CESTNICK

TAX MATTERS

Why a tax treaty matters to the Maple Leafs – and Canadian sports

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I was talking to a good friend this week. "Cary, I've been married for a long time, and I still don't understand Carolyn. Words matter. She'll use words but mean something else entirely," I said. "Tim, you're asking me to explain women?" Cary replied. "I'm still trying to figure out why pizza is round, comes in a square box and is cut into triangles."

Our tax law can also be tough to understand. Words matter – a lot. Call something a "dividend" instead of "salary" and you change the tax result. Today, one word sits at the centre of two Tax Court of Canada cases involving Toronto Maple Leafs forward John Tavares and former Leaf Patrick Marleau. That word is "inducement." And there's more riding on its meaning than millions in tax.

The dispute

When Marleau signed with Toronto in 2017, after nearly two decades with the San Jose Sharks, most of his three-year, US$18.75-million contract was structured as signing bonuses. Tavares followed in 2018, leaving the New York Islanders for the Maple Leafs under a seven-year, US$77-million contract, also heavily weighted toward signing bonuses.

Why does this matter? Article XVI (4) of the Canada-U.S. tax treaty says that when a U.S. resident (such as Marleau and Tavares) receives an amount from a Canadian resident (Maple Leaf Sports and Entertainment) "as an inducement to sign an agreement" to perform services as an athlete, Canadian tax on the payment is capped at 15 per cent.

The Canada Revenue Agency argues these amounts weren't the inducements contemplated by the treaty, but rather employment compensation taxable at ordinary Canadian rates. Tavares is fighting about $6.85-million of additional tax – plus interest (see my article from Aug. 15, 2024).

Yet, Marleau's testimony describes an inducement in pretty plain English. He testified that Toronto wasn't initially on his radar, and that former Leafs coach Mike Babcock explained the treaty tax treatment as a lever Canadian teams could use to attract players. Marleau said he wouldn't have come to Toronto without this treatment of his signing bonus.

If something causes you to accept an offer you otherwise wouldn't have accepted, "inducement" seems like a pretty good word for it.

The treaty

Here's some history. Canada and the United States deliberately amended the tax treaty in 1983 to deal specifically with signing inducements paid to athletes. The official U.S. Treasury explanation says the provision was intended to clarify the treatment of signing bonuses and distinguishes these from salary paid for actually playing the game.

The U.S. government identified that recipients weren't protected by a limit on source-country tax, which is a problem. The solution was Article XVI (4): Inducements could be taxed by the country from which they were paid – capped at 15 per cent.

Tax treaties aren't loopholes. They're negotiated agreements between countries. Canada agreed to this one, and 43 years later, we shouldn't be surprised that Canadian teams rely on this treaty provision when persuading an athlete to cross the border to play here.

And consider the word the two governments chose: "inducement." The treaty doesn't say the payment must be the only inducement. Of course, Tavares and Marleau considered money, family, contract length and the chance to win. Who wouldn't? The relevant question should be whether the signing bonus genuinely induced them to sign – not whether other factors mattered, too.

The consequences

Some Canadians won't lose sleep over pro hockey players paying more tax. I get it. But this is much bigger than Tavares and Marleau.

Imagine a Canadian NHL team pursuing an elite free agent who also has offers from Carolina, Tampa or Vegas. Think about the Toronto Raptors competing with Boston, Cleveland or Los Angeles for an NBA superstar. Or the Blue Jays trying to lure a marquee free agent with multiple American options.

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Canada already presents tax challenges; Ontario's top combined federal-provincial marginal rate, for example, is 53.53 per cent. Some U.S. states have no state income tax. Now, if you significantly weaken one of the treaty tools available to Canadian franchises when recruiting talent, what happens?

At the margin, fewer great players come north, and Canadian teams become less competitive. And the consequences don't stop at the box office. Remember the Raptors' 2019 championship? Kids across the country watched Kawhi Leonard and company and then picked up basketballs themselves.

After the Blue Jays' 2025 World Series run, minor baseball organizations across Canada have reported surging enrolment in 2026. Burlington, Ont., where I live, had to secure additional baseball diamond permits to accommodate demand.

Professional success can encourage children to try a sport. Franchises also support community programs and grassroots initiatives, while their stars become heroes that children imitate in driveways, gyms and local rinks.

The Tax Court will decide whether Marleau's and Tavares's signing bonuses meet the test of "inducements." But Canada and the U.S. reached an agreement in 1983, and it should be respected. The consequences for sport in Canada – particularly for our children – are significant.

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