



# FLORES GROUP ATTORNEYS & ADVISORS

Member of



## U.S. TAXATION OF FOREIGN ATHLETES AND ENTERTAINERS

### 1. FOREIGN ATHLETES AND ENTERTAINERS TAXATION

As a general rule, the United States Internal Revenue Code (the “Code”) taxes United States sources income earned by nonresident’s aliens. Payments to nonresident aliens for personal services performed in the U.S. are generally considered U.S. source income. Under most circumstances, payments from organizations to foreign athletes and entertainers for personal services performed in the U.S. are subject to U.S. tax. Foreign athletes and entertainers performing personal services in the U.S. are taxed at graduated rates on their taxable income after allowable deductions. Personal service income includes wages, salaries, commissions, fees, per diem allowances, and employee allowances and bonuses. The income is taxable to the foreign athlete or entertainer whether paid in the form of cash, services, or property.

Foreign athletes and entertainers may also be subject to state and local income taxes for income earned within a particular state. State income tax liability may exist even if there is no federal income tax liability; and if the income is exempt from tax as a result of an income tax treaty. A foreign athlete or entertainer should refer to specific state tax laws or seek the assistance of a tax professional to determine applicable state tax requirements including the necessity to file a state income tax return. Generally, this information is available on the state’s website.

### 2. NONRESIDENT ALIEN (NRA) WITHHOLDING

## **A. General Rule**

Generally, a foreign person, whether a foreign corporation or a nonresident alien individual, is subject to U.S. tax on U.S. sources income. Most types of U.S. source income, including compensation for personal services performed in the U.S., received by a foreign persons are subject to a U.S. tax of 30 percent. A reduced rate or exemption may apply if there is a tax treaty between the foreign person's country of residence and the United States.

A payer (withholding agent) is personally liable for any taxes required to be withheld. The liability is independent of the tax liability of the foreign person to whom the payment is made. If the payer fails to withhold and the foreign payee fails to satisfy its U.S. tax liability, then both the payer and the foreign person are liable for tax, as well as interest and any applicable penalties. The applicable tax will be collected only once. If the foreign person satisfies its U.S. tax liability, the payer may still be held liable for interest and penalties for a failure to withhold.

## **B. Payments Subject to Withholding**

To ensure collection of income taxes on U.S. sources income from nonresident aliens, the Code requires the payers to withhold 30 percent ("NRA Withholding") of the gross payment and remit that amount to the Internal Revenue Service. The payer cannot reduce the gross amount by any deductions. Withholding is required at the time of the payment. A payment is made to a person if that person realizes income whether or not there is an actual transfer of cash or other property. A payment is also considered made to a person if it is made to that person's agent.

The withholding applies to personal services performed in the U.S. irrespective of the payer's place of residence, where the contract for services was made, or the place of payment. That is, the place that the personal services are performed determines the source of the income. U.S. organizations engaging foreign athletes and entertainers for tours outside the U.S. should note that a nonresident alien independent contractor is not taxed on compensation for services performed outside the U.S.

**If the foreign athlete or entertainer is an independent contractor, organizations should be aware that payments that are made to third parties on the foreign athlete or entertainer's behalf for food, lodging, or other expenses with respect**

**to personal services performed in the United States are also income subject to U.S. tax withholding.**

### **C. Beneficial Owners**

Contracts for personal services of foreign athletes and entertainers frequently request that the payer make payments to either a U.S. or foreign management agent. In considering the appropriate withholding, the payer must determine the “beneficial owner” of the payment. The beneficial owner is the person who is the owner of the income for tax purposes and who will benefit from owning the income. Thus, a person receiving income strictly to pass the payment on to another person is not the beneficial owner of the income.

**If the foreign athlete or entertainer is the beneficial owner of a payment made to an agent**, then the withholding must be handled similar to a payment directly to a foreign athlete, entertainer or foreign , but may also require additional documentation from the agent. Failure of the payer to acquire the beneficial owner documentation would preclude the foreign athlete, entertainer or foreign organization from either obtaining tax treaty benefits or credit for the withheld taxes.

**If the payment is made to a U.S. management agent and the foreign athlete or entertainer is the beneficial owner**, the payer must still acquire the regular documentation from the foreign athlete or entertainer, that is, a Form 8233, Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual.

**If the payment is made to a foreign management agent and the foreign athlete, entertainer or foreign organization is the beneficial owner**, the payer should acquire a Form W-8IMY, Certificate of Foreign Intermediary, from the foreign management agent in addition to the documentation of the foreign athlete, entertainer (Form 8233) or foreign nonprofit organization (Form W8-EXP, Form W-8BEN, or Form W8-ECI).

## **3. EXCEPTIONS TO NRA WITHHOLDING REQUIREMENT**

In most situations the general rule that organizations should withhold 30 percent from payment to foreign athletes and entertainers and remit such amounts to the IRS will apply. However, the Code and the Federal Regulations provide several exceptions to

withholding that might apply in certain circumstances.

There are several exceptions to the Withholding requirement with regard to compensation paid for personal services, if such compensation is effectively connected with the conduct of a trade or business within the United States. Income earned by foreign athletes and entertainers for their personal services performed within the United States is considered income effectively connected to a trade or business in the United States.

The exceptions to Withholding, which are relevant to the circumstances common to foreign athletes and entertainers, are as follows:

- Compensation that is subject to withholding under Section 3402 (“graduated withholding”) and the regulations under that section. (Employee/Employer relationship);
- Compensation for services performed by a nonresident alien who is a resident of Canada or Mexico and who enters and leaves the United States at frequent intervals;
- The nonresident alien enters into a central withholding agreement with the Internal Revenue Service;
- Compensation subject to Internal Revenue Code exceptions, pertaining to payments to certain foreign corporations or certain individuals performing as employees of foreign employers;
- Compensation that is, or will be exempt from the income tax imposed by the Code by reason of a tax treaty.

#### **A. Compensation Subject to Graduated Withholding**

Employers paying wages to nonresident aliens are required to withhold tax at graduated rate as determined by specific tables and procedures, rather than withholding at the 30 percent rate. In general, wages is defined in the Code as all remuneration for services performed by an employee for his employer.

**This excludes payments to an independent contractor.**

Distinguishing an employee from an independent contractor generally depends on the facts and circumstances surrounding the performance of the services. Labels do not

determine an individual's classification. For example, status as an employee cannot be avoided merely by labeling an individual "independent contractor," "consultant" or other term designed to belie an employment relationship exists when the person for whom the services are performed has the right to control and direct the individual performing the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is to be accomplished.

In general, if the foreign athlete or entertainer is an employee, he should be treated as any other employee of the organization for tax purposes. It is likely that most foreign athletes and entertainers will not be considered employees, and the organization will not therefore be exempt from the Withholding requirement under this category.

## **B. Central Withholding Agreement**

The central withholding agreement (CWA) is a mechanism whereby the Internal Revenue Service agrees to accept a withholding amount based upon the foreign athlete or entertainer's net income rather than upon gross receipts. If the Internal Revenue Service and the nonresident alien individual reach a central withholding agreement, compensation for personal services within the U.S. of a nonresident alien individual may be wholly or partially exempt from the Withholding requirement. Thus, the foreign athletes or entertainers may avoid over-withholding.

The central withholding agreement is particularly useful when athletes and entertainers on a U.S. tour with multiple venues seek exemption from foreign withholding, or when an athlete or entertainer plans to work in the U.S. for an extended period of time. Note: The process for obtaining a central withholding agreement may be too lengthy to make the CWA a practical option for many foreign guest athletes and entertainers working in the U.S. for a short period of time or on an occasional basis, unless the engagements are planned far in advance. Athletes and entertainers seeking to enter into a CWA should plan to complete the agreement 90 days before the paid performance to ensure the agreement is processed in time.

The CWA provides the Internal Revenue Service sufficient accounting and procedural assurances that the actual tax liability will be collected and paid. Among other assurances, the nonresident alien individual must agree to timely file an income tax return for the current taxable year. If a foreign athlete or entertainer is interested in requesting a CWA, Revenue Procedure 89-47, provides detailed information

regarding such a request. The application process for a CWA is a very detailed process and should be pursued with the assistance of a tax professional.

### **C. Internal Revenue Code Exceptions**

Specific provisions of the Code may exempt a nonresident alien from U.S. tax, and thus, withholding. These exemptions require the nonresident alien to be performing services as an “employee” of a foreign employer (includes foreign corporations, partnerships, and individuals) and such foreign employers cannot be engaged in trade or business in the United States. In addition, an exemption from NRA withholding, but not from U.S. tax, is available for payments to foreign corporations and partnerships for services rendered in the U.S. by their employees.

### **D. Tax Treaties**

The United States has entered into income tax treaties with a number of foreign countries. Under these treaties, residents of foreign countries are taxed at a reduced rate, or are exempt from U.S. income taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income. If a treaty exemption applies to a particular foreign athlete or entertainer, and the proper documentation is presented, the arts organization will also be exempt from the Withholding requirement. Unfortunately, most tax treaties have provision that prevent performing athletes and entertainers from fully availing themselves of the exemptions available to other country residents. IRS Publication 901, U.S. Tax Treaties, summarizes the treaty exemption on a country-by-country basis.

**Source:** Internal Revenue Code and IRS website

## **CONCLUSION**

We hope this alert has been informative to you.

We are Tax Attorneys and Advisors, we strive to provide our clients the highest quality of legal and tax representation in the complex area of tax law. This alert has provided only general information and specific factual scenarios may change any conclusions that would apply.

Please call to discuss your specific situation with our legal and tax advisors.

Should you need additional information it will be our pleasure to assist you.

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