Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Signing bonus planning for Canadian and U.S. professional athletes

Planning to maximize the amount you get to keep after taxes

Please contact us for more information about the topics discussed in this article.

As a professional athlete, you may enter into several contracts throughout your professional career with various Canadian or U.S.-based sports teams. Many of these contracts may offer a signing bonus. With proper tax planning, it may be possible to reduce the overall tax payable on the signing bonus and maximize the amount you get to keep after taxes are paid.

This article will discuss the Canadian and U.S. income tax treatment of a signing bonus received by a professional athlete who is a tax resident of Canada or the U.S. and who plays for a Canadian or U.S.-based team. It will highlight some of the tax planning strategies to consider to minimize your taxes.

Understanding the taxation of a signing bonus

In general, the taxation of your signing bonus will depend on whether you're a resident of Canada or the U.S. for income tax purposes, as well as where the team paying your bonus is located. There are situations where a signing bonus may be taxed in both Canada and the U.S. Therefore, understanding the tax rules of each country, and planning ahead where possible, can help minimize the income tax you may pay.

Tax based on country of residence or citizenship

The Canadian tax system is based on residency. If you're a resident of Canada for income tax purposes when you receive your signing bonus, you're subject to Canadian federal income tax on the full amount of the signing bonus. You'll also generally be subject to provincial or territorial tax in the Canadian province or territory where you reside on December 31 of the calendar year it is received — or in the province or territory in which you last lived if you're no longer a resident of Canada at the end of the year. Canada uses a graduated tax rate system (which includes a federal and provincial or territorial income tax) (i.e. increasing tax rates on increasing levels of taxable income).

The U.S. tax system is based on residency and citizenship. If you're a resident of the U.S. when you receive a signing bonus, you will be subject to U.S. federal tax and state tax. A U.S. resident includes a green-card holder and an individual who meets the U.S. substantial presence test. This test, a discussion of which is beyond the scope of this article, is based on a formula applied to the days of presence in the U.S. in the current and prior two calendar years.

Provided the professional sports contract is structured properly, the signing bonus is generally taxable only in the state where you're a resident for U.S. state tax purposes. If not structured properly, the signing bonus may need to be allocated to each state where your services are performed, and the allocated amount may be subject to tax in each of those states. For discussion purposes, this article assumes the signing bonus is subject to tax based on your U.S. state of residence for income tax purposes.

Unlike Canada, you're also taxable in the U.S. based on U.S. citizenship. Therefore, if you're a U.S. citizen but are not living in the U.S., you will still be subject to US federal tax — it does not matter where you live. This also generally applies in the case of a U.S. green-card holder living outside the U.S.

For U.S. federal income tax purposes, tax is levied based on graduated tax rates. For U.S. state tax purposes, the rates vary by state. Some states do not levy an individual income tax; some levy a flat tax rate and others levy tax based on a graduated tax rate system.

Tax based on the country where the sports team is located

The country where the sports team paying your signing bonus is located may also tax your bonus, even if you're not otherwise subject to tax in that country because you don't have residency status and/or citizenship. For example, under Canada's income tax laws, a non-resident of Canada who earns income from employment in Canada may be required to pay tax on that income in Canada. However, under the Canada-U.S. Income Tax Treaty ("Treaty"), tax relief is provided to professional athletes who are tax residents of one country and receive a signing bonus from a team located in the other country. The

> A player may be able to significantly reduce the overall tax they pay on receiving a signing bonus if they implement proper planning.

Treaty limits the amount of tax on the signing bonus that may be imposed by the country where the sports team is located. This limit is 15% of the gross amount paid. In most cases, a 15% withholding tax is applied to the bonus. However, in the case of a U.S. citizen or green-card holder living in Canada who receives a signing bonus from a U.S.-based team, the manner in which to limit the effective U.S. federal tax rate to 15% is through the use of foreign tax credits that may be claimed on their U.S. tax return.

Minimizing or eliminating double taxation

If your signing bonus is subject to tax in both Canada and the U.S. it's generally possible to minimize or eliminate double taxation by claiming foreign tax credits. Generally, one country has the first right to tax the bonus and the other permits foreign tax credits for tax paid in that country. As a result, your overall tax rate is generally the higher of the two countries' tax rates.

Canada versus U.S. tax rates

Canada's tax rates are generally much higher than U.S. tax rates. For example, a much larger amount of taxable income is required before you reach the top marginal U.S. tax rate. Also, the combined federal and provincial/territorial top marginal tax rate in Canada is generally higher than the combined U.S. federal and state tax rate (with the exception of certain U.S. states with high tax rates).

Signing bonus planning strategies

A player may be able to significantly reduce the overall tax they pay on receiving a signing bonus if they implement proper planning. Table 1 summarizes the tax rules and the potential planning opportunities to consider in relation to receiving a signing bonus, based on your tax status in the country where the professional sports team is located. The table is followed by a discussion of signing bonus planning considerations.

Note: Unless specifically noted, a Canadian resident does not include a U.S. citizen or green-card holder. And, where U.S. state tax is applicable for a U.S. resident, it's assumed that the signing bonus is subject to tax based on the player's U.S. state of residency.

Table 1: Country where player is resident when signing bonus is received and country where sports team is based

	Canadian resident signing with a U.S.-based team	Canadian resident signing with a Canadian-based team	U.S. resident signing with a Canadian-based team	U.S. resident signing with a U.S.-based team
Taxation of signing bonus	Canada – Fully taxed (graduated Canadian tax rates) but tax may be reduced or eliminated by foreign tax credits for U.S. tax paid U.S. – 15% tax rate (even if U.S. citizen or green-card holder)	Canada – Fully taxed (graduated Canadian tax rates) U.S. – If U.S. citizen or green-card holder living in Canada, fully taxed (graduated U.S. tax rates) but tax may be reduced or eliminated by foreign tax credits for Canadian tax paid	Canada – 15% tax[1] if received as a non-resident of Canada U.S. – Fully taxed (graduated U.S. tax rates) but tax may be reduced or eliminated by foreign tax credits for Canadian tax paid	Canada – No tax U.S. – Fully taxed (graduated U.S. tax rates)
Signing bonus planning consideration	Receive bonus as a Canadian resident and become a U.S. resident by end of year	If possible, become a resident of a lower-tax Canadian province at year-end	Receive bonus as a U.S. resident (may depend on U.S. state of residence)	If possible, receive bonus as a resident of a lower-tax U.S. state

1) Pursuant to Article XVI (4) of the Canada-U.S. Income Tax Treaty

You're a Canadian resident signing with a U.S.-based team

If you're a Canadian resident signing with a U.S.-based team and you plan to become a U.S. resident, there may be a tax advantage to receiving your signing bonus while you're still a Canadian resident and then your salary as a U.S. resident. You may wish to speak to a qualified tax advisor to discuss any strategies that can be implemented to reduce or limit the overall tax paid on your signing bonus, potentially to as low as 15%.

You're a Canadian resident signing with a Canadian-based team

If you're a Canadian resident signing with a Canadian-based team and you'll remain a Canadian resident, a potential strategy to reduce your overall Canadian tax with respect to your signing bonus or base salary is to change your Canadian residency status to that of a lower-taxed province or territory by December 31. The provincial or territorial tax you'll pay depends on the province or territory where you're a resident on December 31 of the calendar year. The determination of your province or territory of residence is based on your individual facts and circumstances. Generally, you're considered to be resident in the province or territory to which you have the most significant residential ties on December 31.

Similarly, if you're already a resident of a province with a lower tax rate and you sign with a Canadian-based sports team located in a province or territory with a higher tax rate, consider taking steps to remain a resident of the province or territory with the lower tax rate. Note that the combined federal and provincial tax rates in provinces where major Canadian sports teams are based may not vary as widely as they have in the past.

If you're a U.S. citizen or green-card holder resident in Canada, you will also have to report the signing bonus on your U.S. tax return. You may be able to reduce or eliminate your U.S. tax through the use of foreign tax credits for Canadian taxes paid on the signing bonus. Your overall effective tax rate will be the higher of the two countries' tax rates.

You're a U.S. resident signing with a Canadian-based team

Depending on the tax rates of the U.S. state where you currently reside, and the province or territory where you will establish Canadian residency, it may be preferable to receive the signing bonus before establishing Canadian residency to avoid the potentially higher overall Canadian marginal tax rates on the signing bonus.

For example, if you receive the signing bonus from a Canadian team before establishing Canadian residency, pursuant to the Treaty, the Canadian tax rate on the bonus is 15%. As a U.S. resident, you will also be subject to U.S. federal and state tax; however, the 15% Canadian tax can be claimed as a foreign tax credit against U.S. federal tax to reduce the U.S. tax on the signing bonus. Some states also allow a foreign tax credit to reduce taxes but some may not.

If you become a Canadian resident before you receive the signing bonus, you will be subject to Canadian tax on the signing bonus at your marginal tax rate. If you're also subject to U.S. tax based on your U.S. residency status and/or U.S. citizenship, you may be able to claim a foreign tax credit on your U.S. tax returns for the Canadian tax paid. However, as mentioned earlier, Canadian income tax rates are generally higher than U.S. rates, so this may result in higher overall taxes.

Understanding your overall tax exposure based on the tax rates that apply in both countries is key before making a final decision.

You're a U.S. resident signing with a U.S.-based team

The signing bonus is taxable for U.S. federal tax purposes. If the contract is structured properly to qualify for state taxation based on state residency, the signing bonus is typically taxed in the U.S. state where you're living when you receive it. Therefore, depending on the residency rules in that state and the differing state tax rates, it may be possible to minimize the U.S. tax on the signing bonus if you reside in a U.S. state that has lower tax rates or no state tax (e.g. Florida, Texas, etc.).

Other planning considerations

A planning option to reduce your overall tax exposure that's not addressed in this article involves the use of a retirement compensation arrangement (RCA). This strategy may provide significant tax savings in respect of your base salary, especially where you decide to retire outside of Canada. Please ask your RBC advisor for a copy of a separate article discussing the use of an RCA.

Before you finalize the contract

It's important to consult with a qualified tax advisor who's familiar with both Canadian and U.S. tax laws before finalizing a contract and related signing bonus terms. A review of the potential tax and residency planning strategies that relate to receiving a signing bonus as part of your contract may present opportunities to save significant tax dollars.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

Wealth Management

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