or sponsorship income is not predominantly attributable to the performance itself, the income will fall under Articles 7, 12, or 14 of the U.S. Model Treaty.

3. Signing Bonus Income

A signing bonus is a payment made to an athlete upon joining a team.⁶² Different countries characterize and allocate signing bonus income using very different rules. Signing bonuses can be characterized as payment for entering into a non-compete agreement, as payment for services previously rendered, or as payment for services to be rendered in the future. Each of these types of income can be taxed differently. Additionally, several countries—such as the U.S. and Canada—have had great internal difficulty characterizing signing bonus income.⁶³ Thus, athletes often

56. *Id.*

57. *Id.*

58. *Id.*

59. OECD MODEL TAX CONVENTION 2008, *supra* note 14, art. 12.

60. U.S. MODEL TECHNICAL EXPLANATION, *supra* note 14, at 51.

61. *Id.*

62. GUIDE ON SPORTSPERSON TAXATION IN CERTAIN RELEVANT JURISDICTIONS 144 (Félix Plaza Romero ed., 2008) [hereinafter GUIDE ON SPORTSPERSON TAXATION].

63. See discussion *infra* Part II.B.3.

have diverse types of income, which countries can characterize and tax in very different ways.

II. UNITED STATES: TAXATION OF INTERNATIONAL ATHLETES

The United States is the pinnacle of professional sports. The U.S. produces the bulk of the world's best athletes and hosts most of the world's top professional leagues and sporting events.⁶⁴ The U.S. is home to top professional leagues and events in tennis, golf, baseball, football, basketball, auto racing, horse racing, soccer, poker, boxing, mixed martial arts, and more. These unparalleled opportunities attract many of the best athletes from around the world, and generate exorbitant amounts of income. Thus, the IRS and U.S. Treasury continually target athletes for tax examinations, and created the Project on Foreign Athletes and Entertainers ("FAE") in 2008 to focus on athletes' tax compliance.⁶⁵ Because of these professionals' potentially high income and transient nature, the IRS plans to continue its strict scrutiny of foreign athletes.⁶⁶

The U.S. taxes its citizens and resident aliens on their worldwide income, regardless of the geographical source.⁶⁷ The U.S. generally taxes nonresident aliens only on their U.S.-source income; however, U.S.-source income that is effectively connected with a U.S. trade or business will be taxed differently than income that is not connected at all with a U.S. trade or business.⁶⁸ Further, the U.S. utilizes a foreign tax credit system to reduce double-taxation for its citizens and residents; however, the system has various limitations.⁶⁹ Thus, the U.S. tax regime is compli-

64. See, e.g., Jonah Freedman, *The 50 Highest-Earning American Athletes*, SI.COM (Jan. 10, 2011), <http://sportsillustrated.cnn.com/specials/fortunate50-2010/index.html>. In another potential twist, sovereign Indian Tribes in the U.S. often host professional sporting events such as boxing, mixed martial arts, and women's basketball. See Drew K. Barber, *The Power of Indian Tribes to Tax the Income of Professional Athletes and Entertainers Who Perform In Indian Country*, 41 CONN. L. REV. 1785 (2009).

65. I.R.S. & U.S. DEP'T OF TREASURY, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE 1, 75 (2007), available at http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

66. *IRS Focus on Foreign Athletes & Entertainers*, IRS.GOV (May 3, 2010), <http://www.irs.gov/businesses/small/international/article/0,,id=176176,00.html>

67. See SANDLER, *supra* note 39, at 149.

68. See discussion *infra* Part II.A.2.

69. See I.R.C. §§ 901–908 (2010). Under a foreign tax credit system, a country gives its citizens and residents a credit against their domestic tax liability for tax paid to a foreign jurisdiction. For a discussion of the application of the foreign tax credit to athletes, see Carole C. Berry, *Taxation of U.S. Athletes Playing in Foreign Countries*, 13 MARQ. SPORTS L. REV. 1, 11–25 (2002).

cated for athletes and hinges on both residency and the characterization of income.

A. Taxation of Nonresident Athletes

The U.S. taxes various foreign athletes differently depending on whether there is a treaty in place with the athlete's country of residence.⁷⁰ When there is no treaty in place, the Internal Revenue Code ("I.R.C.") governs the tax treatment of the foreign athlete and is much more complex than the tax codes of other countries.⁷¹ Under the I.R.C., an athlete's tax liability depends on various factors, including residency, connection to a U.S. trade or business, and strict withholding.

1. Definition of Nonresident

The decisive first step is to determine whether the foreign athlete is a resident or nonresident alien under the I.R.C. This determination often results in vastly different tax consequences for the athlete. A foreign individual qualifies as a resident if the individual satisfies either one of two tests: the "Permanent Residency Test" or the "Substantial Presence Test."⁷² Under the "Permanent Residency Test," any foreign individual who applies for an alien registration card (a green card) during the calendar year is a resident alien for tax purposes.⁷³ Under the "Substantial Presence Test," any foreign individual is a resident alien for tax purposes if the individual is present in the U.S. for at least: (1) thirty-one days during the calendar year, and (2) a total of 183 days or more during the current year and two preceding calendar years combined.⁷⁴

The U.S. does provide an important exception to the aforementioned residency rule to encourage athletes to participate in charitable events.⁷⁵ A professional athlete's time spent competing in a "charitable sports event" does not count as time spent in the U.S. when calculating the "Substantial Presence Test."⁷⁶ Many U.S. tour events contribute their profits to charities or have charitable status themselves—such as the U.S.

70. See generally I.R.C. §§ 901–908.

71. See *id.*

72. I.R.C. § 7701.

73. I.R.C. § 7701(b)(1)(A)(i). This test is also known as the Green Card Test.

74. I.R.C. §§ 7701(b)(1)(A)(ii), (b)(3). There is also an exception where the foreign athlete can qualify as a nonresident if he was present in the U.S. for less than 183 days during the taxable current year and can establish a "tax home" in a foreign country with which he had a closer connection than with the U.S. I.R.C. § 7701(b)(3)(B).

75. Winnie, *supra* note 43, at 71.

76. See I.R.C. §§ 274(l)(1)(B), 7701(b)(5)(A)(iv) for definition of "charitable sports events."

Golf Association and U.S. Tennis Association—thus enabling foreign athletes to avoid resident status under the “Substantial Presence Test.”⁷⁷ If the foreign individual meets neither of the two tests and has not elected resident treatment, the individual is a nonresident alien for tax purposes.

2. Taxable Income of a Nonresident

The U.S. taxes resident aliens on their worldwide income, regardless of source, in essentially the same way as U.S. citizens. However, the U.S. taxes nonresident aliens much differently.⁷⁸ Nonresident aliens are taxed in two ways: on U.S.-source income that is effectively connected with a trade or business and U.S.-source income that is not effectively connected with a trade or business. Income that is effectively connected with a U.S. trade or business is taxed, after deductions, at the same graduated rates applicable to U.S. citizens and resident aliens.⁷⁹ Performance of personal services in the U.S., either as an employee or independent contractor, is considered a U.S. trade or business.⁸⁰ Related income—such as salary, fees, wages, compensation, bonuses, and prize winnings—is, thus, effectively connected with a U.S. trade or business and is U.S.-source income.⁸¹ This income is subject to tax at progressive rates that peak at 35%.⁸²

However, income that is not effectively connected with a U.S. trade or business is taxed at a final flat rate of 30% on the total amount of gross income.⁸³ Generally, passive investment income falls into this category and is subject to the flat withholding tax.⁸⁴ Naturally, nonresidents are not subject to U.S. taxation on non-U.S. source income.

77. Victor Abrams et al., *International Taxation of Entertainers and Athletes: Report by Organization for Economic Cooperation and Development Spotlights the Area*, 10 ENT. L. REP. 3, 8 (1988).

78. See, e.g., I.R.C. §§ 871, 906.

79. I.R.C. § 871(b)(1). Deductions that are related to both a U.S. trade or business and a non-U.S. trade or business may be apportioned. I.R.C. § 873(a). Of course, the athlete will need to file a tax return to claim deductions. See SANDLER, *supra* note 39, at 157.

80. I.R.C. §§ 864(b), 861(a)(3).

81. See I.R.C. § 871(b)(1). However, there is a *de minimis* exception where this income is not taxable in the U.S. if the nonresident alien was temporarily present in the U.S. for less than ninety total days during the taxable year and earned gross U.S.-source service income of less than \$3,000 during the taxable year. See I.R.C. §§ 864(b), 861(a)(3). Additionally, if the nonresident performs services for a non-U.S. employer, the income is not effectively connected with a U.S. trade or business. I.R.C. § 861(a)(3).

82. I.R.C. § 1(i)(2).

83. I.R.C. § 871(a).

84. Income that is not effectively connected with a U.S. trade or business generally falls into the category of Fixed, Determinable, Annual, or Periodical (“FDAP”) income.

3. Withholding

The U.S. requires that tax be withheld on all income paid to nonresidents for their personal services,⁸⁵ however the withholding rate depends on whether the nonresident is an employee or independent contractor. If the nonresident is an employee, the employer must withhold at ordinary graduated rates just like it does for U.S. employees.⁸⁶ However, if the nonresident is an independent contractor, the payor must withhold at a flat 30% rate.⁸⁷ The IRS strictly enforces the withholding of nonresident athletes' income even if the income may be exempt from U.S. taxation under the code or a treaty.⁸⁸

4. Treaties

As mentioned above, the U.S. has an income threshold for the Athlete article in its treaties.⁸⁹ This threshold complicates matters because it is often impossible to determine if an athlete will exceed the threshold until the end of the year. If the athlete exceeds the income threshold he will be taxed under the treaty, but if the athlete does not exceed the income threshold he will be taxed under the I.R.C. Thus, the source country can withhold and later refund the tax if applicable, however, this treatment necessitates that the athlete file a tax return, sometimes in several different countries.

B. Characterization of Income

After the complex residency determination is complete, the athlete must next determine the character of his income. The U.S. has struggled with characterizing athletes' income for at least fifty years.⁹⁰ In 1994, the IRS issued a Market Segment Study on Foreign Athletes and Entertainers, which provides roughly three hundred pages of guidance regarding

See Fixed, Determinable, Annual, Periodical (FDAP) Income, IRS.GOV (Nov. 17, 2010), <http://www.irs.gov/businesses/small/international/article/0,,id=96404,00.html>.

85. *See* I.R.C. § 1441(a).

86. *See* I.R.C. § 3121(d).

87. I.R.C. § 1441(a). For independent personal service income that is effectively connected with a U.S. trade or business, the withholding tax is not final and the nonresident can file a tax return to claim deductions.

88. *See* I.R.S. & U.S. DEP'T OF TREASURY, WITHHOLDING TAX ON NONRESIDENT ALIENS AND FOREIGN ENTITIES 1, 6 (2010).

89. *See* discussion *supra* Part I.A.1.c.2.

90. The cases below, such as the *Armour* case from the 1950s, illustrate this difficulty. *See* discussion *infra* Part II.B.2.

income characterization, ultimately recognizing that there is no “clear cut” answer.⁹¹

1. Athletic Performance Income

There is generally little controversy over characterizing personal service income for athletic performances. The difficulty lies with allocating the income if the athlete performs in multiple countries. Personal service income is sourced where the performance takes place.⁹² If an athlete is employed by a team and performs both inside and outside the U.S., the performance income “must be allocated and apportioned between U.S. and foreign sources of income.”⁹³ The “allocation is generally based on the number of days that the athlete is present in the U.S.”⁹⁴

2. Endorsement & Sponsorship Income

Endorsement and sponsorship income pose a challenge as they can be characterized as either royalties or personal service income. The U.S. taxes and sources these types of income in a very different manner. Royalty income earned by nonresidents is not effectively connected with a U.S. trade or business and is, thus, subject to a final 30% gross withholding tax.⁹⁵ Additionally, absent a treaty, royalties are sourced in the place of use.⁹⁶ Allocating royalty payments based on place of use can be difficult. The athlete’s contract may specify an allocation, although that is unlikely to completely satisfy the IRS. Depending on the circumstances, royalty income can also be allocated based on percentage of gross product sales or advertising expenses in the U.S. compared to total global sales or expenses, or based on the number of days the athlete plays in the U.S. compared to days played abroad.⁹⁷ On the other hand, as stated above, personal service income is taxed on a net basis at graduated rates and sourced in the place of performance.⁹⁸

91. See generally I.R.S. MARKET SEGMENT STUDY ON FOREIGN ATHLETES AND ENTERTAINERS (Training 3153-102 (10-94); TPDS 83777C) 95 TAX NOTES INT’L 3-41 (1994) [hereinafter I.R.S. MARKET SEGMENT STUDY].

92. I.R.C. § 861(a)(3).

93. See SANDLER, *supra* note 39, at 153; Winnie, *supra* note 43, at 72.

94. Treas. Reg. § 1.861-4(b) (2000); see also SANDLER, *supra* note 39, at 153; Winnie, *supra* note 43, at 72.

95. See GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 145.

96. I.R.S. § 861(a)(4). Under the U.S. Model Treaty, royalties are sourced to the country of residence.

97. See I.R.S. MARKET SEGMENT STUDY, *supra* note 91, at 39-40, 50.

98. I.R.C. § 861(a)(3).

Characterizing income as royalty or personal service requires a factual analysis. Royalties are generally based on the use of an athlete's name, likeness, or signature.⁹⁹ If the income is based on a percentage of sales, the income is generally a royalty.¹⁰⁰ If the athlete is required to perform services—such as acting in a commercial or making a public appearance—the income is generally personal service.¹⁰¹ However, endorsement contracts often include elements of both, and thus, require an analysis of the athlete's degree of active participation to determine the correct character of the income. Both the language of the contract and the underlying substance of the transaction must be evaluated.¹⁰²

If an endorsement contract includes compensation for both future royalties and future personal services, the compensation must be apportioned between the two.¹⁰³ If there is a lump sum payment at the beginning of the contract, it will be apportioned based on the apportionment of the first year's compensation under the contract.¹⁰⁴

Two Tax Court cases addressed whether an endorsement payment was royalty or personal service income. In *Thomas D. Armour*, a golfer licensed his name to a golf ball maker, and the Tax Court held that the income was a royalty.¹⁰⁵ In *Kramer*, a manufacturer paid a tennis player to use his name for the sale of tennis equipment.¹⁰⁶ However, under the endorsement/sponsorship contract, the player also agreed to wear the tennis company's logo during matches and to make promotional appearances.¹⁰⁷ In this particular situation, the Tax Court allocated 70% of the income to royalties and 30% to personal services.¹⁰⁸

In 1999, the IRS released a Technical Advice Memorandum that evaluated the characterization and allocation of endorsement income.¹⁰⁹ Essentially, endorsement income is personal service income if it is "closely and proximately related" to the athlete's U.S.-based performance.¹¹⁰ The IRS gives two examples on this subject. In the case of a golfer, endorsement payments for him to drive a particular type of car and appear at auto dealerships is not related to the golfer's performance, whereas wearing

99. I.R.S. Rev. Rul. 81-178, 1981-2 C.B. 135 (1981).

100. See Winnie, *supra* note 43, at 81.

101. *Id.*

102. See *Boulez v. Comm'r*, 810 F.2d 209 (D.C. Cir. 1987).

103. See I.R.S. Field Serv. Adv. 199947028, 1999 WL 1065269 (Nov. 26, 1999).

104. See *id.*

105. See *Thomas D. Armour v. Comm'r*, 22 TC 181 (1954).

106. *J. A. Kramer v. Comm'r*, 80 TC 768, 770 (1983).

107. *Id.*

108. *Id.* at 783.

109. I.R.S. Tech. Adv. Mem. 199938031 (July 30, 1999).

110. *Id.* Thus, the income would fall under the athlete provision of U.S. treaties.

a corporate logo on his visor during a tour event is related to his performance.¹¹¹ In the case of a tennis player, endorsement payments for the use of his name or likeness on store displays is not related to the tennis player's performance, whereas using a certain type of racket is related to his performance.¹¹² The IRS also recognized that it may require examining comparable third-party contracts to allocate between personal service and royalty income.¹¹³ Although the IRS has provided some guidance, properly characterizing endorsement and sponsorship income is still challenging and uncertain.

3. Signing Bonus Income

The U.S. has struggled mightily with characterizing and allocating signing bonus income. Generally, a payment is signing bonus income if it is consideration for signing a contract and is not based on previously rendered services.¹¹⁴ Otherwise, the income is likely personal service income and will result in different tax treatment.

The controversy surrounding signing bonuses began when the U.S. withheld tax when a Venezuelan baseball player signed a minor-league contract with a U.S. club to play for a Latin American team.¹¹⁵ International soccer players challenged the tax treatment and the IRS issued a controversial Revenue Ruling.¹¹⁶ The IRS initially concluded that an agreement that does not require a player to perform any services is essentially a covenant not to compete and that the bonus is consideration for the non-compete agreement.¹¹⁷ Because the bonus is not compensation for personal services performed and not effectively connected with a U.S. trade or business, the U.S. portion of the gross bonus income is subject to a flat 30% U.S. withholding tax.¹¹⁸

The IRS later retracted its position regarding the Venezuelan player and issued perplexing guidance. The IRS distinguished the Latin American baseball players' contracts from the international soccer players'

111. *Id.* at 11.

112. *Id.* at 12.

113. *Id.*

114. *See* Winnie, *supra* note 43, at 72.

115. *See* I.R.S. Chief Counsel Advisory 200219011, 2002 WL 968661 (May 10, 2002).

116. I.R.S. Rev. Rul. 74-108, 1974-1 C.B. 248 (1974).

117. *Id.*

118. Winnie, *supra* note 43, at 72. The apportionment of the bonus income between U.S. and foreign sources must be reasonable under the circumstances. I.R.S. Rev. Rul. 74-108, 1974-1 C.B. 248 *supra* note 116. The apportionment for a non-compete agreement will be based on where the athlete gave up the right to play for another team. *See* Winnie, *supra* note 43, at 81.

contracts based on *when* the signing bonus was paid.¹¹⁹ If the bonus was paid before the player had entered into an employment agreement, as was the case with the soccer players, the payment was an inducement to sign and thus consideration to enter into a non-compete agreement.¹²⁰ If the bonus was paid after the player had entered into an employment agreement, it was not a true signing bonus but, rather, advance payment for personal services.¹²¹ In 2004, the IRS revoked the Revenue Ruling and now essentially all signing bonuses are considered wages, which are personal service income.¹²² If a payment is made “in connection with the establishment of the employer-employee relationship,” the payment will be taxed as wages.¹²³ Although it took the U.S. thirty years, it now has a clear and logical position regarding signing bonus characterization. The difficulty characterizing signing bonus income was a result of the complexities of the U.S. tax regime. Many other countries have not struggled to characterize signing bonus income, but they have complexities and difficulties of their own.

III. UNITED KINGDOM: TAXATION OF INTERNATIONAL ATHLETES

The United Kingdom is also an established leader in professional leagues and sporting events. The U.K. is home to some of the best professional soccer leagues in the world, and hosts world-class events in tennis, golf, cricket, rugby, and polo.¹²⁴ Like the U.S., the U.K. faced tax compliance difficulties regarding athletes.¹²⁵ In 1986, the U.K. implemented a withholding regime for athletes because the country felt it was losing substantial tax revenue, estimated at upwards of £75 million annually.¹²⁶

119. See I.R.S. Chief Counsel Advisory 200219011, *supra* note 115.

120. *Id.*; see also *Linseman v. Comm’r*, 82 T.C. 514, 523 (1984).

121. I.R.S. Chief Counsel Advisory 200219011, *supra* note 115. Thus, the income should be allocated based on the location of the teams games. *Id.*

122. See I.R.S. Rev. Rul. 2004-109, 2004-2 C.B. 958 (2004). It is important to note that this Revenue Ruling is not retroactive, and thus only applies to employment agreements entered into after Jan. 12, 2005. *Id.*

123. *Id.* It is interesting to compare the U.S. treatment of signing bonus income with that of Canada, where signing bonuses are Canadian income for the athlete if the payment was deductible by a Canadian taxpayer. Income Tax Act R.S., 1985, c.1 (Can.).

124. Most notably, the U.K. is home to the Premier League, Wimbledon, and the British Open.

125. See generally SANDLER, *supra* note 39.

126. See SANDLER, *supra* note 39, at 121. The U.K. also created a separate Foreign Entertainers Unit (“FEU”) to administer tax law for athletes and entertainers. *Id.* at 122.

A. Taxation of Nonresident Athletes

The U.K. generally taxes its residents on their worldwide income and nonresidents only on U.K. source income.¹²⁷ The U.K. admittedly treats nonresident athletes differently than resident athletes, and even nonresidents in general. Further, athletes who are residents but are not domiciled in the U.K., face different taxation.¹²⁸ Generally, the U.K. will only tax its non-domiciled residents on foreign income and capital gains on a remittance basis—that is, only income that is remitted to the U.K.¹²⁹ However, the 2008 Finance Bill limited this beneficial tax treatment.¹³⁰ Under the new law, if an individual is a non-domiciled resident for seven of the past nine years, the individual must pay an annual £30,000 fee in addition to tax on any income remitted to the U.K.¹³¹

1. Definition of Nonresident

The U.K. classifies individuals as residents if they either: (1) spend 183 days or more in a taxable year in the U.K., or (2) visit the U.K. regularly and spend, on average, at least 91 days per year in the U.K. (evaluated over a four year period).¹³² Under the second test, if the individual intends to spend at least 91 days per year in the U.K., the individual will be a resident starting in the first tax year. If not, the individual will only become a resident when he has satisfied the test in the past four years, thus becoming a resident in the fifth tax year.¹³³ As in the U.S., it is sometimes beneficial for an athlete to be considered a resident instead of

127. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 129–32; *see also* HM REVENUE & CUSTOMS, FEU50: A GUIDE TO PAYING FOREIGN ENTERTAINERS (Mar. 2000) [hereinafter GUIDE TO PAYING FOREIGN ENTERTAINERS], *available at* <http://www.hmrc.gov.uk/leaflets/feu.htm>.

128. *See generally* HM REVENUE & CUSTOMS, RESIDENCE, DOMICILE, AND THE REMITTANCE BASIS (Dec. 2010, pt. 5 rev. Feb. 2010), *available at* <http://www.hmrc.gov.uk/cnr/hmrc6.pdf>.

129. *See id.* Thus, non-domiciled residents avoid worldwide taxation imposed on residents generally.

130. Finance Act, 2008, c.9, § 809 (Eng.); *see generally* GUIDE ON SPORTSPERSON TAXATION, *supra* note 62.

131. Finance Act, 2008, c.9, § 809 (Eng.); GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 129–35.

132. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 134–35. Recently the U.K. changed its law, that determines the number of days spent in the country. Under the new law, an individual is considered present in the U.K. for each day where the individual was present in the U.K. at midnight. HM REVENUE & CUSTOMS, 2008 BUDGET NOTE 102 (Mar. 12, 2008), *available at* <http://www.hmrc.gov.uk/budget2008/master-notes.pdf>; GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 135.

133. *See sources cited supra* note 132.

a nonresident.¹³⁴ Thus, tax planning opportunities for athletes are abundant in both the U.S. and the U.K.

2. Taxable Income of a Nonresident

The U.K. has a schedular income tax system, thus, all income must be traced to a specific type of source to determine the extent of taxation. Generally, the income of athletes who play for a team will be classified as employment income, while the income of independent athletes will be classified as self-employed “trade or profession” income.¹³⁵ Trade or profession income is generally subject to lower social security taxes and more generous business expense deductions.¹³⁶ Income that in any way derives, directly or indirectly, from the performance of the athletic activity is included as trade or profession income.¹³⁷ Both employment income and self-employed trade or profession income are generally subject to progressive rates that currently peak at 40%, but may rise to 50% in the next few years.¹³⁸

3. Withholding

In the U.K., tax is withheld on employment income under a Pay As You Earn system.¹³⁹ However, no tax is generally withheld on self-employed trade or profession income, which often allowed athletes to avoid tax in the U.K.¹⁴⁰ In response, the U.K. enacted a notoriously expansive withholding tax regime for nonresident athletes.¹⁴¹ The U.K. requires that a flat tax of the basic rate, currently 20%, be withheld from any payment made to a nonresident athlete in connection with any U.K. performance.¹⁴² The U.K. applies this withholding regime very broadly,

134. See GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 137, 149.

135. *Id.* at 130. Employment income falls under Schedule E, while self-employment income falls under Schedule D. SANDLER, *supra* note 39, at 129.

136. SANDLER, *supra* note 39, at 127–28; GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 130–35. For a list of relevant deductions, see SANDLER, *supra* note 39, at 130.

137. SANDLER, *supra* note 39, at 129; *see also* Income and Corporation Taxes Act 1988 § 557. Further, the athletic activities form a distinct trade or profession for the athlete which can limit deduction offsets. *See* SANDLER, *supra* note 39, at 129.

138. *See, e.g.*, PAUL KRUGMAN, ROBIN WELLS & KATHRYN GRADDY, *ECONOMICS EUROPEAN EDITION* 518–19 (2007); *see also* Andres Bazo, *A Proposal for the Taxation of Athletes*, 56 TAX NOTES INT'L 35 (2009). Not long ago, the rate peaked at 60%.

139. *See* SANDLER, *supra* note 39, at 132–33.

140. *Id.* at 132–33, 136.

141. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 130–31.

142. *Id.* at 131. The withholding applies to any payments made to nonresident loan-out companies as well. *Id.* Further, the athlete’s performance and image rights are likely subject to the Value Added Tax (“VAT”). VAT is essentially a sales tax that is imposed at

as “[a]ny payer who makes a payment to any person, which in any way arises directly or indirectly from a UK appearance by a non resident entertainer must deduct tax at the basic rate.”¹⁴³ The withholding is not a final tax, but it is uncommon for athletes to file a tax return.¹⁴⁴ The marginal tax rate is likely much higher than the withholding rate and the U.K. has no other means to enforce compliance except through a withholding regime.¹⁴⁵ An athlete can file an application to waive or reduce the withholding tax, but it is often impractical because of the athlete’s uncertain income and the Foreign Entertainers Unit’s (“FEU”) detailed requirements.¹⁴⁶ Thus, the U.K. has attempted to cope with the inherent difficulties of applying its tax regime to international athletes, which has resulted in an overly complex and discriminatory regime that has discontented both tax administrators and athletes.

B. Characterization of Income

The majority of the characterization issues in the U.K. revolve around whether the athlete’s income falls within the withholding regime. This determination requires a number of steps, as detailed below.

1. Athletic Performance Income

An athlete falls into the special withholding regime if they perform as an “entertainer” in any kind of “sport.”¹⁴⁷ For these purposes, a sport is any activity of a physical kind performed by an athlete, which is, or may be, made available to the public, whether for payment or not.¹⁴⁸ The athlete’s activities fall into the withholding regime if they are performed in his character as an athlete or “in connection with a commercial occasion.”¹⁴⁹ Commercial occasion is not clearly defined, but includes all advertising, sponsorship, and endorsement activities.¹⁵⁰ Payments for

each stage of production (e.g. wholesaler to retailer to consumer), with a credit for VAT paid at the earlier stages. Thus, the incremental tax accounts for the value added in that particular stage of production. SANDLER, *supra* note 39, at 95, 97, 144–47.

143. GUIDE TO PAYING FOREIGN ENTERTAINERS, *supra* note 127.

144. SANDLER, *supra* note 39, at 140.

145. *Id.* The U.K. does not have a “sailing permit” enforcement mechanism like the U.S. *Id.*

146. *See id.*

147. Income Tax (Entertainers and Sportsmen) Regulations, 1987, S.I. 1987/530, s. 2 (U.K.); *see also* SANDLER, *supra* note 39, at 137.

148. *See* sources cited *supra* notes 149, 151.

149. Income Tax (Entertainers and Sportsmen) Regulations, 1987, S.I. 1987/530, s. 6(2) (U.K.); *see also* SANDLER, *supra* note 39, at 138.

150. Income Tax (Entertainers and Sportsmen) Regulations, 1987, S.I. 1987/530, s. 6(2), (3) (U.K.).

these activities fall into the withholding regime so long as the payments are in any way derived directly or indirectly from the athletic performances.¹⁵¹ The FEU interprets these activities very broadly, and provides examples of activities that fall into the withholding regime, including: “appearance fees, achievement bonus, exhibition income, box office percentage, TV rights, broadcasting/media fees, tour income, tournament winnings, prize money, advertising income, merchandising income, endorsement fees, and film fees.”¹⁵² Further, payments made to loan-out companies also fall into the withholding regime.¹⁵³

2. Endorsement, Image Rights & Sponsorship Income

Image rights are not separate intellectual property in the U.K.¹⁵⁴ Thus, the U.K. generally characterizes image rights payments to nonresident athletes as personal service income and, thus, avoids much of the controversy in the U.S. system.¹⁵⁵ Nonresident athletes can generally avoid U.K. tax on image rights only if those rights do not form a part of their activity in the U.K.—i.e., the rights are not sourced in the U.K.¹⁵⁶ In the 2006 Andre Agassi case, the House of Lords clarified the application of the athlete withholding regime to sponsorship income.¹⁵⁷ The House of Lords held that a sponsorship payment from a nonresident company to a nonresident athlete was taxable in the U.K.¹⁵⁸ This broad decision essentially allows the U.K. to tax all sponsorship payments that relate to a performance in the U.K., regardless of the residence of the payor or athlete. Thus, avoiding U.K. tax on sponsorship income is very difficult for nonresident athletes.

151. See Income and Corporation Taxes Act, 1988, c.1 §§ 555, 556 (U.K.).

152. HM REVENUE & CUSTOMS, *FEU50: A Guide to Paying Foreign Entertainers*, *supra* note 127.

153. SANDLER, *supra* note 39, at 138.

154. See GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 131–32. The U.K. imposes a withholding tax on some royalties, but not the type generally relevant to athletes. See SANDLER, *supra* note 39, at 135–36.

155. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 131–32. Although licensing of image rights (by the employer or independent athlete) are generally subject to the 17.5% VAT. *Id.* at 132–33.

156. See *id.* at 132.

157. *Agassi v. Robinson*, [2006] UKHL 23, [17] (appeal taken from Eng.).

158. *Id.* (Agassi wore the sponsor’s logo while playing in the U.K.).

IV. GERMANY: TAXATION OF INTERNATIONAL ATHLETES

Germany has the largest economy in the EU and the fourth largest in the world.¹⁵⁹ Germany is also the most populated country in the EU.¹⁶⁰ Germany hosts myriad athletic events, including soccer, Formula One racing, tennis, cycling, golf, rugby, and basketball. Germany has a controversial withholding regime for nonresident athletes.¹⁶¹ Income of nonresident athletes is subject to a final 15% withholding tax on gross income.¹⁶² In several circumstances, the nature of Germany's final gross withholding tax—as compared with the U.K.'s withholding tax—has been held incompatible with the European Convention.¹⁶³

A. *Taxation of Nonresident Athletes*

German residents are taxed on their worldwide income, and nonresidents are taxed only on German-source income. Due to recent challenges to Germany's athlete withholding regime, nonresident athletes who are residents of a European Economic Area ("EEA") country can elect to be taxed under a parallel withholding regime.

1. Definition of Nonresident

Compared to other countries—particularly the U.S.—Germany has a very simple, yet fact-based, definition of residency. Germany considers an individual a resident if his "domicile" or "habitual place of abode" is in Germany.¹⁶⁴ Germany defines "domicile" as a home or dwelling at the disposal of the taxpayer that is maintained long-term.¹⁶⁵ Germany defines

159. FACTS ABOUT GERMANY: ECONOMY, <http://www.tatsachen-ueber-deutschland.de/en/content-home/facts-and-figures/economy.html> (last visited Feb. 28, 2011) [hereinafter FACTS ABOUT GERMANY]; *Gross Domestic Product 2009*, WORLD BANK (Dec. 15, 2010), <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf> [hereinafter *Gross Domestic Product 2009*].

160. FACTS ABOUT GERMANY, *supra* note 159.

161. SANDLER, *supra* note 39, at 88; see Einkommensteuergesetz [EStG, Income Tax Law], Oct. 8, 2009, BGBl. I at 3366, last amended by Gesetz [G], Apr. 8, 2010, BGBl. I at 386, § 50a (Ger.) [hereinafter EStG].

162. EStG § 50a(2). Prior to January 1, 2009, Germany imposed a progressive withholding tax with the top rate of 20%. IBFD, COUNTRY ANALYSIS, INDIVIDUAL TAXATION, GERMANY (2009) [hereinafter IBFD, GERMANY]. In 1996, Germany increased the rate to a flat 25%, but began lowering it after reportedly receiving a letter from Michael Jackson threatening to boycott Germany. Jorg-Dietrich Kramer, *Taxation of Nonresident Artists and Athletes in Germany*, 42 TAX NOTES INT'L 41 (2006).

163. See discussion *infra* Parts IV.A–B.

164. SANDLER, *supra* note 39, at 84.

165. IBFD, GERMANY, *supra* note 162, § 1.1.

a habitual place of abode as a location where an individual is physically present for a continuous period of more than six months in a calendar year.¹⁶⁶

2. Taxable Income of a Nonresident

It is generally irrelevant in Germany whether a nonresident athlete is an employee or independent performer, as both are subject to the same athlete withholding regime.¹⁶⁷ Athletes are also subject to the German VAT on income from performances and image rights, however they will often qualify for the “zero-arrangement” and thus avoid any VAT liability.¹⁶⁸ For non-athletes, the German income tax act has separate provisions for independent service income, independent business income, employment income, and royalties.¹⁶⁹ Nonresidents outside the athlete withholding regime, which encompasses athletes’ nonathletic income, are taxed on a progressive basis with a top marginal rate of 45%.¹⁷⁰ There is also a solidarity surcharge of 5% that is added to the income tax of both athletes and mere mortals in Germany.¹⁷¹

3. Withholding

The aspect that truly sets Germany apart is its special withholding regime for nonresident athletes.¹⁷² Gross income of nonresident athletes is subject to a final 15% withholding tax.¹⁷³ This withholding tax applies to income in excess of €50 that is derived from performances in Germany or from the exploitation of performances in Germany.¹⁷⁴ The withholding is applied to the athlete’s gross income including reimbursements for expenses, such as travel.¹⁷⁵ Germany allows no deductions under the

166. SANDLER, *supra* note 39, at 84; *see also* EStG § 1(1). Short interruptions are not taken into account. IBFD GERMANY, *supra* note 162, at § 1.1.

167. *See* IBFD, GERMANY, *supra* note 162.

168. *See* SANDLER, *supra* note 39, at 95, 97.

169. EStG §§ 18, 15, 19. The difference between independent service income and independent business income is that the latter is subject to German municipal trade tax. *See generally* Kramer, *supra* note 162. An athlete’s income is generally considered independent business income. *See id.*

170. IBFD, GERMANY, *supra* note 162, § 1.9.1.1.

171. *Id.* § 2.3.

172. SANDLER, *supra* note 39, at 88; EStG § 50a.

173. EStG § 50a(2).

174. *Id.*

175. *See id.*

withholding tax, and the tax is final.¹⁷⁶ Further, it requires that the tax be withheld even if there is an applicable treaty that would reduce or eliminate the tax, although in that case, the tax may be refunded.¹⁷⁷ Image rights income is distinguished from personal service income in Germany, however it is also subject to the same 15% withholding tax.¹⁷⁸

However, if the nonresident athlete is a citizen and resident of an EEA country, the athlete may elect to deduct expenses related to the athletic income directly at the withholding stage.¹⁷⁹ In that case, the withholding tax rate is 30% of the net payments to the athlete, or 30% of the gross income reduced by the elected deductions.¹⁸⁰ The impetus behind this election was the 2003 *Gerritse* case where the ECJ held that Germany's withholding tax violated the freedom of services principle because German residents were taxed on their net income and other EU residents were taxed on their gross income.¹⁸¹ There are still questions as to whether the withholding regime violates other EC freedoms.¹⁸²

B. Characterization of Income

The primary issue in Germany is determining if the nonresident athlete's income is from services related to the athletic performance.¹⁸³ If so, the income falls under the aforementioned athlete withholding regime and gross income is taxed at 15%. However, if the income is not from related services, it is considered trade or business income and will likely avoid German taxation unless the athlete has permanent establishment in Germany.¹⁸⁴ In 2004, the German Federal Finance Court clarified that an athlete's personal service income that is unrelated to his athletic activity falls outside the withholding regime and is trade or business income.¹⁸⁵ In this case, the net income would be subject to progressive rates up to

176. SANDLER, *supra* note 39, at 88. Although no deductions are allowed, the tax may be refunded if the athlete's directly connected expenses exceed 50% of the gross receipts. Kramer, *supra* note 162; EStG § 50(5) no. 3.

177. SANDLER, *supra* note 39, at 93; EStG § 50d.

178. EStG §§ 50a(1), (2).

179. EStG § 50a(3).

180. EStG § 50a(2).

181. See Case C-213/01, *Gerritse v. Neukölln-Nord*, 2003 E.C.R. I-5933.

182. See Kramer, *supra* note 162.

183. SANDLER, *supra* note 39, at 85. Because the German athlete withholding regime taxes an athlete's income at the same 15% rate regardless of characterization, the primary issue is whether the income falls into the German athlete withholding regime. *Id.*

184. *Id.* at 85 (the assumption is that there is an applicable tax treaty).

185. See Kramer, *supra* note 162; Bundesfinanzhof [BFH] [Federal Tax Court] Jan. 28, 2004, I R 73/02 (Ger.).

45%.¹⁸⁶ Thus, it may be much more beneficial for an athlete to fall into one regime or the other, depending on his circumstances, so athletes need to plan carefully. It is also possible that the athlete could use a foreign loan-out corporation for income not related to the athletic performance and thus avoid German tax, subject to economic substance concerns.¹⁸⁷ Additionally, royalties are subject to a withholding tax of 25%, however this rate is often reduced through tax treaties.¹⁸⁸

V. SPAIN: TAXATION OF INTERNATIONAL ATHLETES

While Germany is a seasoned host of myriad athletic events, Spain is quickly becoming a global leader in producing world-class athletes and athletic events. Spanish athletes now grace the upper echelons of many sports, including basketball, tennis, and golf.¹⁸⁹ Spain has one of the world's best soccer leagues and has explosive growth in its professional basketball leagues.¹⁹⁰

One of the reasons for Spain's dramatic ascent in professional sports is its special tax laws designed specifically for athletes. The generous Spanish tax laws provide a "very attractive tax regime for foreign athletes."¹⁹¹ Specifically, these tax benefits allow Spanish teams to offer larger salaries and attract top foreign athletes and, thus, produce superior sporting events.¹⁹²

A. Taxation of Nonresident Athletes

Spain has a final gross withholding regime like Germany, however, Spain applies this regime to all nonresidents. Also, like Germany,

186. See Kramer, *supra* note 162.

187. See SANDLER, *supra* note 39, at 86.

188. *Id.* at 87; IBFD, GERMANY, *supra* note 162, § 1.9.2.

189. See, e.g., *Most Popular Sports in Spain*, MOSTPOPULARSPORTS.NET, <http://www.mostpopularsports.net/in/spain/#> (last visited Jan. 11, 2011).

190. *Spain Travel: Soccer in Spain*, ABOUT.COM (last visited Jan. 11, 2011), http://gospain.about.com/od/sportinspain/a/soccer_spain.htm; *Spain Travel: Spain to Host 2014 Basketball World Championships*, ABOUT.COM (last visited Jan. 11, 2011), <http://gospain.about.com/b/2009/05/23/spain-to-host-2014-basketball-world-championships.htm>.

191. Bazo, *supra* note 138.

192. *Id.* Further, Spain has a preferential retirement plan deferral for professional athletes. Professional athletes can contribute up to €24,250 annually to a deferred tax retirement plan (equivalent to a traditional Individual Retirement Account) and can withdraw the money one year after the athlete ceases to be a professional. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 123–24. The contribution limit for non-athletes is only €10,000. *Id.*

Spain's withholding regime was deemed inconsistent with the European Convention and required modification for residents of the EU.¹⁹³

1. Definition of Nonresident

An individual is a Spanish resident if they satisfy any of three tests:

- (1) . . . [the individual] spends more than 183 days in Spain in the calendar year;
- (2) [t]he center of [the individual's] economic interests is located in Spain; or
- (3) . . . [the] center of [the individual's] vital interests is in Spain."¹⁹⁴

Further, if a Spanish citizen transfers his residence to a tax haven country, he will be taxed as a Spanish resident for the four years following the transfer.¹⁹⁵

Spain also enacted the preferential "Beckham Law," which allows a new Spanish resident to elect either resident or nonresident tax treatment for the year of the move and the following five years.¹⁹⁶ Thus, the resident has the choice of progressive rates up to 43% on net income or a final flat rate of 24% on gross income (under the withholding regime).¹⁹⁷ To qualify for the election, the resident must: (1) not have been a Spanish resident in the ten years prior to the move; (2) have moved to Spain as a consequence of employment; (3) effectively perform work in Spain, for a Spanish resident; and (4) not be exempt from nonresident income tax.¹⁹⁸

2. Taxable Income of a Nonresident & Withholding

Under the Spanish withholding regime, nonresidents are subject to a final flat rate of 24% on gross income from Spanish sources.¹⁹⁹ If the

193. See *infra* text accompanying note 201.

194. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 120.

195. *Id.* at 120.

196. Bazo, *supra* note 138; GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 121. Spain also has an exemption for certain Spanish residents performing work abroad. See *Id.* at 121–22.

197. Law Governing Income of Natural Persons art. 93 (B.O.E. 2006, 285) (Spain). Additionally, the nonresident status subjects the individual to wealth tax only on Spanish property instead of worldwide property. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 121.

198. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 121.

199. Law Governing Income of Natural Persons art. 14 (B.O.E. 2006, 285) (Spain). The nonresident tax is officially titled: "Impuesto sobre la Renta de No Residentes (IRNR)." See Real Decreto Legislativo (R.C.L., 2004, 5/2004) (Royal Decree Law

athlete's income derives, directly or indirectly, from the athlete's performance, that income falls within the withholding regime regardless of characterization.²⁰⁰ However, a nonresident who is a resident of an EU member state may elect to be taxed as a Spanish resident, so long as they earn at least 75% of their annual worldwide income in Spain.²⁰¹

In addition to the withholding tax on nonresidents' employment and personal service income, Spain imposes a final flat 24% withholding rate on gross image rights income regardless of characterization as personal service or royalty income, or the athlete's residence status.²⁰² However, the withholding rate will likely differ for nonresidents if there is an applicable tax treaty. If such a treaty exists, the character of the image rights income is crucial.

B. Characterization of Income

Although image rights income characterization is only necessary for nonresident athletes in the treaty context because of the nonresident withholding regime, this characterization is very important for Spanish resident athletes for the reasons described below.

1. Resident Athlete's Image Rights Income

Spain characterizes image rights income as either personal service income or royalty income.²⁰³ Regardless of the characterization, image rights income is taxed at the resident athlete's marginal rate, which peaks at 43%.²⁰⁴ However, if the income is characterized as personal service income, the resident athlete can deduct certain expenses.²⁰⁵

Recently, most image rights licensing in Spain has been accomplished through corporate intermediaries.²⁰⁶ The payments to the intermediary are subject to taxation at a maximum corporate rate of 30% instead of

5/2004 of March 5, approving the revised text of the Nonresident Income Tax Law) (Spain).

200. An athlete's income may be taxed under the resident regime if the income is not derived from athletic performance and the athlete has a permanent establishment in Spain. IBFD, COUNTRY ANALYSIS, INDIVIDUAL TAXATION, SPAIN, § 7.3.1.3 [hereinafter IBFD, SPAIN].

201. This election is a result of the ECJ's decision in *Schumacker* (C-279/93). See IBFD, SPAIN, *supra* note 200, § 7.3.1.2.

202. Law Governing Income of Natural Persons art. 25(1)(f) (B.O.E. 2006, 285) (Spain). GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 119.

203. Spain uses the terms "economic activity income" and "income from movable capital." GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 115.

204. *Id.*

205. *Id.* at 115–16

206. *Id.* at 116.

43% for an individual.²⁰⁷ These arrangements are specifically allowed under Spanish law.²⁰⁸ If the resident athlete's employer makes image rights payments, the arrangement must satisfy the 85/15 rule.²⁰⁹ This rule mandates that the resident athlete's employment income be at least 85% of his total athletic income, that is, employment income plus the image rights income the employer pays to the corporate intermediary.²¹⁰ Thus, as long as no more than 15% of the resident athlete's total compensation from the employer is subject to taxation at the favorable corporate rate, the arrangement is permitted.²¹¹ If the image rights payments come from an entity other than the athlete's employer, the entire image rights payment can be made to the corporate intermediary.²¹²

2. Characterization of Image Rights Income in the Treaty Context

As mentioned above, the characterization of image rights income is crucial to determine the tax consequences under a treaty. However, the Spanish National Appellate Court has inconsistently characterized image rights income recently.²¹³ In one case, the Court held that image rights income was a general royalty, subject to a 15% withholding tax under most treaties.²¹⁴ In another case, the Court held that image rights income was more akin to licensing a copyright and, thus, qualified for the preferential withholding rate of 0–5% under most treaties.²¹⁵ And in yet another case, the Court held that image rights income was business income, which may be subject to no withholding tax under most treaties depending on the circumstances.²¹⁶ Thus, there is considerable uncertainty as to how Spain will characterize image rights income, which can result in very different tax liabilities and makes planning difficult.

207. *Id.* at 117. However, the corporation's licensing of the image rights is subject to a 16% VAT. *Id.* at 119.

208. *See id.*

209. *Id.* at 117.

210. *Id.* The "employment income" can include personal services and image rights income, so long as it is taxed at the individual's rate. *See id.*

211. *Id.* at 117. This arrangement can net almost 2% more after-tax income, which may equate to substantial amounts for professional athletes. *Id.*

212. *Id.* at 117–18.

213. *Id.* at 120.

214. *Id.*

215. *Id.* (Opinions dated Sept. 25, 2007 and May 4, 2007).

216. *Id.* at 120 n.1 (Opinion dated July 18, 2007). If the income recipient was resident of another country and did not have a permanent establishment in Spain, there would be no Spanish withholding tax on the income.

VI. BRAZIL: TAXATION OF INTERNATIONAL ATHLETES

Brazil's ever-growing economy is the eighth largest in the world.²¹⁷ Additionally, Brazil accounts for almost half the total population, land mass, and economic output of South America.²¹⁸ Brazil is widely regarded as producing the world's best soccer players, such as Pele, Ronaldo, and Ronaldinho.²¹⁹ Additionally, Brazilian Jiu Jitsu has become increasingly popular and many Brazilians dominate the ranks of mixed martial arts.²²⁰

It is interesting to note how Brazil taxes sports-related employers. Generally, employers are subject to substantial payroll and social security taxes.²²¹ However, since 1997, Brazil has been creating special rules for soccer clubs because so many were run poorly and amassed enormous tax debts.²²² In 2006, Brazil created the "Club Mania Law," which essentially exempts soccer clubs from taxation through 2011 and implements a lottery to help soccer clubs pay their tax debts.²²³

A. Taxation of Nonresident Athletes

Like the aforementioned countries, Brazil taxes its residents on worldwide income, regardless of source.²²⁴ And like Germany and Spain, Brazil taxes all nonresidents on Brazilian-source income through a final withholding tax regime.²²⁵

217. *Gross Domestic Product 2009*, *supra* note 159 (Brazil had the eighth largest gross domestic product in the world in 2009); Matthew S. Poulter, *My Client's Going to Brazil: A U.S. Practitioner's Guide to Brazilian Limitadas Under the New Civil Code*, 11 SW. J. L. & TRADE AM. 133, 134 (2005) (stating that Brazil "possesses large and well-developed agricultural, mining, manufacturing, and service sectors . . . and represents almost half of South America in total population, territory and economic output.").

218. *See id.*

219. *Embassy of Brazil in London Sport*, BRAZIL.ORG, <http://www.brazil.org.uk/culture/sport.html> (last visited Jan. 1, 2011).

220. *Id.*

221. *See* GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 27. These total payroll and social security taxes can total over 47%. *Id.*

222. *Id.* at 27.

223. Lei No. 11.345, de 14 de Setembro de 2006, DIÁRIO OFICIAL DA UNÃO [D.O.U.], de 15.09.2006 (Braz.) (amended at Lei. No. 11.505, de 18 de Julho de 2007, D.O.U., de 19.7.2007). *See also* GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 27–28. Football clubs are subject only to a 1% payroll tax and 5% social security tax (based on sport event revenue). Normal Brazilian corporations face an income tax of roughly 25%, a profits tax of 9%, and payroll taxes of up to 47%. *Id.*

224. Lei No. 5.172, de 25 de Outubro de 1966, D.O.U., 4 (43, t.4):12452, de 10.1966 (Braz.).

225. *See* discussion *infra* Parts VI.A.–B.

1. Definition of Nonresident

In comparison to other countries, Brazil's definition of nonresident is straightforward. Brazil defines a resident as an individual who either lives permanently in Brazil, has a permanent visa in Brazil, or has a temporary visa in Brazil.²²⁶

2. Taxable Income & Withholding

Brazil requires withholding on personal service, sponsorship, and image rights payments for both residents and nonresidents.²²⁷ However, the rules are quite different for nonresidents. For residents, tax is withheld at progressive rates for all income sources; however, the top rate of 27.5% applies at a fairly low income threshold, at least for most athletes.²²⁸ For nonresidents, personal service income is treated differently than sponsorship or image rights income. For personal service income of nonresidents, tax on gross income is withheld at a final flat 25% rate.²²⁹ This rate also applies to any payments made to a tax haven jurisdiction, such as the Cayman Islands.²³⁰ For sponsorship or image rights income of nonresidents, tax is withheld at a final flat 15% rate.²³¹

Further, any Brazilian resident that makes royalty payments to nonresidents is subject to a 10% contribution tax (Contribuição de Intervenção no Domínio Econômico or "CIDE").²³² It is unclear whether image rights payments fall into this category and are thus subject to the 10% CIDE, and Brazilian tax authorities have yet to provide relevant guidance.²³³ The CIDE does not apply to personal services or sponsorship payments,

226. See Instrução Normativa No. 208, de 27 de Setembro de 2002, D.O.U. de 11.3.2004. (Braz.). If the individual has a temporary visa, they will not become a resident until: (1) arrival date if visa is for employment, (2) after 184 days in Brazil, or (3) the date they obtain a permanent visa or employment. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 24.

227. See GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 24–25.

228. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 25. The top rate currently applies if income exceeds approximately \$18,000 per year. However, taxes are assessed on a monthly basis, which may impact athletes if their income is concentrated into a short period of time.

229. Decreto No. 3.000, de 26 de Março de 1999, D.O.U., 3 (685, 1) de 17.4.1999 (Braz.); GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 26.

230. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 26.

231. Decreto No. 3.000, de 26 de Março de 1999, D.O.U., 3 (710, 1) de 17.4.1999 (Braz.); GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 26.

232. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 26 (explaining, "[t]he CIDE rate . . . is owed by the Brazilian party which pays the royalties, not the recipient of the payment.").

233. *Id.*

however.²³⁴ And of course, although treaties can reduce these withholding rates, the U.S. does not have a treaty with Brazil.

B. Characterization of Income

Brazil imposes income tax on its residents identically regardless of whether their income is from personal service, sponsorship, or image rights.²³⁵ However, as detailed above, Brazil taxes nonresidents differently based on the character of their income.²³⁶

1. Endorsement, Image Rights & Sponsorship Income

Brazil taxes nonresidents at 25% for personal service income and 15% for royalty income. However, because royalty income, which includes sponsorship and image rights income, is subject to the 10% CIDE, the effective tax rate is identical regardless of the characterization. Some athletes have assigned their image rights to an intermediary corporation, which is subject to net taxation at only 14.53%, instead of a top rate for residents of 27.5% and a flat gross rate of 25% for nonresidents.²³⁷ However, Brazilian tax authorities have strictly scrutinized and penalized these arrangements.²³⁸

VII. CHINA: TAXATION OF INTERNATIONAL ATHLETES

China has the world's third largest economy and largest population.²³⁹ Sports—particularly soccer, golf, badminton, and ping pong—are very popular in China.²⁴⁰ Basketball may now be the most popular sport in China due to the meteoric success of Yao Ming in the NBA.²⁴¹ However, professional athletics are relatively new to China.²⁴² Thus, complex commercial tax arrangements are still relatively rare in China outside basketball and soccer.²⁴³

234. *Id.*

235. *Id.* at 23.

236. *Id.*

237. *See id.*, at 23–25.

238. *Id.* at 25.

239. *Gross Domestic Product 2009*, *supra* note 159.

240. *Popular Sports*, CHINA.ORG.CN, <http://www.china.org.cn/english/features/38333.htm> (last visited Feb. 25, 2011).

241. Shan Lei, *Basketball on Track to Becoming China's First Sport*, ENGLISH.NEWS.CN (Dec. 23, 2010), http://news.xinhuanet.com/english2010/china/2010-12/23/c_13660492.htm.

242. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 32.

243. *Id.*

A. Taxation of Nonresident Athletes

China has a very unique method for taxing all nonresidents. Although the definition of a nonresident is fairly straightforward, China taxes nonresidents on broader sources of income as they spend more time in China.²⁴⁴

1. Definition of Nonresident

Generally, an individual is a Chinese resident if the individual holds a habitual residence in China or spends more than one year in China.²⁴⁵ However, resident status and subsequent taxation is different for residents of a country that have a treaty with China, depending on how long the individual stays in China.²⁴⁶

2. Taxable Income of a Nonresident in the Treaty Context

Nonresidents are subject to tax on incrementally broader sources as they spend more time in China. If the individual is in China for less than 183 days, they are subject to Chinese tax only on income related to China and paid by Chinese entities.²⁴⁷ If the individual is in China between 183 days and one year, they are also subject to Chinese tax on income related to China and paid by foreign entities.²⁴⁸ If the individual is in China for more than one year and less than five years, they are also subject to Chinese tax on income related to foreign countries and paid by Chinese entities.²⁴⁹ And finally, if the individual is in China for five years or more, they are also subject to Chinese tax on income related to foreign countries and paid either by foreign or Chinese entities.²⁵⁰

B. Characterization of Income

In China, income characterization is extremely important. China taxes employment income, personal service income, and royalties differently. Further, China divides personal service income into business income and professional services income.²⁵¹

244. *Id.* at 31–35; see discussion *infra* Parts VII.A.–B.

245. GUIDE ON SPORTSPERSON TAXATION, *supra* note 62, at 34. Habitual residence is based on familial and economic interests in China. *Id.*

246. *Id.* at 34–35.

247. *Id.* at 34.

248. *Id.*

249. *Id.*

250. *Id.*

251. *Id.* at 34–35.

1. Athletic Performance Income

China taxes employment income at progressive rates up to 45%.²⁵² However, China classifies independent personal services of athletes as professional services income.²⁵³ China taxes professional services income at a flat rate of 20%, although China can increase the rate up to 40% if the payment is abnormally large.²⁵⁴ Additionally, China does not allow deductions for business expenses related to employment or professional services income, but rather, allows a standard monthly deduction.²⁵⁵

2. Endorsement & Sponsorship Income

In China, image rights income is characterized as either professional service or royalty income. Image rights income generally qualifies as professional service income if the athlete attends commercial activities.²⁵⁶ If the image rights income is professional service, it is subject to a flat income tax of 20%, with the possibility of an increase to 40%.²⁵⁷ If the image rights income is a license fee, it is treated as a royalty and subject to a flat withholding tax of 20%, although this rate is generally reduced to 10% under China's tax treaties.²⁵⁸ Regardless of the classification, the image rights income is also subject to a 5% business tax.²⁵⁹ Thus, there is incentive to structure compensation arrangements as licensing of image rights.

The use of corporate intermediaries for image rights licensing is prevalent in China, and explicitly allowed under Chinese law.²⁶⁰ Although the Chinese corporate income tax rate is 25%, there are still several benefits to using a corporate intermediary.²⁶¹ First, the corporation may have larger deductions than the individual (including any salary paid to the individual) and, thus, may have an effective tax rate lower than the 20%

252. *Id.*

253. IBFD, COUNTRY ANALYSIS, INDIVIDUAL TAXATION, CHINA, § B.1.4. If an athlete is performing other personal services that do not fall into China's professional services category, the athlete will be taxed on that business income under a system that provides progressive rates and business expense deductions. *Id.*

254. *Id.*

255. *Id.*

256. *Id.* at 31.

257. *Id.*

258. *Id.* at 31, 33–34.

259. *Id.* at 31.

260. *Id.* at 32.

261. Note that the corporate intermediary would also be subject to the 5% business tax. *Id.* at 33.

individual royalty rate. Second, corporations allow for flexibility and consolidation if the athlete is licensing to multiple sources or engaged in other commercial endeavors.²⁶² Finally, under the pre-2008 Income Tax Code, it was common practice for local tax bureaus to allow Chinese companies to adopt a deemed-profit-rate tax method, and then pay tax at a 10% to 20% rate.²⁶³ Thus, corporate intermediaries are still prevalent in Chinese image rights licensing.

VIII. ANALYSIS: A MULTILATERAL REGIME FOR THE INTERNATIONAL TAXATION OF ATHLETES

As the foregoing comparative analysis illustrates, six of the most important and sophisticated countries in the world have struggled to apply and adapt their own tax regime to athletes. It is extremely difficult, even for a tax attorney, to decipher these alternate tax regimes in multiple countries, let alone effectively navigate the various withholding and characterization traps. This tangled web of disparate and inconsistent tax systems is a nightmare for tax administrators and athletes alike. A separate international athlete tax regime must balance the goals of both the tax administrator and the athlete.²⁶⁴ The tax administrator's goal is to obtain a fair share of tax revenue from the athlete's performance income. The athlete's goal is to minimize the risk of double taxation and the compliance burden.²⁶⁵ And simplicity is a concept that both tax administrators and athlete taxpayers can appreciate.

A. Justifications for a Separate Regime

There are several justifications for a separate tax regime for international athletes. International athletes' unique characteristics result in unparalleled diversity of income character and source, and present significant enforcement difficulties.²⁶⁶ The lack of a universal regime leads to inconsistency and distorts taxpayer behavior. Further, a separate tax regime would aid developing countries and act as a stepping stone for international tax harmonization.

262. *See id.*

263. *Id.*

264. *See Evans, supra* note 17, at 297–98; *see also Winnie, supra* note 43, at 70.

265. "Taxpayers should not care where their income tax is paid provided it is paid only once (probably in accordance with the marginal rates in the State of residence)." SANDLER, *supra* note 39, at 347.

266. *See generally Evans, supra* note 17; SANDLER, *supra* note 39; Winnie, *supra* note 43.

1. Diversity of Income

As detailed above, athletes have extremely diverse types of income, which can be very difficult to characterize. Athletes also have diverse sources of income. An international athlete may perform and promote products in scores of countries in a very short time. And an athlete's diversity of character and source of income grows with his popularity. Technology has only exacerbated the complexity of determining both the character and source of an athlete's income.²⁶⁷ For instance, an athlete endorsing a product in an internet advertisement can literally be viewed in every country in the world, which makes the proper allocation of that income virtually impossible. The only effective way to cope with the realities of today's athletic income is to implement a separate international tax regime for athletes.

2. Enforcement & Information Exchange

Due to athletes' diverse income and transient nature, it is extremely difficult for tax authorities to obtain the necessary information and then collect tax revenue. Information exchange between countries' tax administrators can be exceedingly difficult, particularly when several different languages or developing countries are involved. Many developing countries may not keep detailed records or even sufficiently identify taxpayers. Often, lower-income athletes fail to report income, either intentionally or unintentionally, and higher-income athletes utilize sophisticated tax planning strategies to minimize or avoid taxation.²⁶⁸ Further, tax liabilities are frequently discovered after the athlete has squandered his riches and lost the ability to pay.²⁶⁹ The solution is a multilateral agreement that includes information exchange and administrative assistance provisions. The EUMAAT illustrates that a multilateral agreement providing for information exchange is feasible and beneficial.²⁷⁰

In addition to challenging tax administrators, the current environment imposes a massive compliance burden on international athletes. Prominent sports agent and tax attorney Leigh Steinberg describes the current environment as an "accounting nightmare."²⁷¹ Tax complexities can lead

267. Technology also raises jurisdictional concerns, as there may be a question whether a requisite degree of contact exists to justify a certain country taxing an athlete's income. See Winnie, *supra* note 43, at 83–84.

268. See Evans, *supra* note 17, at 325.

269. See *id.*

270. The EUMAAT illustrates how a substantially large group of countries, which speak many languages, can come together and share information to aid tax compliance.

271. Winnie, *supra* note 43, at 69 (citing Earl C. Gottschalk Jr., *Welcome Traveler*, WALL ST. J., Apr. 15, 1993, at A1, A6).

to public relations disasters for both athletes and tax administrators. International athletes are some of the highest-profile taxpayers in the world and in order to maintain taxpayer morale, tax authorities cannot let them get away with not paying their fair share of tax. On the other hand, international athletes are essentially their own marketing brand and they need to avoid bad publicity, or it can cost them millions in lost endorsements. History is littered with examples, such as German Steffi Graf,²⁷² Brazilian Helio Castroneves, and plenty of American athletes.²⁷³ Generally, sports fans do not care if the tax underpayment was intentional or not—the athlete is quickly labeled a “tax cheat.”²⁷⁴ Thus, both tax administrators and athletes stand to benefit a great deal from a simplified universal tax regime.

3. Consistency

In addition to adding substantial complexity, the current inconsistent tax treatment of athletes distorts behavior. Inconsistent tax treatment gives an athlete strong financial incentive to reside or perform in certain countries. When a country—such as Spain—gives athletes tax preferences so its leagues can attract better athletes, it creates a race to the bottom, whereby athletes reside and perform in countries with the most favorable tax treatment. For instance, many top soccer stars are lured to Spain instead of the U.K. because of the favorable Spanish tax laws.²⁷⁵ One analyst estimates that in order to pay a soccer player £50,000 after taxes, a U.K. soccer club would have to pay £100,000 whereas a Spanish soccer club would only have to pay £66,000.²⁷⁶ The result is a potential tax revenue loss of £20 million for the U.K., and a loss of any revenues that would have stemmed from having the world’s top players performing in the U.K.²⁷⁷ A consistent international tax regime would significantly aid parity in each sport.

Some may argue that a separate regime for athletes would violate horizontal equity because it would treat athletes differently than other service professionals, such as lawyers.²⁷⁸ However, athletes and other service

272. *Graf Case Transfixes Germans*, N.Y. TIMES, Oct. 13, 1995, at B11.

273. Shane Igoe, *The World’s Biggest Tax Cheats*, ESPN.COM (Apr. 15, 2010), <http://sports.espn.go.com/espn/page2/story?page=igoe/100415>.

274. *See, e.g., id.*

275. *See Bazo, supra* note 138.

276. Alex Hawkes, *UK Misses Out on Top Footballers—And Tax*, ACCOUNTANCY AGE (Jan. 9, 2006), available at <http://www.accountancyage.com/2148238>.

277. *Id.*

278. *See Winnie, supra* note 43, at 79 (citing DANIEL SANDLER, *THE TAXATION OF INTERNATIONAL ENTERTAINERS AND ATHLETES* 347 (1995)). The principle of horizontal

professionals are not similarly situated taxpayers. Athletes' diversity of income character and source, ability to generate substantial sums during very short stays, and worldwide publicity make athletes a unique class of taxpayers. Thus, a separate tax regime for athletes is proper and would add much-needed consistency in international sports.

4. Aiding Developing Countries

Virtually all lucrative athletic events take place in developed countries—primarily in the U.S. and Western Europe.²⁷⁹ There are many reasons why these source countries should receive tax revenue; primarily, because they provide the legal, commercial, and physical infrastructure that make the sporting events possible. However, many athletes that compete in these sporting events are citizens of developing countries, many of which do not have tax treaties with the U.S. or other OECD countries.²⁸⁰ Thus, these developing countries are deprived of tax revenue, even though they often cultivate and prepare the athlete for elite competition. For example, U.S. professional baseball is full of Dominican and Cuban players,²⁸¹ and the world's most successful distance runners hail from Kenya and Ethiopia.²⁸² Further, many of these developing countries do not have sufficient legal systems or technology to effectively tax anyhow.²⁸³ An international athlete tax regime can allocate revenues to such deserving developing countries and help advance their legal infrastructure.

equity demands that similarly situated taxpayers be taxed similarly. Horizontal equity works to prevent arbitrary discrimination. For example, a lawyer making a certain salary should be taxed in the same way as if that lawyer were instead a doctor making the same salary. *Id.*

279. See, e.g., Peter J. Schwartz, *The World's Top Sports Events*, FORBES.COM (Mar. 5, 2010, 12:20 PM), <http://www.forbes.com/global/2010/0315/companies-olympics-superbowl-daytona-worlds-top-sports-events.html> ("To determine the most valuable sporting event brands—the equity built up in a name over many years—[Forbes] ranked [these events] on gross revenue generated per day of competition.").

280. See Winnie, *supra* note 43.

281. In 2010, almost 28% of Major League Baseball players, and almost 50% of minor league baseball players, were foreign-born. The Dominican Republic has the highest number of citizens in U.S. baseball. *Percentage of Foreign-Born Major League Baseball Players Dips Slightly from Last Year*, ESPN.COM (Apr. 6, 2010), <http://sports.espn.go.com/mlb/news/story?id=5060822>.

282. Vincent O. Onywera et al., *Demographic Characteristics of Elite Kenyan Endurance Runners*, J. SPORTS SCI. 415, 416 (2006).

283. See Winnie, *supra* note 43, at 86.

5. A Stepping Stone Toward International Tax Harmonization

A multilateral tax agreement could act as a stepping stone toward international tax harmonization. In fact, any universal international agreement in the area of taxation would be a step in the right direction. Such an agreement could also be a first step toward a general tax treaty between the U.S. and Brazil. The capital export neutrality goal of the U.S. and capital import neutrality goal of Brazil have prevented agreement thus far.²⁸⁴ However, if both countries are a party to a multilateral tax treaty targeted at a narrow area of taxation, they will share common ground and have an open dialogue that may lead to broader treaties in the future. The same concept could be true for other Central and South American countries with which the U.S. has largely failed to engage in tax treaties. A multilateral treaty would be a monumental first step toward tax harmonization and developing new economic relationships among all countries.²⁸⁵

B. Proposal: A Multilateral International Athlete Tax Regime

The key to a separate international athlete tax regime is a multilateral agreement between all the world's major countries. Although universal involvement may sound unattainable, if the most economically powerful countries initiate this narrow, targeted agreement and propose fair tax principals, both developed and developing countries will stand to benefit and have little reason to abstain. An international athlete tax regime should incorporate a flat tax, a central withholding agency, and simplified allocation methods.

1. Flat Tax

The foundation of an international athlete tax regime is a flat tax. The flat tax would provide much needed simplicity and consistency. The regime's flat tax would eliminate "exemptions, loopholes, and targeted breaks with a system that is so simple that the international athlete could file his taxes on a postcard size form."²⁸⁶ The simplicity of the flat tax would benefit both tax administrators and international athletes.

284. See *supra* notes 222–25 and accompanying text. Brazil is very quickly becoming one of the most economically powerful nations in the world, and Brazil is arguably the most important nation with which the U.S. has failed to engage in a tax treaty. *Id.*

285. Furthermore, by agreeing to compromise in the area of taxation, the U.S. may improve its image and aid in further cooperation in the future.

286. Winnie, *supra* note 43, at 86.

From an administrative standpoint, most major countries already employ some type of flat tax for nonresident athletes, as illustrated above.²⁸⁷ Most importantly, the flat tax would apply consistently to all the athlete's related income, thus obviating the very problematic income characterization.²⁸⁸ Personal service income would be taxed in exactly the same manner as royalty income. All income directly or indirectly related to the athlete's performance would fall into this regime, which would remove the often difficult determination of tax treatment under bilateral treaties.²⁸⁹

Another benefit of the flat tax is that it levels the playing field for all countries and all athletes. The flat tax would prevent the race to the bottom, currently exemplified between Spain and the U.K. Uniformity would prevent tax law from distorting athletes' decisions on where to reside and where to perform. And the flat tax, under a universal tax regime, would treat all athletes the same, thus it is fair and horizontally equitable within this specialized group of taxpayers.²⁹⁰

The international athlete tax regime should impose a significant flat tax rate.²⁹¹ A rate of approximately 30% represents a practical compromise²⁹² and should appease most countries and athletes.²⁹³ The flat tax should be a final tax on the athlete's gross income, but after applying a standard deduction, much like the Chinese system.²⁹⁴ Because athletes would significantly reduce their expenses under the new regime, business expense deductions would not be as important as they are currently. Ath-

287. See discussion *infra* Parts I–VII.

288. “[T]here is no need to differentiate between types of income at all” SANDLER, *supra* note 39, at 347.

289. As an illustration of this difficulty, the recent OECD proposed changes to its Article 17 commentary, focusing heavily on determining which activities are related to the performance and thus fall within Article 17. ORG. FOR ECON. CO-OP. AND DEV. (OECD), DISCUSSION DRAFT ON THE APPLICATION OF ARTICLE 17 (ARTISTES AND SPORTSMEN) OF THE OECD MODEL TAX CONVENTION 4–6 (Apr. 23, 2010–July 31, 2010), available at <http://www.oecd.org/dataoecd/31/15/45058769.pdf>.

290. Although the flat tax would violate vertical equity, ability to pay is generally not a concern with athletes and a *de minimis* exception can further alleviate ability to pay concerns, and also encourage cultural exchange.

291. The withholding rate should be set at “full rate” close to the corporate tax rate. See SANDLER, *supra* note 39, at 347.

292. As discussed above, most developed countries have progressive rates from 0% to 45%. See discussion *supra* Parts I–VI.

293. This 30% flat tax should be the only tax levied on the athlete's relevant income. Thus, the athlete should not be subject to VAT, social security, or employment taxes.

294. This deduction could be limited to a dollar amount or percentage of gross income, or a combination of both like the Chinese system. A 20% deduction would likely satisfy countries and athletes.

letes who are currently taxed at lower rates would still likely benefit overall, as the new regime would prevent double taxation and drastically reduce legal and accounting expenses.²⁹⁵ And even countries that currently impose a higher effective tax rate would likely increase revenues due to significantly improved compliance.

2. Central Withholding Agency

The international athlete tax regime should establish a Central Withholding Agency (“CWA”) to further simplify administration for both countries and athletes.²⁹⁶ Any entity that pays an athlete would withhold the flat tax and submit it to the CWA.²⁹⁷ The payor would also submit information related to the payment such as the athlete’s identification number and relevant country or countries involved.²⁹⁸ Importantly, by providing a centralized withholding infrastructure, the CWA will relieve all of the parties involved, especially developing countries, of the administrative burden that is often difficult to overcome.

The CWA would alleviate the need for international athletes to file any tax returns relating to their athletic income.²⁹⁹ The CWA would automatically calculate the standard deduction based on the athlete’s yearly gross income and, if necessary, simply send the athlete a check at the end of the year.³⁰⁰ Additionally, the CWA would automatically determine whether an athlete satisfied the *de minimis* exception, and if so, would send the athlete a complete refund check.

3. Allocation

The final component of the international athlete tax regime is the allocation of tax revenues. Simplicity and fairness should dictate this allocation. The CWA should allocate the collected revenue 50% to the source country and 50% to the combined countries of citizenship and resi-

295. Athletes may even significantly reduce travel/living expenses because they would not need to try to avoid certain tax regimes.

296. The CWA would be funded through a small percentage of the overall athlete tax revenue.

297. Assuming the payment is made to the athlete relating at least indirectly to his performance as an athlete.

298. The CWA can assign each athlete a unique taxpayer identification number to avoid publicity concerns.

299. Athletes will still need to comply with their residence country’s tax laws for income unrelated to their athletic performance.

300. If the standard deduction is simply a percentage of gross income with no limitation, it could be deducted at the source and the CWA would not need to send any checks.

dence.³⁰¹ Thus, if the athlete is resident of a country other than his country of citizenship, each should be allocated 25%.

Under this allocation structure, the CWA still needs to determine the source of the athlete's income. This determination will be much easier due to free information exchange and a central repository in the CWA. Additionally, the CWA can uniformly determine how to allocate the tax revenue if multiple source countries are involved.³⁰² The result is a simple, consistent, and fair allocation of athletes' tax revenue.

CONCLUSION

The purpose of this Article was threefold. First, to compare how six significant countries currently deal with the inherent problems of taxing extremely mobile, transient, high-income taxpayers with diverse income. Second, to illustrate that each country takes a very different—and often very convoluted—approach that has resulted in confusing, complex, and inconsistent regimes. And finally, to propose a solution that will benefit tax administrators and athletes alike.

International athletes' unique characteristics necessitate a separate tax regime. A single, consistent regime would eliminate substantial enforcement difficulties for tax administrators as well as massive compliance burdens and potential double taxation for athletes. This Article presents a rough blueprint for a feasible regime that is simple, effective, efficient, and extremely beneficial for both tax administrators and athletes. Now the sports world will have to wait and see if any countries are willing to play ball.

301. See Bazo, *supra* note 138.

302. The CWA will not have the conflicting interests of a country's own tax authority. Additionally, countries will have less motivation to challenge source determinations because they will likely receive some portion of the tax revenue, unlike the current all-or-nothing system.