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A beginner's guide to cross-border tax issues for professional athletes: Part one

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Law360 Canada (August 19, 2024, 3:19 PM EDT) -- Professional sports in North America is a multibillion-dollar industry. Television rights, merchandise and sports betting are major areas in which the sporting industry has and continues to expand its global reach. However, at the centre of it all are the athletes themselves.

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Professional athletes work incredibly hard for a chance to make it to the biggest stage in their respective sport. Achieving personal success and winning championships is the ultimate goal; however, with that success comes the issue of contract negotiations. The decision for many athletes of where to compete can be complicated — opportunity, family considerations and the possibility of team success are the most commonly discussed reasons for an athlete choosing a certain event to compete in or city and team to play for.

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However, the decision can be complicated further by federal, provincial/state and municipal taxes on earnings, particularly for cross-border athletes (e.g., a Canadian athlete signing with an American team or an American signing with a Canadian team). A resident of Canada pay tax on their entire salary in Canada and are only taxed in the United States for U.S.-sourced income — for which foreign tax credits will be available. A resident of the United States will pay taxes on their entire salary in the United States and only in Canada for Canadian-sourced income (again, tax credits are likely available).

This two-part article series will discuss some of the considerations Canadian athletes and their advisers should keep in mind when deciding whether to compete professionally in the United States.

Residency status

Overview of Canadian residency rules

For many Canadians working in the United States, residency for tax purposes can be tricky. This is a particular concern for athletes given that the professional sports calendar does not generally span the full 12-month calendar year and the athletes may return to their hometown during the off-seasons. Residents of Canada are taxed on worldwide income (*Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) at ss. 2(1) and 2(2) [ITA]) whereas nonresidents are only taxed on Canadian-source income (ITA, at subsection 2(3)). Determining an athlete's residency can have a major impact on taxes, filing obligations and planning.

An individual who is "ordinarily resident" in Canada is considered to be a resident of Canada for tax purposes (ITA, at subsection. 250(3)). However, the phrase "ordinarily resident" is not defined by the *Income Tax Act* (Canada), leaving it to the courts and the Canada Revenue Agency (CRA) to interpret its meaning. The CRA has published a useful guide on determining the residency status of an individual: Income Tax Folio S5-F1-C1, "Determining an Individual's Residence Status." Whether such a person is a resident is dependent on the facts of each situation — the CRA refers to a resident

determined this way as a "factual resident."

There are several "significant" and "secondary" factors used in making a residency determination, though none of the factors by themselves are determinative of residency status — the specific circumstances must be viewed as a whole. A non-exhaustive list of factors noted by the CRA include:

- Significant ties:
  - dwelling places; and
  - location of spouse and dependents.
- Secondary ties:
  - personal property in Canada (such as furniture, clothing, automobiles and recreational vehicles);
  - social ties with Canada (such as memberships in Canadian recreational or religious organizations);
  - economic ties with Canada (such as employment with a Canadian employer and active involvement in a Canadian business and Canadian bank accounts, retirement savings plans, credit cards and securities accounts);
  - landed immigrant status or appropriate work permits in Canada;
  - hospitalization and medical insurance coverage from a province or territory of Canada;
  - a driver's licence from a province or territory of Canada;
  - a vehicle registered in a province or territory of Canada;
  - a seasonal dwelling place in Canada;
  - a Canadian passport; and
  - memberships in Canadian unions or professional organizations (Income Tax Folio S5-F1-C1, at paras. 1.11-1.14).

The courts have considered several additional ties for residency determination, including retention of a Canadian mailing address, post office box or safety deposit box, personal stationery (including business cards) showing a Canadian address, telephone listings in Canada and local (Canadian) newspaper and magazine subscriptions. These factors are generally of limited importance unless considered together with the significant and secondary ties (Income Tax Folio S5-F1-C1, at para. 1.15).

Even where an individual does not meet the factual resident criteria, the ITA may still deem an individual to be a resident if they are present in Canada for at least 183 days in a calendar year (ITA, at subsection. 250(1)).

An individual can also be deemed to be a nonresident of Canada if they are considered a resident of another country. This is subject to the tiebreaker rules in the tax treaty between Canada and that other country. Canada and the United States have a treaty — the *Convention Between Canada and the United States of America* (the Treaty), which will be discussed in part two.

Overview of U.S. Immigration rules for Canadian athletes

This section provides a brief overview of the issues and obstacles that athletes may encounter when going to compete south of the border.

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Athletes going to compete in the United States are required to apply for a work visa or permanent residency (i.e. a "green card"). The most common work visas for athletes are O-1 Visas (for Individuals with Extraordinary Ability or Achievement), P-1A Visas (for Athletes) and to a lesser extent H-2B Visas (for Temporary Non-Agricultural Workers). It is important to note that these visas are temporary and may need to be renewed during the course of a contract and will expire when an athlete retires. For U.S. tax purposes, having a work visa is generally a different concept than residency status.

For residency purposes, there are two categories of non-Americans: nonresident aliens (NRA) and resident aliens (RA). RAs are generally taxed on their worldwide income, similar to U.S. citizens. On the other hand, NRAs are only required to pay federal taxes on U.S.-sourced income. Typically, a Canadian individual working in the United States will be considered an NRA unless they meet one of the following two tests:

1. **Green Card Test:** This test is met if, at any time during the calendar year, an individual is considered a "lawful permanent resident" of the United States. An individual is a lawful permanent resident of the United States if they have been given the privilege, according to the immigration laws, of residing permanently in the United States as an immigrant. You generally have this status if the U.S. Citizenship and Immigration Services (USCIS) issued you a Permanent Resident Card, Form I-551, also known as a "green card."

2. **Substantial Presence Test:** To meet this test, an individual must be physically present in the United States on at least:
    - 31 days during the current year, and
    - 183 days during the three-year period that includes the current year and the two years immediately before that, counting:
        - all the days you were present in the current year, and
        - one-third of the days you were present in the first year before the current year, and
        - one-sixth of the days you were present in the second year before the current year.

Athletes who are classified as NRAs are generally obligated to pay U.S. income tax only on U.S.-sourced income. This includes, but is not limited to, compensation for games located in the United States, endorsements, royalties or other income closely related to the U.S.-source income.

Further, NRAs are subject to special tax and withholding rules, codified as Income Codes 42 and 43 (IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities). For athletes classified as independent contractors (generally individual sportspersons, such as tennis players, golfers, etc.), payments to them will have amounts withheld at a 30 per cent rate; for athletes classified as employees (generally athletes that compete on a team, such as in the NHL or NBA), withholding is done at graduated rates (see IRS Publication 515).

Under certain circumstances, NRAs can request a central withholding agreement (CWA) for a lower

rate of withholding. A CWA calculates withholding based on estimated net income. It is an agreement between an athlete, a designated withholding agent and the Internal Revenue Service. However, it is important to note that a CWA will never permit a reduction in tax less than the anticipated amount of income tax liability.

Athletes considered RAs will generally be taxed in the United States on their worldwide income.

Change in residency

When an athlete moves from Canada to the United States, they may cease to be a resident of Canada. In order to cease being a Canadian resident, an individual must sever their ties with Canada. If it is questionable whether ties are/will be severed, the individual can apply for a determination from the CRA (Form NR73). When a person emigrates from Canada, they will be taxed on worldwide income only for the part of the year that they were resident in Canada — for the remainder of the year, they will be only taxed on Canadian-source income (ITA s. 114). A deemed resident (sojourning in Canada for 183 days or more throughout the year, as discussed above) is deemed to be a resident throughout the year and therefore is not subject to this rule.

Immediately before ceasing to be a resident of Canada, a person is deemed to have disposed of and reacquired their property at fair market value, resulting in capital gains that may have accrued. Certain properties are exempted from this rule, including Canadian real property (ITA, para. 128.1(4)(b)).

Athletes moving cross-border should explore any planning opportunities related to changes in their residency status.

Residency summary

There are many factors in play when determining the residency status of a Canadian athlete competing in the United States, for both Canadian and U.S. tax purposes. The rules are such that it may be possible for an athlete to be considered a resident of both Canada and the United States. The Treaty contains tiebreaker rules used to determine residency and taxation of certain types of income. This will be discussed in part two.

Conclusion

The goal of this series is to provide some insight into the complicated cross-border tax issues experienced by professional athletes. In part one, we discussed the concept of residency for tax purposes and why determining residency is vital for athletes competing across the Canada-U.S. border.

Part two will take an in-depth look at the Treaty and how it impacts residency determination and the imposition of tax, as well as discuss a common retirement savings method favoured by athletes in Canada.

Athletes should seek professional advisers in both Canada and the United States to ensure that they are properly aware of, and reactive to, the tax issues they face.

This article has been prepared for general information only and should not be considered personal tax advice. Specific professional advice should be obtained regarding any topic discussed in this article.

If you have any questions about the above information, please contact a member of the Gardiner Roberts LLP’s experienced tax and estates planning group.

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