



CESTNICK

TAX MATTERS

The tax complications that have ensnarled Leafs' John Tavares after his \$15-million signing bonus from 2018

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The life of a professional athlete can be tough. A close friend of mine, Paul, is a professional bagpiper. He suffers from focal hand dystonia – a movement disorder – and may have to give up piping. Now, some might suggest that bagpiping is not a sport – but Paul's lung capacity is on par with an Olympic runner (although this conditioning usually disappears by the fall each year because of general laziness and beer consumption).

Perhaps a better example is John Tavares of the Toronto Maple Leafs. Mr. Tavares has been captain of the Maple Leafs since 2019 but gave up that title this week. Further, he's been in a battle with the Canada Revenue Agency (CRA) that could cost him millions. Today, I want to share more about this tax dispute.

The situation

Canada doesn't tax folks based on citizenship, but on residency. So, generally, if you live here, you'll pay tax here on your worldwide income (some

non-residents pay tax in Canada – but that's a topic for another day). Mr. Tavares left Canada when he moved to New York State in 2009 to play for the Islanders. He became a non-resident and wasn't required to pay tax in Canada while playing in New York.

After becoming a free agent in 2018, he signed a seven-year contract with the Maple Leafs. He was paid a signing bonus on July 1, 2018, while he was still resident in the United States. His deal with the Leafs paid him an annual salary of US\$650,000 for the 2018-19 season, and US\$910,000 a season for the remaining seasons under his contract. He was also provided a signing bonus of US\$70,890,000 paid over the seven years, with US\$15,250,000 of that bonus paid on July 1, 2018.

Mr. Tavares was resident in the U.S. when he received the US\$15,250,000 signing bonus, so he paid tax on it in the U.S. in 2018. Now, he was also taxed in Canada on this US\$15,250,000 because non-residents are required to pay taxes

in Canada in certain situations. In Mr. Tavares's case, the bonus was deemed under our tax law to be received from employment in Canada, and was therefore taxable in Canada, since a Canadian employer (Maple Leaf Sports and Entertainment – MLSE) paid him the amount; there was a significant economic link between Canada and that income.

The problem, of course, is that Mr. Tavares was taxable in both Canada and the U.S. on that signing bonus – which is a double-tax problem. But the Canada-U.S. tax treaty fixes this by doing two things. First, it provides a foreign tax credit so that Mr. Tavares was entitled to claim a credit on his U.S. tax return for the Canadian taxes he paid. Second, the treaty reduces the Canadian tax on a signing bonus for athletes to a 15-per-cent withholding tax. Why? Because the amount of tax paid to Canada would otherwise be higher than taxes paid in the U.S., so athletes who come to Canada may end up unable to claim the full amount of Canadian taxes as a credit against U.S. taxes paid. This is solved by limiting the Canadian tax to 15 per cent. It allows Canadian teams to attract U.S.-resident athletes.

In the end, a U.S.-resident athlete coming to Canada will pay tax on his or her signing bonus at U.S. tax rates, not the higher Canadian rates, but the actual tax dollars are split between Canada (getting the first 15 per cent) and the U.S. (getting the balance).

The reassessment

Back to Mr. Tavares. In November 2022, the CRA reassessed his 2018 tax return and increased his income by \$17,771,862 (the Canadian dollar equivalent of his

US\$15,250,000 signing bonus less US\$1,753,750 of his bonus, which, under the National Hockey League Collective Bargaining Agreement, had to be held in escrow). This would result in additional taxes payable of \$6,847,428 (taking into account the 15 per cent he's already paid to CRA).

Mr. Tavares's lawyer filed a notice of appeal with the Tax Court of Canada on Jan. 31, 2024. The argument is primarily that the signing bonus was an "inducement to sign an agreement relating to the performance of the services of an athlete" and therefore the Canada-U.S. tax treaty should require only a 15-per-cent withholding tax. CRA's argument is, evidently, that the 2018 signing bonus was not an "inducement" but was really part of Mr. Tavares's "salary and other remuneration," which is not eligible for the 15-per-cent tax rate under the treaty.

It's the job of the Tax Court of Canada to decide the nature of the payment made to Mr. Tavares – which will determine his tax fate. I have concerns about the approach CRA has taken here, which I'll share next time.

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