Global View

Update on the Central Withholding Agreement Program for Foreign Athletes and Entertainers

By Robert J. Misey, Jr.

For over a quarter of a century, the IRS has conducted a central withholding agreement (CWA) program to reduce the burden of withholding taxes on the compensation paid to foreign athletes and entertainers who perform in the United States. This fall, the IRS revised Form 13930, which is the required form for a foreign athlete or entertainer to apply for a CWA. Although the revised Form 13930 does not significantly differ from the previous version of the form, the IRS has changed, without guidance, certain procedures of the CWA program.

What Is a CWA?

Payers of U.S.-source compensation to a nonresident alien, such as a foreign athlete or entertainer, must withhold 30 percent of each payment for the IRS.[1] As a result, nonresident aliens working in the United States will incur withholding tax at 30 percent of the gross amount of compensation. After the tax year closes, the nonresident alien should file a return and pay tax on the net income at marginal rates. A foreign athlete or entertainer often incurs significant expenses to generate a refund because the tax at marginal rates on net income will be less than the 30-percent withholding tax on gross income. As a result, the foreign athlete or entertainer will typically receive a refund when filing his or her return.

At the same time, the IRS is concerned with the administrative burden of dealing with numerous potential withholding agents that pay compensation to the foreign athlete or entertainer. Potential withholding agents include everyone in the chain of custody, control or receipt of payment,[2] such as attorneys, accountants, venue managers, and even ticket buyers.

A CWA is an agreement between the foreign athlete or entertainer with the IRS to have one withholding agent withhold the estimated tax liability that would be ultimately reported when using marginal rates based on net income.[3] The IRS provides further guidance for CWAs in Rev. Proc. 89-47.[4] Although updating Rev. Proc. 89-47 was on the IRS's priority list of guidance for 2010, the IRS never issued a new revenue procedure and its update has not appeared on subsequent priority lists.

Suppose, for example, that an entertainer expects to conduct a 30-date concert tour in the United States that will result in $5 million of ticket revenue. If the entertainer incurs expenses of $3 million for rehearsal, lodging, meals, transportation, and other expenses, the net income will only be $2 million. A top marginal

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rate of 39.6 percent on net income of $2 million results in a tax liability of only $792,000, which is $708,000 less than the withholding tax of $1.5 million at a 30-percent rate on the $5 million of ticket revenue. The CWA program allows the entertainer to designate a single agent to withhold the $792,000, instead of pursuing the many holders of the entertainer's money (typically, the thirty venue managers) for the $1.5 million.

Foreign athletes and entertainers are eligible for CWAs.[5] Foreign entertainers include actors, musicians, dancers, and conductors. Foreign athletes typically include athletes in individual sports, such as golfers, boxers, thoroughbred jockeys, tennis players and race car drivers. Although athletes in team sports are eligible for CWAs, athletes in team sports will usually be in the United States for a season that lasts long enough for the athletes to be U.S. residents,[6] rendering the 30-percent withholding rate irrelevant.

Obtaining a CWA

When filing the Form 13930, the foreign athlete or entertainer must also submit a budget, the name of the proposed withholding agent and every contract relating to the income-producing activity in the United States. These contracts include letters of understanding, agent representation, promoter agreements, contracts with venues, *etc*. Provision of these contracts ensures that the IRS and the foreign athlete or entertainer agree to a good estimate of the ultimate tax liability for the income from the performance.

However, the IRS Form 13930 also requires "[a]ll documentation related to merchandising, endorsements, sponsorship income, production or tour support, and reimbursement in any way associated with this activity or event." In practice, the IRS has been inappropriately demanding these documents for the last several years. Merchandising, such as the selling of concert T-shirts, often has little bearing to the personal services of the foreign athlete or entertainer. It is not appropriate to include the merchandising income in the CWA because it does not represent compensation for personal services and, in fact, Rev. Proc. 89-47 does not mention merchandising income whatsoever. Moreover, the merchandising rights are often owned by someone other than the foreign athlete or entertainer.

Soon after filing, the representative will receive a CWA for the designated withholding agent and the foreign athlete or entertainer to sign. The CWA will specify the dates and amounts of the withholding payments, while specifying that any review of the books and records is not an audit.

Form 13930 does not mention that the CWA will require an IRS visit to a concert or a sporting event. As an IRS attorney previously in charge of the CWA program, I drafted the first visitation paragraph in a CWA so that the IRS personnel would have the opportunity to learn about how a concert tour was conducted under the guise of ensuring that the tour was conducted in the manner represented.

Unfortunately, recent CWAs proposed by the IRS go overboard on the visitation. These broadly written paragraphs literally permit the IRS to send an army of employees to any concert on the tour without any notice. The representative for the foreign entertainer should push back and insist on language stating that the IRS can send no more than two employees to one concert on the tour, with advance notice of at least 10 days. The representative should pre-screen a concert, just as the representative would pre-screen a plant tour before an IRS visit during an audit.

Conclusion

The CWA program efficiently reduces the withholding tax burden on a foreign athlete or entertainer who performs in the United States. Although the revised Form 13930 does provide guidance as to how the CWA program operates, it would be helpful to practitioners if the IRS prioritized updating Rev. Proc. 89-47 and actually updated it. Purportedly, the update would include the appropriate guidance regarding the inclusion of merchandising income and venue visitations.

ENDNOTES

1 Code Sec. 1441(a) and (b).
2 Code Secs. 1441(a) and 1442(a).
3 Reg. §1.1441-4T(b)(3).
4 Rev. Proc. 89-47, 1989-2 CB 598.
5 *Id*.
6 Code Sec. 7701(b).