Are You Not Entertained - Is This Not Why You Are Here - U.S. Taxation of Foreign Athletes and Entertainers

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“ARE YOU NOT ENTERTAINED? IS THIS NOT WHY YOU ARE HERE?”¹ U.S. TAXATION OF FOREIGN ATHLETES AND ENTERTAINERS

I. INTRODUCTION

When foreign athletes and entertainers perform in the United States, many Americans just sit back, relax and enjoy the show.² The Internal Revenue Service ("IRS"), however, focuses on foreign athletes' and entertainers' tax liabilities that arise from their performances.³ This focus exists because the IRS wants its portion of the performance income foreigners earn while in the United States.⁴ According to the IRS, the problem is that these foreign athletes and entertainers are not paying their "fair share" of federal income taxes owed.⁵ These individuals' lack of tax compliance, coupled with the abundant taxable revenue generated from their performances, results in attention from the IRS and U.S. Treasury Department ("Treasury").⁶ This targeting of foreign athletes and

¹ GLADIATOR (Dreamworks Pictures 2000).
³ See Stephanie C. Evans, Note, U.S. Taxation of International Athletes: A Reexamination of the Artiste and Athlete Article in Tax Treaties, 29 GEO. WASH. J. INT'L L. & ECON. 297, 297 (1995) (explaining how IRS was concerned not with actual game playing during 1996 Summer Olympics and 1994 World Cup, which were both held in United States but, rather, with taxing visiting foreign athletes' income derived from participation in those events).
⁴ See id. at 297-98 (highlighting taxing authorities' interest in "receiving their fair share of income from athletes who enjoy the benefits of performing within their borders"); see also DANIEL SANDLER, THE TAXATION OF INTERNATIONAL ENTERTAINERS AND ATHLETES—ALL THE WORLD'S A STAGE 149 (Kluwer Law Int'l ed. 1995) (explaining that United States wants its "proper share of the remuneration paid" to foreign athletes and entertainers who come to United States to earn money).
⁵ See Stanley C. Ruchelman & Ian Shane, Tax Concepts Affecting the Foreign Entertainer or Athlete Performing in the United States, 37 TAX MGM'T INT'L J. 272 (2008) (explaining IRS's belief that such individuals are not reporting correctly all their income earned in United States).
⁶ See id. (alluding to fact that athletes and entertainers can make abundant money in form of various types of income); see also SANDLER, supra note 4, at 1 (noting international athletes' and entertainers' ability to make considerable income derived from variety of sources including performances, endorsements, ad-
entertainers to increase their tax compliance in the United States is part of a broader effort to raise revenue and close the federal tax gap.\(^7\)

Foreign artists and athletes have their own concerns about taxes, including the fear of being “double taxed,” the result of being taxed on the same income by the United States and then by their own national governments.\(^8\) Although tax treaties between

vertisements, and other money earning ventures). The IRS is concerned about stopping “tax leakage” as well. Ruchelman, supra note 5. The taxing jurisdictions want to generate the maximum tax revenue from foreign performers’ income before the performers return to their home countries, where they may face little or no taxation at all on that income. See id. (describing that many foreign athletes and entertainers “live in low-tax or no-tax jurisdictions” as well as goal of taxing them). Currently, the IRS has set its sights specifically on taxing foreign golf and tennis stars, as well as foreign musicians. See Tom Herman, Tax Report, High Earners Face Surge in Tax Audits: Hoping to Catch Cheaters, IRS Is Setting New Snare; Targeting Foreign Athletes, WALL ST. J., Jan. 30, 2008, at D1, available at http://online.wsj.com/article/SB120165118416126911.html?mod=rss_Tax_Report (explaining IRS’s efforts to maintain tax compliance among high income earners, particularly those who work for themselves, such as athletes in golf and tennis). The IRS feels that this specific group of foreigners has been especially non-compliant with the Code. See id. (“IRS officials say they have uncovered ‘significant noncompliance’ among foreign athletes, such as golf and tennis stars, and foreign musicians who perform in the U.S. . . . .” (quoting Barry Shott, IRS Deputy Commissioner)).

7. See Herman, supra note 6 (expounding that number of individual income tax audits are at ten year high resulting from Congressional pressure to increase revenue and reduce $290 billion tax gap, which is difference between what taxpayers should be paying and what they actually pay voluntarily and on time). The IRS is focusing on all high-income earners, American and foreign. See id. (explaining IRS pressure on substantial income earners to comply with Code and that Americans are the only people facing this pressure). The 2008 economic stimulus package’s cost provides another economic incentive for the IRS to collect from delinquent or underpaying taxpayers. See id. (noting recent government spending which adds costs that need to be covered); see also I.R.S. and U.S. Dept. of Treas., Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance 1 (2007), available at http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf [hereinafter Reducing the Federal Tax Gap] (blueprinting IRS’s plan to “increase voluntary compliance and reduce the tax gap”). This report states that the IRS has established “Issue Management Teams” to help alleviate “offshore and cross-border compliance risks.” Id. at 99.

8. See Evans, supra note 3, at 298 (“The athletes are worried about more than one country taxing their income – double taxation.”). As Evans explains, double taxation is the imposition of comparable taxes on the same taxpayer, for the same subject matter and for identical periods, by different countries. See id. at 298 n.7 (citing Comm. on Fiscal Affairs, Organisation for Econ. Co-Operation & Dev., Model Tax Convention on Income and on Capital, Mar. 1, 1994, at 1-1). But see Maass v. Higgins, 312 U.S. 445, 449 (1941) (holding that U.S. “Constitution does not forbid double taxation”). Double taxation usually comes in three forms: (1) “residence/residence double taxation,” which occurs when an individual is a resident of more than one state; (2) “residence/source double taxation,” which occurs when one country exercises its residence jurisdiction over income and another country exercises its source jurisdiction over the same income; and (3) “source/source double taxation,” which occurs “when the same income qualifies as domestic source income in two different states.” Richard Mitchell, Note, United States-
the United States and other countries help to coordinate the taxation of foreign performers' incomes and prevent double taxation, the recent crackdown on foreign athletes and artists could turn what was once a "steady flow" of foreign talent to the United States into a trickle.\(^9\) Meanwhile, just trying to navigate another country's tax code presents problems, as the performer may attempt to take advantage of any loopholes in the tax regime, potentially worsening matters.\(^10\)

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10. See Ruchelman, supra note 5 (highlighting tax difficulties for foreign performers who come to United States to entertain); see also Herman, supra note 6 (explaining complexity involved with paying taxes for athletes and artists who earn income in more than one country per year). Artists and athletes have issues such as the "burden of either applying for a Central Withholding Agreement, or making a tax treaty claim, combined with increased record-keeping, administrative time, and the cost of professional tax advisers." Gordon Firemark, Tax Withholding: An Unwieldy Burden for Entertainers and the Organizations that Hire Them, Western Ways, May 12, 2008, available at http://theatrelawyer.com/2008/05/12/tax-withholding/. These performers would prefer to minimize their tax liability, especially in a country of which they are not a citizen. See Herman, supra note 6 (quoting tax attorney, Charles Lubar, and stating that IRS "believe[s] there has been a lot of avoidance by foreign artists and entertainers who go in and out of the United States and don't pay their proper U.S. taxes"); see also Don Robert Spellmann, Note, United States Tax Rules for Nonresident Authors, Artists, Musicians, and Other Creative Professionals, 27 Vand. J. Transnat'l L. 219, 251-57 (1994) (describing strategies for such individuals to minimize U.S. tax consequences).
This cat and mouse tax game has rules, however, established by the Internal Revenue Code ("Code") and tax treaties between the United States and other countries. For the sake of preserving entertainment, closing the tax gap and raising revenue, all parties should adhere to these rules so that in the end, everyone wins.

This Comment provides an analysis of recent IRS adamancy in taxing foreign artists and athletes who perform in and derive income from the United States. It also considers the effects such taxation has on those foreign performers. Section II provides background information on using the Code to determine the residency status of individuals who perform in the United States, which is then used to ascertain their tax liability. Additionally, Section II discusses the Code’s treatment of foreign artists’ and athletes’ taxable income. Section II concludes by explaining how their income is taxed when a tax treaty exists between the United States and their country of residence.

Section III analyzes the IRS’s and the Treasury’s recent efforts to ensure foreign artists’ and athletes’ compliance with tax regulations. Additionally, this section tries to reconcile these initiatives in light of current U.S. economic conditions and the need to raise

11. For example, the Code establishes rules for determining residency, which will help to dictate U.S. tax liability. See, e.g., I.R.C. § 7701(b) (2008) (defining "resident alien" and "nonresident alien"). The Code also establishes rules for withholding taxes on income earned in the United States by foreigners. See id. § 871 (indicating types of income subject to withholding tax). In the end, though, tax treaties’ rules may win out. See Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 27 (reminding that tax treaties often create U.S. tax exemptions for foreign athletes’ and entertainers’ income).

12. Again, the IRS is bolstering its enforcement efforts to collect qualifying income taxes from foreign athletes, artists, and other high-income earners as a means of generating tax revenue. See generally Herman, supra note 6 (explaining current tax targeting of foreign performers). Meanwhile, the United States remains a source of employment opportunity and potential wealth such that it should continue to be an attractive work locale to foreign artists and athletes. See id. (explaining that such individuals are high income earners); see also Sandler, supra note 4, at 149 (noting, for example, that United States is "largest producer of motion pictures in the world, and actors from many countries have appeared in US films[,]" that "there is also a considerable number of professional sporting events which occur in the US, in virtually all areas of sport[,]" and that "every year, thousands of individuals go to the US to perform in movies, compete in sporting events, perform in concerts and endorse products").

13. For a further discussion of the determination of residency status of aliens in the United States, see infra notes 20-42 and accompanying text.

14. For a further discussion of taxation of nonresident aliens’ income, see infra notes 43-71 and accompanying text.

15. For a further discussion of income taxation according to tax treaties, see infra notes 72-91 and accompanying text.

16. For a further discussion of the IRS initiative to achieve tax compliance among foreign artists and athletes, see infra notes 127-161 and accompanying text.
revenue without imposing more costs on the American public.\textsuperscript{17} This section also discusses how the IRS's aims will affect the flow of talent into the United States, as well as possible tradeoffs between the cost of raising revenue and the loss of good entertainment.\textsuperscript{18} Finally, Section IV concludes that the government must strike a balance between taxation and tax relief in order to incentivize foreign artists and athletes to perform in the United States.\textsuperscript{19}

II. BACKGROUND

A. Determining Residency Status of Aliens

The first step in deciding whether to tax foreign artists and athletes is to determine their residency status.\textsuperscript{20} Residency status determination is the first step because whether and how U.S. tax laws apply to foreigners depends on their categorization as either resident aliens or nonresident aliens.\textsuperscript{21} In general, determining whether foreign artists or athletes are residents of any country can be especially difficult because, as they garner fame, they often spend more time traveling and less time in any single country, which weakens their status as residents in those countries.\textsuperscript{22}

With respect to resident aliens, the United States taxes them on their worldwide income.\textsuperscript{23} On the other hand, the United

\textsuperscript{17} For a further discussion of the reasons tax compliance initiatives have been enacted, see infra notes 92-161 and accompanying text.

\textsuperscript{18} For a further discussion of possible negative effects taxation has on foreign athletes and entertainers, see infra notes 162-188 and accompanying text.

\textsuperscript{19} For a further discussion of the ultimate implications due to taxation for both the government and foreign athletes and entertainers, see infra notes 189-199 and accompanying text.

\textsuperscript{20} \textit{See} Ruchelman, supra note 5 ("The starting point for any discussion regarding foreign entertainers and athletes is whether the individual is actually foreign.").

\textsuperscript{21} \textit{See} Spellmann, supra note 10, at 223 (explaining that, in case of non-U.S. citizens, tax law application and scope depends on their alien categorization).

\textsuperscript{22} \textit{See} Sandler, supra note 4, at 1 (describing problems inherent in taxing entertainers and athletes because they lack strong residency ties with countries from which they derive income).

\textsuperscript{23} \textit{See} 26 C.F.R. § 1.871-1(a) (2008) ("Resident alien individuals are, in general, taxable the same as citizens of the United States; that is, a resident alien is taxable on income derived from all sources, including sources without the United States."). The United States taxes its citizens on worldwide income. \textit{See id.} § 1.1-1(b) ("In general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States."). \textit{See generally} Jones v. Kyle, 190 F.2d 353 (1951) (interpreting Sixteenth Amendment to hold that U.S. government has power to tax taxpayer's income earned outside of United States). "Every person born or naturalized in the United States and subject to its jurisdiction is a citizen." 26 C.F.R. § 1.1-1(c).
States taxes nonresident aliens on income effectively connected to a U.S. trade or business\textsuperscript{24} or on income derived from a U.S. source.\textsuperscript{25} Essentially, the U.S. government is interested in collecting taxes on all potentially taxable income, regardless of whether the taxation is categorized as source-based or residency-based.\textsuperscript{26}

U.S. residency is determined according to definitions established by the Code.\textsuperscript{27} An alien is considered a resident if he or she passes one of the residency tests under I.R.C. § 7701(b)(1)(A).\textsuperscript{28} Accordingly, an alien will be considered a nonresident if he or she is neither a U.S. citizen nor passes the tests under I.R.C. § 7701(b)(1)(A).\textsuperscript{29}

The first residency test under I.R.C. § 7701(b)(1)(A) is the green card test.\textsuperscript{30} It holds that a person is a U.S. resident if he or she is a lawful permanent resident during any point of the year.\textsuperscript{31}

\begin{itemize}
  \item 24. See I.R.C. § 871(b)(1) (2008) ("A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable . . . on his taxable income which is effectively connected with the conduct of a trade or business within the United States."); see also 26 C.F.R. § 1.871-1(a) (explaining taxation of nonresident alien individuals).
  \item 25. See, e.g., I.R.C. § 871(a)(1) (stating "there is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual") (emphasis added); see also 26 C.F.R. § 1.871-1(a) (explaining taxation of nonresident alien individuals).
  \item 27. See generally I.R.C. § 7701(b) (defining "resident alien" and "nonresident alien").
  \item 28. See id. § 7701(b)(1)(A) (stating that alien individual will qualify as resident if individual "is a lawful permanent resident of the United States at any time during such calendar year" or meets requirements of "substantial presence test"). Nonresident aliens may also elect to be treated as U.S. residents for purposes of taxation, although for purposes of this comment, this election option will not be discussed. See id. §§ 7701(b)(1)(A)(iii), (b)(4) (explaining election process).
  \item 29. See id. § 7701(b)(1)(B) ("An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States . . . .") For a definition of "citizen," see supra note 23.
  \item 30. See Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 6 (stating that test is "known as green card test because these aliens hold immigrant visas (also known as green cards)"); see also Kenneth R. Meyers, Note, New Exemptions from Withholding of Federal Income Taxes on Compensation Paid to Nonresident Aliens, 19 VAND. J. TRANSNAT’L L. 585, 599-600 (1986) (explaining why test is called "green card" test).
  \item 31. See I.R.C. § 7701(b)(1)(A)(i) (2008) ("An alien individual shall be treated as a resident of the United States with respect to any calendar year if (and only if)
\end{itemize}
Basically, if the alien resides permanently in the United States, then he or she passes this test.  

Aliens, however, often apply for visas or temporary work permits allowing them to enter the United States for performances. Thus, the green card test is not completely relevant for artists and athletes because of the nature of these work permits they receive. Fortunately, a better barometer for determining residency status of artists and athletes exists: the substantial presence test.

The substantial presence test holds that an alien is a resident if he or she has met two criteria. First, the individual must be present in the United States for at least thirty-one days during the current calendar year. Second, the weighted aggregate number of days of "presence" of the current calendar year and the two previous years must total at least one hundred and eighty-three days. Mere physical presence will also suffice to meet the "presence" requirement.

On the other hand, an individual will not pass the substantial presence test if he or she is present less than half the year during

... such individual is a lawful permanent resident of the United States at any time during such calendar year.

32. See Meyers, supra note 30, at 599 (noting that foreigner's green card or permit is evidence of lawful U.S. residence).

33. See 8 C.F.R. § 214.2(h) (2008) (stating how foreigners gain entry into United States for temporary employment); see also Susser, supra note 9, at 620-21 (describing immigration problems associated with working in United States and methods artists and athletes employ to gain entry for work).

34. See Susser, supra note 9, at 620-21 (stating that artists and athletes do not apply for permits or green cards).

35. See id. at 621 (highlighting reason why substantial presence test may be better suited for determining residency of alien artists and athletes).

36. See I.R.C. §§ 7701(b)(1) (A)(ii), (b)(3)(A) (explaining "substantial presence test").

37. See id. § 7701(b)(3)(A)(i) (defining factor as "such individual was present in the United States on at least 31 days during the calendar year").

38. See id. § 7701(b)(3)(A)(ii) (stating that "the sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days"). The number of days is weighted according to the year in question. See id. (indicating basic formula). Basically, the number of days the individual is present during the current year is multiplied by one; the number of days the individual was present in the first previous year is multiplied by one-third; and the number of days the individual was present in the second previous year is multiplied by one-sixth. See id. (indicating how days are aggregated). Finally, the sum of these year-weighted values must be greater than or equal to 183 to pass the test. See id. (indicating dividing line for meeting test).

39. See id. § 7701(b)(7)(A) ([A]n individual shall be treated as present in the United States on any day if such individual is physically present in the United States at any time during such day.").
the current calendar year, has a tax home in a foreign country and has a closer connection to that country.\textsuperscript{40} Additionally, in the case of athletes, they may exempt some days of "presence" if their presence in the United States is due to participation in a charitable event.\textsuperscript{41} Notwithstanding these exceptions, if the presence totals are met, then substantial presence is established and the individual will be considered a resident.\textsuperscript{42} For purposes of this Comment, any foreign artists and athletes are assumed to be nonresident aliens.

B. Taxing Nonresident Aliens' Income

1. Nature of Income's Source

Income earned from performances of personal services in the United States and income in the form of royalties or rentals of property located in the United States are considered U.S. source income and subject to U.S. income taxation.\textsuperscript{43} A nonresident

\textsuperscript{40} See id. § 7701(b)(3)(B) (stating exception to substantial presence test); see also 26 C.F.R. § 301.7701(b)-2 (2008) (defining "tax home" and "closer connection").

\textsuperscript{41} See I.R.C. § 7701(b)(5)(A)(iv) (2008) (explaining that "[a]n individual is an exempt individual for any day if, for such day, such individual is . . . a professional athlete who is temporarily in the United States to compete in a charitable sports event"). This rule helps to "encourage[e] athletes to appear in tournaments sponsored by charities." \textsc{sandler, supra} note 4, at 151. Another exception to "presence" available to any foreigner relates to medical conditions. See I.R.C. § 7701(b)(3)(D) (highlighting medical condition exception).

\textsuperscript{42} See generally id. § 7701 (explaining test). Even in meeting some of these criteria, however, an alien still will not be treated as a resident if tax treaty rules intervene. See Ruchelman, \textsc{supra} note 5 (describing "determination of residence status under a treaty"). Ultimately, though, determination of residency status rests with the courts. See Johansson v. United States, 336 F.2d 809, 813-14 (5th Cir. 1964) (holding that federal court is not bound by tax treaty in deciding residency status of foreigner).

\textsuperscript{43} See I.R.C. § 861(a)(3) (explaining that compensation for personal services performed in United States is considered U.S. source income); see also id. § 861(a)(4) (stating that income from royalties or rentals of property located in United States is considered U.S. source income); U.S. \textsc{const}. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived . . . .") (emphasis added). Generally, artists and athletes make much of their income in one of these forms. See \textsc{sandler, supra} note 4, at 149-62 (giving examples of types of income); see also Spellmann, \textsc{supra} note 10, at 235-40 (highlighting such sources of income). For a nonresident alien to have U.S. tax liability stemming from performances of personal services, he or she must be present in the United States for greater than ninety days during the tax year, have an aggregate compensation totaling more than $3,000, and must be the person performing the personal services. See I.R.C. § 861(a)(3) (noting exception to compensation for personal services as income rule). Whether the income for performance of personal services is earned as an employee or independent contractor is irrelevant as both types are considered income derived from a U.S. source. See 26 C.F.R. § 1.861-4(a) (2005) (stating that way income is earned does not change fact that income is still of U.S. source).
alien’s income, subject to U.S. income taxation, is divided into two categories: (1) income “effectively connected” with a trade or business in the United States; or (2) income “not effectively connected” with a trade or business in the United States. This categorization is the key factor as to which tax regime will apply.

a. Income derived from a trade or business

Any nonresident alien’s income effectively connected with a U.S. trade or business will be taxed in the same way with the same graduated rates that apply to U.S. residents. If a nonresident alien conducts business activities with a U.S. trade or business, either directly or through a representative, courts usually will consider such a person to be engaged with that U.S. trade or business. Income that the engaged nonresident alien makes must be “effectively connected” with the activities of the U.S. trade or business. Income derived straight from a U.S. business is “effectively connected.” Also, foreign source income attributable to a business office located in the United States and consisting of rents and royalties is “effectively connected.”


45. See Spellmann, supra note 10, at 224 (“The United States applies two different tax regimes to nonresidents.”). “The tax liability’s scope turns on whether the nonresident receives income connected with a United States business.” Id.

46. See I.R.C. § 871(b)(1) (“A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in [the Code] on his taxable income which is effectively connected with the conduct of a trade or business within the United States.”). The graduated tax rate schedules are provided in I.R.C. § 1. See id. § 1 (listing schedules). Nonresidents will have to file a tax return when taxed in this way. See Spellmann, supra note 10, at 226 (“The Code requires these nonresidents to file an annual nonresident tax return with the IRS that reports their effectively connected income and any resultant United States tax liability.”).

47. See Spellmann, supra note 10, at 226 (“Courts generally consider a nonresident to be engaged in a [U.S.] trade or business if he conducts regular and continuous business activities in the [United States], either directly or through an agent or other representative.”).


49. See id. § 864(c)(3) (explaining effectively connected income); see also 26 C.F.R. § 1.864-3 (giving rules and examples for determining whether income is effectively connected); 26 C.F.R. § 1.864-4 (explaining when U.S. source income is considered effectively connected with U.S. trade or business).

50. See I.R.C. § 864(c)(4)(B)(1) (defining “effectively connected”); see also 26 C.F.R. § 1.864-5 (explaining how foreign source income may be effectively connected with U.S. trade or business). “[I]ncome . . . shall not be considered as attributable to an office or other fixed place of business within the United States.
The Code stipulates that "trade or business" incorporates personal service performances. As a result, salaries and other wages, bonuses and prize money will be considered effectively connected income.

A nonresident alien who is taxed in this way will be eligible for any deductions or exemptions that are made available to U.S. residents. Nevertheless, just because income is effectively connected to a U.S. trade or business will not bar a withholding tax from being levied on it as well.

b. Income not derived from a trade or business

The U.S. government levies a withholding tax on any nonresident alien's income not effectively connected with a U.S. business or trade. The tax is levied at a flat rate of thirty percent. The types of income that are subject to this withholding tax vary greatly, including compensation, royalties and gains made through property sale.

unless such office or fixed place of business is a material factor in the production of such income ... " I.R.C. § 864(c)(5)(B).

51. See I.R.C. § 864(b) ("[T]he term 'trade or business within the United States' includes the performance of personal services ... ."); see also 26 C.F.R. § 1.864-2 (explaining trade or business further).

52. See Evans, supra note 3, at 302 (stating that "salary, fees, wages, compensation, bonuses or prize winnings received for U.S. performances is effectively connected U.S. source income").

53. See generally I.R.C. § 873 (listing allowable deductions and exceptions for nonresident aliens who are taxed on income effectively connected with U.S. trade or business similar to those deductions and exceptions allowed for U.S. citizens and residents).

54. See Sandler, supra note 4, at 153 ("It is important to note that the fact that income is effectively connected with a [U.S.] trade or business does not preclude the possibility that tax must be withheld [on] payments [made to a nonresident]."). In effect, the payee may have to withhold tax from the payment to the artist or athlete, and then, once the payee receives payment, such individual may be subject to the graduated tax rates. See id. (explaining how two tax regimes may apply to one payment).

55. See I.R.C. § 871(a)(1) (2008) (describing withholding tax). Furthermore, "[t]he Code contains comprehensive withholding tax provisions in order to ensure compliance with its provisions." Sandler, supra note 4, at 162. For example, in the case where an agent represents and makes payments to an artist or athlete, that agent is responsible for withholding the tax. See I.R.C. § 1441(a) (describing withholding tax in case of nonresident alien represented by others, such as agents).

56. See I.R.C. § 871(a)(1) ("[T]here is hereby imposed for each taxable year a tax of 30 percent of the amount received . . . "); see also id. § 1441(a) (stating that where nonresident alien receives payments from agent or other representative type, such representative must withhold tax of 30 percent).

57. See, e.g., id. §§ 871(a)(1)(D), 1441(b) (stating types of income subject to withholding tax).
Additional notable aspects about this tax include that it may be levied on income derived from performances of personal services, even though such income is considered effectively connected with a U.S. trade or business.\textsuperscript{58} Also, the tax rate levied on income derived from U.S. businesses has been reduced in recent years in accord with overall tax rate declines, while the withholding tax rate remained the same.\textsuperscript{59} Moreover, unlike the tax on income effectively connected with a trade or business that is applied to net income, the withholding tax is levied on gross income.\textsuperscript{60}

Some recourse exists, however, in that a tax credit may be given to those who pay the withholding tax but are later found to be exempted.\textsuperscript{61} Additionally, foreign artists and athletes who per-

\textsuperscript{58} See 26 C.F.R. § 1.864-4(c)(6)(ii) (2005) (stating nonresident alien’s income received for performing personal services may be considered effectively connected with such trade or business); see also Sandler, supra note 4, at 154 (using as examples of compensation in exchange for personal services that are subject to withholding tax, “purse” for winning boxing match or tournament, “gate receipts or tickets sales,” and “royalties”). Although the withholding tax may be levied in instances where the artist or athlete is considered an independent contractor or in ambiguous employment situations, it may not be levied in situations where such individual is considered an employee. See Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 26 (explaining when withholding tax is applied in case of personal service performances).

\textsuperscript{59} See Spellmann, supra note 10, at 228 (explaining how nonresident aliens whose income is not effectively connected with U.S. trade or business potentially face higher tax rates than nonresident whose income is connected).

\textsuperscript{60} See id. (explaining that withholding tax is “tax . . . assessed on gross income, not net income”). The flat withholding tax is withheld by the payer, and after payment, the payee may have to file a tax return. See id. (explaining taxpaying process). In other words, the Code requires the withholding tax be withheld at the source rather than be paid later. See, e.g., I.R.C. § 1441 (2008) (stating withholding duties of agent or representative of nonresident alien).

\textsuperscript{61} See Evans, supra note 3, at 303 (“The IRS takes the strict position that tax must be withheld at the rate of thirty percent on payments to nonresident athletes, even though payments may be exempt from U.S. tax under either the Code or a tax treaty.”). This tax is withheld always at the source. See id. (explaining withholding). If, later, the nonresident alien on whom the tax is withheld is found tax exempt under a treaty, the nonresident alien will be given a tax credit. See id. (explaining tax credit). This system exists “because the exemption may be based upon factors that cannot be determined until after the end of the year.” Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 27. Johansson v. U.S. illustrates the need for such procedures. 396 F.2d 809, 811 (5th Cir. 1964). Johansson, a Swedish boxer, fought three times in the U.S for which he owed hundreds of thousands of dollars in U.S taxes. See id. (detailing facts of case). The United States brought the action to collect taxes from his winnings. See id. (identifying government action). Because the United States-Sweden tax treaty provided him no relief, Johansson claimed Swiss residence status in order to gain more favorable tax treatment and to be exempt from U.S. taxes under the United States-Switzerland tax treaty. See id. at 812 (discussing attempts by taxpayer to avoid U.S. taxation). The Fifth Circuit Court of Appeals, however, held Johansson was not a Swiss resident nor was he exempt under the United States-Switzerland treaty, and his bout winnings were subject to U.S. income taxation. See id. (finding
form in the United States may apply for a withholding agreement, thereby reducing their tax liability.\textsuperscript{62} These withholding agreements, however, will not reduce the tax liability below the minimum that it would have been had no withholding tax been levied.\textsuperscript{63}

2. \textit{Types of Income}

The tax laws recognize that nonresident alien entertainers and athletes may receive income in different forms.\textsuperscript{64} Many athletes and artists receive income in the form of compensation for personal services or from royalties and rentals of property in the United States.\textsuperscript{65} Compensation for the performance of personal services, however, must be distinguished from income relating to royalties and rentals of property located in the United States.\textsuperscript{66}

boxer was not Swiss resident for, among other things, spending little actual time in Switzerland and for being present in United States for 218 days during relevant taxable year).

\textsuperscript{62} See Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 27 (noting that such individuals “performing or participating in athletic events in the United States may be able to enter into a withholding agreement with the IRS for reduced withholding”). Certain requirements and procedures must be fulfilled to obtain such an agreement. \textit{See id.} (listing steps in getting withholding agreement, including turning over all contracts for performances). Central withholding agreements carry other benefits as well. For example, such an agreement “[p]rovides for withholding that more closely relates to the ultimate tax liability, thus not tying up the nonresident alien athlete’s or entertainer’s funds until a tax return is filed.” I.R.S. and U.S. Dept. of Treas., Frequently Asked Questions (FAQ) about Central Withholding Agreements, http://www.irs.gov/businesses/small/international/article/0,,id=149709,00.html# (last visited Nov. 26, 2008) (listing numerous benefits, inter alia, of such agreements).

\textsuperscript{63} See Withholding of Tax on Nonresident Aliens and Foreign Entities, supra note 9, at 27 (explaining that withholding agreements will reduce tax liability only to “anticipated income tax liability”).

\textsuperscript{64} See Spellmann, supra note 10, at 229 (highlighting compensation as one form of income for such individuals and taxation of compensation). In fact, many top athletes receive compensation from endorsements and sponsorship deals. See Ruchelman, supra note 5 (detailing compensation athletes receive for performances).

\textsuperscript{65} Compare I.R.C. § 861(a)(3) ("Compensation for . . . personal services performed in the United States . . . ") with I.R.C. § 861(a)(4) ("Rentals or royalties from property located in the United States . . . ").

\textsuperscript{66} See Spellmann, supra note 10, at 234-35 (differentiating between types of income made by foreign entertainers). The key distinguishing factor is whether the artist or athlete has retained a property interest in the product or activity. \textit{See id.} (noting distinguishing factor). Spellmann highlights an example of a case where income is classified as royalty income. \textit{See id.} at 231 (citing Sabatini v. Commissioner, 98 F.2d 753 (2d Cir. 1938)). In that case, Sabatini, the taxpayer, was a nonresident author. \textit{See Sabatini,} 98 F.2d at 754. A U.S. publisher published Sabatini’s book in the United States. \textit{See id.} (explaining facts of case). Sabatini argued he was being compensated for labor he performed in England, but the court disagreed and held that he was compensated with royalty income from the publishing
Generally, the determination of whether income falls under compensation for personal service performances is based partly on the particular facts and circumstances but mainly on who has control over the "entertainment."\textsuperscript{67} Whereas no property interest is retained in personal service performances, both royalty and rental income imply that the artist or performer has retained some property interest.\textsuperscript{68} Examples of income made from royalties and rentals include, inter alia, income from the use of patents, copyrights and trademarks.\textsuperscript{69}

Usually, a contract signed prior to a performance or to a product's distribution in the United States stipulates as to which form of payment the entertainer will receive.\textsuperscript{70} Contractual language is not...
dispositive, however, and the IRS may determine that the income is in a form other than that which the contracting parties intended.\textsuperscript{71}

C. Tax Treaties

Tax treaties between the United States and other countries exist to help alleviate tax coordination issues and to prevent double taxation.\textsuperscript{72} These treaties affect the taxation of nonresident aliens under the Code.\textsuperscript{73}

1. Residency under a Tax Treaty

Tax treaties often will determine the residency status of an alien in the United States.\textsuperscript{74} Not surprisingly, an individual will claim that a tax treaty's residency determination overrides the Code

\textsuperscript{71} See, e.g., Boulez v. Commissioner, 83 T.C. 584 (1984) (holding that income will be labeled compensation income despite fact that contract intended payments to be for royalties in addition to existence of tax treaty). Ultimately, "[t]his determination . . . depends on the particular facts and circumstances of the [individual's] transaction." Spellmann, supra note 10, at 234.


\textsuperscript{73} See Ruchelman, supra note 5 (describing tax treaties and their effect on taxation of foreign athletes and artists). "Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate or are exempt from U.S. 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." Tax Treaties - A to Z, supra note 9. Furthermore, if no treaty exists between a nonresident alien's country and the United States, or if such individual's income is not covered under a treaty, then he or she will be taxed according to the respective tax return. See id. ("If the treaty does not cover a particular kind of income, or if there is no treaty between your country and the United States, you must pay tax on the income in the same way and at the same rates shown in the instructions for the applicable U.S. tax return.").

\textsuperscript{74} See Ruchelman, supra note 5 (describing interplay between tax treaties and Code). An advantage of treaties is that they "may override U.S. domestic tax rules applicable to the residence of aliens. As a result, even though a foreign individual may be deemed to be a [U.S. resident] under [the Code], the individual is, nonetheless, taxed as if he were a nonresident." Id. (citing II.R. Rep. No. 432 (Part 2), 98th Cong., 2d Sess. 1528 (1984)).
if the treaty's determination results in more favorable tax treatment to the individual.\textsuperscript{75} Notwithstanding residency, a tax treaty may also allow the individual to opt to be taxed in the country in which he or she will face lesser income taxes.\textsuperscript{76} This tax treaty determination of residency status and taxation generally is controlling.\textsuperscript{77} Ultimately, a final determination of tax status, however, rests with the courts.\textsuperscript{78}

At times, an individual may be deemed a “dual resident,” having residency in both the United States and a country with which the United States has a tax treaty.\textsuperscript{79} In these situations, a tiebreaker provision typically will determine the residency of the individual.\textsuperscript{80} These tiebreaker provisions are contained in the tax treaties.\textsuperscript{81}

2. \textit{Taxing Compensation under a Tax Treaty}

Initially, the common goal was to have a uniform multilateral tax treaty to which all countries could abide.\textsuperscript{82} Later, however, bilateral tax treaties, specifically tailored to address the problems of double taxation, became the standard.\textsuperscript{83} The flexible nature of

\begin{quote}
\textsuperscript{75} See id. (“In many instances, an individual contends that an income tax treaty of the United States mandates a result that is more favorable than that under U.S. domestic law.”); see generally Johansson v. United States, 336 F.2d 809 (5th Cir. 1964) (highlighting situation where nonresident alien attempted to claim residency in country whose tax treaty with United States would have offered better tax consequences to individual).

\textsuperscript{76} Ruchelman, supra note 5 (noting opportunity for choice of country with better tax treatment).

\textsuperscript{77} See Susser, supra note 9, at 628 (discussing how, in past, IRS would ignore tax treaties exemptions and attempt to tax foreign entertainers but that “[IRS] had little success because the courts gave great deference to the treaties”); see also Ruchelman, supra note 5 (explaining residency determination according to tax treaties versus tax code).

\textsuperscript{78} See generally Johansson, 336 F.2d 809 (holding court was not bound by income tax treaty between United States and Switzerland in determining international boxer’s residency status).

\textsuperscript{79} See I.R.S. and U.S. Dept. of Treas., Dual Status Aliens, http://www.irs.gov/businesses/small/international/article/0,,id=129226,00.html (last visited Nov. 3, 2008) (explaining dual status residents and how their status may be determined). Here, the potential for double taxation of the resident/resident kind exists. For a further discussion of this form of double taxation, see supra note 8 and accompanying text.

\textsuperscript{80} See Ruchelman, supra note 5 (describing tie-breaker situations).

\textsuperscript{81} See I.R.S. and U.S. Dept. of Treas., Residency Starting and End Dates – Residency Starting Date under the terms of a Tax Treaty, http://www.irs.gov/businesses/small/international/article/0,,id=129391,00.html (last visited Nov. 5, 2008) (“If dual residency in two countries results, then most treaties contain “tie-breaker” rules to determine to which country residency pertains.”).

\textsuperscript{82} See Evans, supra note 3, at 304-05 (explaining that as far back as 1928, League of Nations considered such options).

\textsuperscript{83} See Evans, supra note 3, at 304 (stating that “[t]ax treaties arose out of a need to address double taxation” and that uniform tax treaty is best approach).
\end{quote}
these modern treaties helps to keep the flow of foreign talent running into the United States. 84

Now, in many tax treaties, artists and athletes are specifically exempt from paying income taxes to the source country. 85 If not specifically exempt, tax treaties may require that income be apportioned between countries in situations like those where an entertainer performs in more than one country. 86

A balance remains, however, such that the host country may still collect some tax benefits. 87 Tax treaties that at one time had no limitations on the amount of exemptions that athletes and artists could claim now contain some restrictions, based on the amount earned and the time in which it is earned. 88 In a move to help remedy this situation, the United States has created its own Model Tax Treaty. 89 This model treaty places specific limitations on income exemptions from taxes. 90 Still, even as countries attempt to collect taxes on foreign entertainers, exemptions and tax freedoms continue to be offered to encourage them to bring their performances to domestic shores. 91

84. See Susser, supra note 9, at 627 (stating treaties help to “encourage[e] foreign professionals to bring their skills into the nation”).

85. See Ruchelman, supra note 5 (identifying U.S.-U.K. tax treaty and artist and athlete exemption from income taxes under treaty).

86. See id. (“Where a foreign . . . entertainer receives income from a series of events, such as a North American tour that has venue sites both in the [United States] and foreign countries, the income . . . must be allocated between [the countries].”).

87. See Susser, supra note 9, at 629 (explaining that host countries still would like to collect some taxes while bringing in foreign talent).

88. See id. (discussing changes to old tax treaties in want of more pro-foreign entertainer tax treatment).

89. See generally Model Income Tax Treaty, supra note 72 (discussing reasons why United States adopted such model treaty).

90. See Susser, supra note 9, at 630 (describing Model Income Tax Treaty).

91. See id. at 633-34 (describing limitations of Model Income Tax Treaty). For example, tax exemptions are available for students and trainees who come to the U.S. to live and learn. See Model Income Tax Treaty, supra note 72, at 29 (identifying potential exemptions).
III. Analysis

A. IRS Crackdown on Taxpayers

1. The Tax Gap

The IRS recently has been trying to achieve greater tax compliance among all taxpayers. The ultimate aim is to reduce the federal tax gap. As the Treasury has stated,

The vast majority of [taxes are] collected through our voluntary compliance system, under which taxpayers report and pay their taxes with no direct enforcement and minimal interaction with the government. The overall compliance rate achieved under this system is quite high . . . . Nevertheless, an unacceptably large amount of the tax that should be paid every year is not, requiring compliant taxpayers to make up for the shortfall and giving rise to the "tax gap." The Administration is committed to working with Congress to reduce the tax gap.

The primary cause of the tax gap is underreporting, which occurs mostly in the individual income tax context. In addition to un-
underreporting, non-filing and underpayment contribute to the size of the tax gap. Blame must be placed on the government because some of this underreporting, non-filing and underpayment is due to the complications of the tax system. These faults have caused the Treasury and the IRS to focus on enhancing taxpayer service and simplifying the tax law, which are components in the tax gap reduction plan. In fact, the Treasury and the IRS currently are conducting studies to determine precisely how much of the tax gap to attribute to the government.

2. **Closing the Gap**

In September 2006, the Treasury released *A Comprehensive Strategy for Reducing the Tax Gap*, the first step in reducing the tax gap. The report outlined the approach that would be taken to achieve the Treasury’s goals for solving the problem. It explained the framework of the Treasury’s strategy to close the tax gap and identified four principles and seven components that will effectuate this strategy. To elaborate on this plan, the Treasury and the IRS

overstating offsets to income or to tax, and net math errors.” *Id.* at 8. In 2001, underreporting of individual income tax accounted for $197 billion dollars of uncollected tax. *Id.* at 10.

96. *See Reducing the Federal Tax Gap, supra* note 7, at 8-9 (listing causes of tax gap). “The nonfiling gap is defined as the amount of true tax liability that is not paid on time by taxpayers who do not file a required return on time (or at all).” *Id.* at 8. An individual who has no duty to file a return is a “legitimate nonfiler” and is not counted in the nonfiling gap. *Id.* “The underpayment gap is the portion of the total tax liability that taxpayers report on their timely filed returns but do not pay on time.” *Id.* at 9.

97. *See id.* at 4 (suggesting that IRS must attempt to “enhance taxpayer service” because “[s]ervice is especially important to help taxpayers avoid unintentional errors”).


99. *See Reducing the Federal Tax Gap, supra* note 7, at 44 (“The IRS does not know what percent of the tax gap is due to inadvertent, unintentional noncompliance that arises from the complexity and confusion surrounding our tax laws . . . [but] several research studies are currently underway . . . to measure the impact . . .”). Some of the studies underway in this area include, the “Bench mark Survey of Taxpayers”, the “NRP Study”, and “The Compliance Impact of Preparer, IRS and Self-Prepared Returns”. *See id.* at 44-45 (listing some research currently being conducted).

100. *See generally A Comprehensive Strategy for Reducing the Tax Gap, supra* note 93 (discussing tax gap and plan to reduce it).

101. *See id.* at 2 (“This document outlines the Administration’s aggressive strategy for addressing the tax gap.”).

102. *See id.* at 2-4 (listing “[f]our key principles guid[ing] the development of this strategy” and seven components of strategy). The four principles are: (1) “unintentional taxpayer errors and intentional taxpayer evasion should both be addressed”; (2) “sources of noncompliance should be targeted with specificity”; (3)
jointly released a more extensive report entitled *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance*. This report provided greater detail on the tax gap and proposed measures to address the problem. The IRS's goal is eighty-six percent taxpayer compliance by 2009. The Treasury and the IRS believe that compliance can be achieved in the long term by properly setting up and executing the plan identified in their report.

To make specific compliance improvements, the IRS wants to make more efficient use of the portion of its annual budget allocated to collecting and processing tax returns. The IRS also hopes to reduce the amount of time it takes to process collections, improve collection efficiency and reach a broader collection base. The Treasury and the IRS plan for changes through legislative enactments and published directions for better compliance to help with this effort. Further, the Treasury and the IRS wish to

"enforcement activities should be combined with a commitment to taxpayer service"; and (4) "policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden." *Id.* at 2. The seven components designed to effect this strategy include: (1) "reduce opportunities for evasion"; (2) "make a multi-year commitment to research"; (3) "continue improvements in information technology"; (4) "improve compliance activities"; (5) "enhance taxpayer services"; (6) "reform and simplify the tax law"; and (7) "coordinate with partners and stakeholders." *Id.* at 2-4.


104. See generally *id.* (explaining in detail tax gap and causes as well as seven components for solving tax gap). The principles of targeting sources of noncompliance with specificity and maintaining a balance between compliance and imposition of taxpayer burden are of considerable importance for this comment. See generally *A Comprehensive Strategy for Reducing the Tax Gap,* supra note 95 (discussing these principles and components). Of equal importance are the effectuating components of improving compliance activities, simplifying the tax code and coordination with tax partners. See generally *id.* (highlighting goals that could have implications for foreign entertainers).

105. See *Reducing the Federal Tax Gap,* supra note 7, at 1 ("The IRS Oversight Board has adopted an 86 percent voluntary compliance goal by 2009 and Senate Finance Committee Chairman Max Baucus has asked for a 90 percent voluntary compliance goal by 2017.").

106. See *id.* (explaining that IRS feels that "[o]nce implemented, these steps will improve the IRS' ability to gauge progress in achieving specific long-term compliance objectives").

107. See *A Comprehensive Strategy for Reducing the Tax Gap,* supra note 95, at 12-13 (explaining that IRS will attempt to "improve efficiency and productivity through process changes, investments in technology, and streamlined business practices").

108. See *id.* at 13 (noting IRS hopes to "increase yield, and expand coverage").

109. See *id.* at 9-10 (detailing component number one of plan, which is to reduce opportunities for evasion). In fact, sixteen new pieces of legislation have been proposed which the Treasury estimates "would generate $29.5 billion over the next 10 years." Reducing the Federal Tax Gap, supra note 7, at 20 (using as
better coordinate efforts with local, state and federal agencies to enhance services including providing more tax education to taxpayers.\footnote{110} The IRS and the Treasury also want to work more closely with foreign tax authorities for better tax administration.\footnote{111} Here, the IRS will attempt to share with and obtain information from other countries on various international tax avoidance maneuvers.\footnote{112} Moreover, the United States, Canada, Australia and the United Kingdom have formed the Joint International Tax Shelter Information Center, which functions as a super tax authority that attempts to proactively strike down abusive tax practices.\footnote{113} These countries' cooperative effort will be executed in accordance to the tax treaties between them.\footnote{114}

In addition to closing the tax gap, the federal government would like to solve the growing national deficit and soften the blow of the costly economic stimulus package passed in the spring of 2008.\footnote{115} The deficit is estimated to reach $482 billion by the end of 2008, which would be a record high in the United States.\footnote{116}

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example, the Small Business and Work Opportunity Tax Act of 2007, which would change, inter alia, some "collection due process procedures for employment tax liabilities".

10. See Reducing the Federal Tax Gap, supra note 7, at 53-56 (explaining component number seven, which is to “Coordinate with Partners and Stakeholders”).

11. See id. at 53 (explicating that U.S. desires “[p]artnering with foreign tax agencies as part of the Organization for Economic Cooperation and Development's (OECD) Forum on Tax Administration”).

12. See id. (“The IRS, in connection with the OECD Working Party on Aggressive Tax Planning, is currently designing a database of various cross-border tax avoidance schemes in order to share knowledge and information among the OECD members.”).

13. See id. (explaining that these four countries “continue their collaboration at the Joint International Tax Shelter Information Center (JITSIC) to supplement the ongoing work of each of the tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements, and schemes”). “The objectives of JITSIC are to deter promotion and investment in abusive tax schemes, primarily through exchange of information.” Id.

14. See id. (“Exchange of information in JITSIC is done in accordance with the provisions of the bilateral treaties between each of the four countries involved.”).

15. See Herman, supra note 6 (highlighting pressure IRS is facing from Congress about growing spending and costs, especially those associated with economic rebate).

The 2008 economic stimulus rebate added to this growing deficit. The economic stimulus package included payments, which unaffected tax returns, made to over one hundred and twenty-four million households and was distributed beginning in May of 2008 and continuing through that year. The stimulus package cost approximately $150 billion. Congress and the Treasury will likely try to make up this cost wherever they can.

3. Results

Recently, the IRS and the Treasury have focused on enforcing tax compliance of high-income earners to achieve their goals of greater across-the-board tax compliance. Accordingly, the year 2007 saw an increase of eighty-four percent in the number of audits of individuals who made at least $1 million that year. Further, in 2007, almost a thirty percent increase occurred in the number of audits of individuals earning more than $200 thousand. Finally, the number of audits of individuals who earn at least $100 thousand in income increased as well. These efforts helped increase revenue by more than $10 billion from 2006 totals and by more than $20 billion from 2002 totals. In fact, Reducing the Federal Tax Gap

117. See Pear, supra note 116 (“Another factor adding to the deficit is the distribution of tax rebates to individuals under the economic stimulus package.”)


119. See Herman, supra note 6 (identifying estimated cost of stimulus package).

120. See id. (noting financial stresses faced by government and its resulting focus of compliance initiatives on high income earners and foreign athletes and entertainers as part of effort to make up for growing debts).

121. See id. (“The IRS is turning up the heat on high-income taxpayers . . . .”); see also Brian Wingfield, Pity the Celebrity Taxpayer, FORBES.COM, July 17, 2008, http://www.forbes.com/2008/07/17/celebrity-tax-troubles-biz-cx_bw_0717celebtax.html (“These days, the Internal Revenue Service is shining its unwanted spotlight on some marquee celebrities.”).

122. See Fiscal Year 2007 Enforcement and Services Results, supra note 92 (explaining increase of audits of this class of individuals). In fact, 17,015 of such individuals were audited in 2006, while 31,382 were audited in 2007. See id. (noting increase in audits). “One out of 11 individuals with incomes of $1 million or more faced an audit in 2007.” Id.

123. See id. (“Audits of individuals with incomes over $200,000 reached 113,105 returns [in 2007], up 29.2 percent from prior year total of 87,885.”).

124. See id. (“The IRS increased audits of individual returns with income of $100,000 or more, auditing 293,188 of these returns in 2007, up 13.7 percent from [2006’s] total of 257,851.”).

125. See id. (stating “enforcement revenue reached $59.2 billion, up from $48.7 billion in 2006 and nearly $34.1 billion in 2002”).
identified "high income non-filers" as a particular group on which focus must be directed to increase compliance.\textsuperscript{126}

4. Artists and Athletes

As part of the crackdown on non-filers, the IRS is centering its focus on foreign artists and athletes.\textsuperscript{127} The Treasury and the IRS specifically cited foreign artists and athletes as a targeted group.\textsuperscript{128} In the initiative to tackle foreign compliance risks, the Treasury and the IRS note that one of the milestones of 2008 was the Project on Foreign Athletes and Entertainers ("FAE"), which was designed to help secure accurate reporting of income as well as detailing the sources of that income.\textsuperscript{129} The Treasury and the IRS plan on continuing this project into 2009.\textsuperscript{130}

The IRS has reasons to target foreign artists and athletes, including the fact that such individuals and their managers earn substantial income, which obligates the IRS to ensure proper tax reporting in this group.\textsuperscript{131} Moreover, these individuals' rising in-

\textsuperscript{126} See Reducing the Federal Tax Gap, supra note 7, at 33-35 (detailing component of improving compliance activities).

\textsuperscript{127} See I.R.S. and U.S. Dept. of Treas., IRS Begins Focus on Foreign Athletes and Entertainers, http://www.irs.gov/businesses/small/international/article/0,,id=176176,00.html (last visited Nov. 5, 2008) ("IRS has launched an Issue Management Team focused on improving U.S. income reporting and tax payment compliance by foreign athletes and entertainers who work in the United States."). The IRS has not forgotten, however, about domestic entertainers, from whom they can collect tax revenue. See Wingfield, supra note 121. Currently, the government is claiming that movie star Nicholas Cage did not properly write off over $3 million in personal expenses. See id. (detailing IRS focus on Nicholas Cage). In addition, Wesley Snipes was prosecuted for failing to pay his income taxes, totaling in the millions of dollars. See id. ("In April [2008], a federal district court sentenced . . . Wesley Snipes to three years for failing to pay taxes on $13.9 million in income from 1999 to 2001.").

\textsuperscript{128} See Reducing the Federal Tax Gap, supra note 7, at 75 ("Initiate Project on Foreign Athletes and Entertainers (FAE) to ensure appropriate reporting and sourcing of income.").

\textsuperscript{129} See id. (explaining what project entails). The income sourcing effort has been addressed, in fact, by a proposed regulation under § 861 that seeks, in part, to better establish income source rules. See Tillinghast, supra note 26 (discussing proposed legislation).

\textsuperscript{130} See Reducing the Federal Tax Gap, supra note 7, at 75 (checking box for "Beyond FY 2009" in category for continuing FAE).

\textsuperscript{131} See IRS Begins Focus on Foreign Athletes and Entertainers, supra note 127 ("These individuals and those associated with arranging their appearances in the U.S. and managing their financial affairs are typically high income individuals. Thus, it is important to ensure proper tax reporting and payment."). Another group highly publicized for the amount of money they make is that comprised of CEOs and other executives of companies. See CEOs Are Ridiculed for Huge Salaries: Why Aren't Athletes and Entertainers?, KNOWLEDGE@WHARTON, Nov. 19, 2003, http://knowledge.wharton.upenn.edu/article.cfm?articleid=877 (describing double standard that exists for focus on athletes and entertainers versus other high income
come figures have the taxing authorities on alert. As Barry Schott, the IRS's Deputy Commissioner, has stated, "[w]e do have a compliance problem . . . . It is not with every athlete certainly, but we do have problems. As the world gets smaller and athletes become better known, and the ability to compete and travel around the world has so improved, this has become an important issue."

Recently, racecar driver Helio Castroneves became an IRS target. In October 2008, a grand jury indicted Castroneves for allegedly using offshore accounts to evade over $5 million in U.S. income taxes from 1999 to 2004. IRS Commissioner Doug Shulman commented on the Castroneves situation, stating, "[t]his case sends a clear message that the IRS is committed to vigorously enforcing the tax laws and stopping offshore tax evasion." Additionally, the IRS has audited numerous golf and tennis players, hoping to collect back taxes. The focus with this group has been on prize and product endorsement money and has been similarly imposed on foreign entertainers.

earners). One reason for the differences in scrutiny levels is that artists and entertainers are beloved by fans and produce something for them. See id. (highlighting reasons why artists and athletes do not come under as much "fire" as do CEOs regarding income). In the past, however, provisions in the tax code specifically targeted at CEOs and other executives have been enacted. See, e.g., I.R.C. § 162(m) (1993) (setting deductibility limits on how much publicly traded companies can pay executives); see also id. § 4999 (1984) (imposing tax on executive parachute payments above certain limits).

132. See Evans, supra note 3, at 320 ("The escalation of salaries, bonuses, tournament and prize winnings, and endorsements paid to athletes has triggered a financial interest in taxing athletes.").


135. See id. (identifying charges, and reasons for them, against Castroneves); see also United States v. Castroneves, No. 08-20916-CR, 2009 WL 528251, at *1 (S.D.Fla. Mar. 2, 2009) (noting that, on October 2, 2008, grand jury indicted Castroneves and others for tax evasion).

136. Castroneves Pleads Innocent, supra note 134.

137. See Kaplan, supra note 133 (stating that IRS "already has audited at least 60 golfers and tennis players, some of whom are appealing rulings that they owe, in certain cases, millions of dollars in back taxes"); see also Herman, supra note 6 (noting significant crackdown on golfers and tennis players).

138. See Herman, supra note 6 (explaining where focus lies and on which type of income); see also Kaplan, supra note 133 ("The IRS task force, or issue management team, is also looking at foreign entertainers . . . .").
Again, escalating salaries and compensation are predominant factors in the IRS’s heightened scrutiny. Major League Baseball (“MLB”) represents a good example of foreign athletes making exorbitant salaries. Two hundred and thirty-nine foreign-born players were on MLB rosters or disabled lists on opening day in 2008. In that same year, the average salary of a MLB player was $3,154,845.

Another benefit to taxing high profile artists and athletes, as one tax attorney noted, is that “[t]he IRS likes celebrities because they get the most bang for their buck in terms of publicity. If you bust a [celebrity], that’s going to get press all over the place, and theoretically scare the public into complying.”

Other, more general, reasons exist for why countries should tax and increase efforts for tax compliance of foreign athletes and entertainers. Foremost, foreign athletes and entertainers enjoy the benefits and services that come with performing in the income source country and, therefore, they should pay their fair share for the enjoyment of these perks. Additionally, efficiency costs to the taxing jurisdiction do not arise when it taxes foreign athletes and entertainers because it is not increasing its own citizens’ or residents’ tax burdens. Taxing is a great way for source countries to raise revenue while not necessarily having to change current rates of income tax on citizens, residents or corporations within its boundaries. Finally, the source country is in a good position to determine how much income and monetary benefit foreign ath-

139. See Evans, supra note 3, at 320 (highlighting tax alert due to increased incomes).
143. Wingfield, supra note 121 (quoting Alan Straus’ statements about taxing celebrities).
145. See id. at 451 (“The primary argument ... for source-based taxation is that the jurisdiction in which the income is earned has normally provided significant services to the person who earned the income.”).
146. See id. at 452 (explaining this argument for source based taxation and that costs are those associated with raising taxes on others).
147. See id. (explaining benefits of this type of taxation).
leters and entertainers receive from working there, at least as opposed to their countries of residence.148

In fact, the IRS has recently proposed a new regulation under I.R.C. § 861 to help collect taxes more efficiently.149 This regulation would allow the IRS to tax a greater amount of the income earned in the United States and would establish clear guidelines as to when performances should be taxed, establishing event-based taxation.150 This proposed legislation represents an effort to achieve the IRS’s goal of working with Congress to “develop regulations and other published guidance clarifying ambiguous areas of the law, targeting specific areas of noncompliance, and preventing abusive behavior.” 151

To further facilitate compliance, the IRS and the Treasury will continue to work with other tax jurisdictions to establish a functioning tax system with tax treaties, keeping in line with the plan proposed in the departmental reports.152 Coordination among the United States and other countries is necessary to enable taxation of foreign athletes and entertainers.153 Such coordination ensures that no tax leakage occurs in the United States arising from foreign athletes returning to no-tax or low-tax jurisdictions.154 The United States adamantly wants to “tax all the income earned within [its] respective borders because [it] know[s] that the income may not be subject to tax in any other jurisdiction.” 155 Basically, the United States would like to net as much tax revenue as possible from such

148. See id. at 453-54 (explaining how source countries are in good position to tax because of knowledge of income made within its jurisdiction).

149. See Tillinghast, supra note 26 (discussing proposed regulation set forth by IRS).

150. See id. (explaining proposed regulation direction for taxing). As Tillinghast states, much is left to be desired from the proposed regulation. See id. (explaining his doubts as to effectiveness of proposed regulation). Tillinghast also feels that while a clearer way of taxing based on event taxation exists and that more revenue could be derived from “big-ticket performances,” the uncertainty with how well this regulation will work is too great. See id. (stating shortcomings of legislation).


152. For a discussion of coordination according to tax treaties between taxing jurisdictions, see supra notes 72-73 and accompanying text.


154. See Ruchelman, supra note 5 (explaining that countries with higher taxation want to prevent tax leakage that occurs when foreigners earn money within their borders, then leave and pay little tax or no tax on that income).

155. Id.
highly mobile, high income earning individuals before they leave and take any potential revenue with them.\textsuperscript{156} The IRS also has been coordinating with stadium and arena facility managers, reminding them of their obligation to withhold taxes from foreign athletes and entertainers.\textsuperscript{157}

These measures are part of a larger compliance initiative directed at foreign artists and athletes.\textsuperscript{158} This compliance initiative uses a three pronged approach.\textsuperscript{159} It attempts to: (1) "improv[e] the availability of information and guidance needed to help this group comply with income reporting and tax payment requirements"; (2) "provide IRS enforcement personnel with information they need to identify and work compliance issues frequently encountered with this population"; and (3) "conduct[ ] direct compliance and enforcement activity."\textsuperscript{160} These initiatives should help to implement the larger components of \textit{Reducing the Federal Tax Gap}.\textsuperscript{161}

B. The Other Side of the Crackdown

Not everyone is excited about the focus on improving tax compliance among foreign athletes and entertainers, with one criticism

\textsuperscript{156} See id. (stating "entertainers and athletes can earn huge amounts of diverse types of income . . . , [i]t[hey] are some of the most mobile individuals in the business world . . . [a]nd they can earn substantial amounts of money in a country within a short period"). For a discussion over the concern with stopping "tax leakage," see \textit{supra} note 6 and accompanying text.

\textsuperscript{157} See Turner D. Madden, \textit{Foreign Matters: If foreign entertainers perform in your facility, you may have a tax withholding obligation}, \textit{Legal Corner} (2006) http://www.iaam.org/Facility_manager/Pages/2006_Jun-Jul/Legal.HTM ("[T]he Internal Revenue Service sent out 253 notice letters to arenas and stadiums . . . informing them of their 'responsibility and potential liability' as a tax withholding agent for payments to foreign entertainers performing in their venues."). As Madden describes, ";[t]he letters state: Payments to foreign entertainer(s) who participate in events held in the United States are payments subject to Internal Revenue Code (IRC) § 1441 . . . ." \textit{Id.} (internal quotations omitted). Section 1441 is a withholding tax section and the letters were sent ensuring that taxes will be received. See id. (noting why letters were sent).

\textsuperscript{158} See Tillinghast, \textit{supra} note 26 (describing this initiative and other measures). While the IRS is concerned about the noncompliance among these individuals, it did note in a report that "[n]oncompliance is highest among taxpayers whose income is not subject to third-party information reporting or withholding requirements." A Comprehensive Strategy for Reducing the Tax Gap, \textit{supra} note 95, at 5. The report also indicates, however, that much of the tax gap is linked to self-employment taxes. See id. (stating types of taxes responsible for tax gap).

\textsuperscript{159} See IRS Begins Focus on Foreign Athletes and Entertainers, \textit{supra} note 127 (describing prongs).

\textsuperscript{160} \textit{Id.}

\textsuperscript{161} See generally \textit{Reducing the Federal Tax Gap}, \textit{supra} note 7 (discussing strategic components to attack tax problems).
being that taxing foreign athletes and entertainers is a form of “taxation without representation.” 162 Also, the concept of focusing on artists and athletes seems to go against earlier Treasury sentiment of wanting to promote – or at least not hinder – the flow of talent into the United States. 163 The Treasury has stated that the Model Tax Treaty “reflects the view that cultural exchanges should be encouraged, and that, in the absence of international tax avoidance, entertainers and athletes should not be singled out for special adverse tax treatment.” 164 While tax treaties often help to alleviate tax issues for artists and athletes, these individuals still can be at risk for tax liability if the United States does not have a tax treaty with the country from which they hail. 165

Furthermore, foreign athletes and artists feel that they are being singled out because other persons providing personal services, such as lawyers and pilots, do not face this pressure to comply. 166 This claim may become even stronger upon consideration of the IRS’s possible motivation for taxing athletes and entertainers as a means to implement a general deterrent from tax evasion among the public. 167

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162. See Macnaughton, supra note 144, at 457 (noting complaint about taxation of foreigners and fact that they are taxed in “but cannot vote in” U.S.).

163. See Susser, supra note 9, at 632 (discussing U.S.’s past position on taxing foreign athletes and entertainers). Tied into the argument that the flow of talent across borders should not be hindered is the idea that putting restrictions on foreigners’ ability to perform in other countries, at least in the case of athletics, actually weakens competition. See Jimmy Reade, Don’t Restrict Free Trade in Footballers, OXONOMICS, May, 31, 2008, http://oxonomics.typepad.com/oxonomics/2008/05/dont-restrict-free-trade.html (comparing FIFA’s decision to limit number of foreigners allowed on soccer teams, and its subsequent implications on competition levels in European soccer leagues, to restrictions on free trade).

164. See Susser, supra note 9, at 632 (quoting U.S. Dept. of Treas., The United States Model Tax Treaty, in The Exchange of Information under Tax Treaties (Proceedings of the 19th Technical Conference of the InterAmerican Center of Tax Administration (C.I.A.T.)) 80, 86 (1978)).

165. See Evans, supra note 3, at 298 (stating why tax treaties exist).

166. See Macnaughton, supra note 144, at 458 (noting athletes’ concern about being taxed in foreign countries).

167. For suggestion that the IRS targets artists and athletes precisely because of their fame, see supra note 143 and accompanying text. In fact, even as a new presidential regime entering the White House has many athletes celebrating, they are concerned that the new president will increase taxes on them because of the substantial amounts of money they make. See McNabb, others reflect on Obama’s historic victory, ESPN.COM, Nov. 6, 2008, http://sports.espn.go.com/nfl/news/story?id=3685206 (discussing professional athletes’ reflections on Barack Obama’s presidential election victory). “Several [athletes] and golfer Boo Weekley wondered how Obama’s tax plan would affect their wallet.” Id. Not every athlete is as concerned, however, with some believing that even if their taxes are increased, the revenue could help those less fortunate. See id. (noting some athletes’ feelings that
Meanwhile, foreign athletes and entertainers mistakenly may feel an additional tax burden stemming from the U.S. taxation of their income derived from a U.S. source, although technically one does not exist.\footnote{See Macnaughton, supra note 144, at 453 (explaining potential misperception of tax burden by foreign athletes because of "disaggregation bias" and "framing effect").} The misperception arises because tax treaties will stipulate that foreign artists or athletes receive tax credits, offsetting any taxation of income at the source.\footnote{See id. (identifying misperception's origin).} These tax credits, however, can go unrecognized by the artist or athlete, as focus can fall on the initial tax loss and not the later tax gain.\footnote{See id. (explaining effect of "disaggregation bias" resulting in focus on negative and not positive aspects of taxation).} Accordingly, athletes might pass on opportunities to perform in a country because of the imposition of its taxes, which those athletes might recoup later anyway.\footnote{See id. (stating that "an athlete might seek to not appear in an exhibition game in a jurisdiction with a high non-resident tax rate, even though the tax is completely refunded through a state or federal tax credit").}

Another misperception can occur when an athlete, playing for a team that travels to play in the United States, believes that he or she does not really earn income in the United States but is paid by the franchise at home.\footnote{See id. at 456-57 (explaining argument against taxing athletes who come to country to perform with their team).} Despite being paid by the team, the athlete is really performing services and earning income in the United States.\footnote{See Macnaughton, supra note 144, at 457 (noting counterargument).}

The current tax system for foreign entertainers and athletes may serve as a deterrent to performances and appearances within the United States in other ways as well.\footnote{See Firemark, supra note 10 (discussing significant issues and burdens faced by foreign entertainers that are unshared by domestic taxpayers).} The tax regime's focus could "place a tremendous strain on the . . . limited resources of the arts organizations who must comply, and have a demonstrated chilling effect on such presenters' use of international . . . talent. Foreign artists, already faced with realities of a weakening U.S. dollar, now have less incentive to share their offerings . . . ."\footnote{Id.}

While the tax implications for a foreign artist or athlete are potentially the same for any alien operating in the United States,
the risks associated with non-compliance are more significant.\textsuperscript{176} For example, a foreign artist’s or athlete’s non-compliance may cause his or her fame to diminish among U.S. taxpayers.\textsuperscript{177} Fame and, potentially, revenue earned in the United States diminish because many in the general public become upset when people are not forced to pay their fair share of taxes.\textsuperscript{178}

Moreover, many foreign athletes and entertainers find deciphering and following tax laws to be a difficult task.\textsuperscript{179} This difficulty becomes more pronounced when trying to learn about new legislation, like the proposed regulation to I.R.C. § 861.\textsuperscript{180} Furthermore, if an artist or athlete is not careful, he or she may actually qualify for residency status, which can affect tax rates and their ability to gain home country tax credits.\textsuperscript{181} Some tax advisors claim that the IRS has used changing standards for calculating taxes that sometimes are enacted late in the tax year, which only adds to the complications.\textsuperscript{182} In fact, “[t]he IRS does not dispute that it has been using the events standard that is now proposed, but the agency said it had the leeway to do so under the facts and circumstances approach.”\textsuperscript{183}

\textsuperscript{176} See Ruchelman, supra note 5 (discussing pitfalls of focus on foreign athletes and entertainers, which also include issues relating to residency status, characterization, withholding, and treaty issues).

\textsuperscript{177} See Wingfield, supra note 121 (quoting tax attorney Alan Strauss who comments on potential ripple effects of focus by IRS on foreign entertainers and athletes). The IRS, however, is not yet releasing the names of the sixty or so golf and tennis stars and musicians who are currently the beginning focus of these initiatives. See Herman, supra note 6 (“IRS officials won’t divulge any names of foreign athletes or entertainers under scrutiny.”).

\textsuperscript{178} See Erin Ailworth and Robert Weisman, Public Angry, Anxious, BOSTON GLOBE, Sept. 30, 2008, http://www.boston.com/news/local/massachusetts/articles/2008/09/30/public_angry_anxious/ (describing public anger with U.S. government over current economic conditions). In a comparable situation, Bono, lead singer of U2, has been criticized in his home country of Ireland because he moved his music publishing business to another country to obtain better tax treatment on income derived royalties. See Wingfield, supra note 121 (discussing backlash). Specifically, Bono is criticized for “cheating Ireland out of tax revenue.” Id.

\textsuperscript{179} For a discussion of difficulties foreigners face in addressing tax regime, see supra note 10 and accompanying text.

\textsuperscript{180} See Firemark, supra note 10 (discussing problems foreign athletes and artists have with paying taxes to U.S.); see also Tillinghast, supra note 26 (discussing proposed legislative changes to § 861).

\textsuperscript{181} See Ruchelman, supra note 5 (discussing problems foreign artists and athletes face by maintaining continuing presence in U.S.).

\textsuperscript{182} See Kaplan, supra note 133 (discussing potential move to event based income taxation). The proposed regulation to I.R.C. § 861 has suggested such a form of taxation. See Tillinghast, supra note 26 (explaining proposed regulation).

\textsuperscript{183} Kaplan, supra note 133.
Finally, in the case of source-based taxation, critics claim that it creates more taxpayer compliance costs and governmental administrative costs. If the country of residence taxes an individual’s income, there is only one tax regime with which that individual must comply. When an individual is taxed at the source, however, he or she must file forms and even hire an accountant or tax specialist. On the administrative side, the government must collect and process the returns; if there is noncompliance, the government must then go after its money. In the end, such an individual may be subject to filing returns in multiple countries.

IV. CONCLUSION

The IRS’s compliance initiative is a “wake-up call” to foreign artists and athletes. The tax implications could be significant for both the IRS and foreign entertainers. On the IRS’s side, the goal is to raise revenue for federal government functions, including the cost of the 2008 economic stimulus package. Foreign athletes and artists have the potential to make a substantial amount of money and, thus, be a great source of revenue for taxing jurisdictions.

Furthermore, entertainment and consumer implications could be significant. The United States must be careful not to hinder the talent flow onto its shores by burdening artists and athletes with

184. See Macnaughton, supra note 144, at 454-58 (identifying problems with source based taxation of income, including “compliance costs for taxpayers and administrative costs for government”).

185. See Macnaughton, supra note 144, at 454-58 (comparing taxation methods).

186. See id. (detailing what individuals must do when facing source based taxation).

187. See id. (detailing government processing and collection of taxes); see also IRS Begins Focus on Foreign Athletes and Entertainers, supra note 127 (discussing how IRS will have part to play to help compliance).

188. See Macnaughton, supra note 144, at 454-58 (noting possible consequences). For a discussion of double taxation, see supra note 8 and accompanying text.

189. See Ruchelman, supra note 5 (explaining that foreign entertainers and athletes should be on alert when it comes to paying U.S. income taxes).

190. See id. (noting substantial amounts of money potentially involved in taxation of athletes and entertainers).

191. See Herman, supra note 6 (discussing need for tax initiative directed at high income individuals).

192. See Sandler, supra note 4, at 1 (discussing that countries want to attract foreign athletes and artists precisely because they can tax them).

193. See Susser, supra note 9, at 624-27 (describing “country’s self interest in encouraging foreign professionals to bring their skills into the nation”).
tax consequences.194 These burdens, which may not exist in the current tax code, may nonetheless exist as misperceptions that have significant deterrent effects on foreign entertainers and artists.195

The United States is one of the world's largest economies, allowing people to earn substantial amounts of money.196 The United States is also a place where many musicians perform and, as a major film producing country, where actors can find steady employment.197 Likewise, with four major professional sports leagues, in addition to having a professional golf league and major tennis tournaments, the United States continues to attract athletes from around the globe.198 When these individuals come to the United States, they are paid handsomely, and the IRS, in an effort to help its own citizens and residents, should attempt to collect its "piece of the pie."199 The ultimate goal, therefore, must be a tax regime that balances the needs of both sides and one that can keep everyone entertained.

Stephen Taylor*

194. See id. at 615 (describing potential chilling of foreign talent inflows to U.S.)

195. See Macnaughton, supra note 144, at 455 (discussing potential mental burdens placed on athletes by source taxation); see also Ruchelman, supra note 5 (discussing complexity issue for tax advisors and those who handle foreign athletes and entertainers taxes).

196. See Sandler, supra note 4, at 149 (noting that U.S. market is potentially biggest source of revenue for artists and athletes).

197. See id. (discussing how prevalent arts are in U.S. and stating U.S. is largest producer of motion pictures).

198. See id. (explaining what makes U.S. so attractive to foreign talent).

199. See id. (stating that U.S. wants its "proper share" of income earned by these individuals).

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