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PUBLICATION

John Tavares Takes on the CRA: Legal Implications for the Canadian Sports Industry

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On July 1, 2018, John Tavares signed a 7-year, $77 million (USD) contract with the Toronto Maple Leafs. This contract included a signing bonus of $15.25 million payable in the 2018 tax year. Traditionally, signing bonuses have been a useful tax planning tool for athletes to leverage in contract negotiations to maximize net revenue. For Tavares, the signing bonus structure that the Maple Leafs were able to offer was "integral" in his decision to sign. Signing bonuses are also an important mechanism for professional sports teams to lure top talent. This is why, when the Canada Revenue Agency ("**CRA**") knocks on your door requesting the return of over $8 million (inclusive of arrears interest), the implications for the Canadian sports industry are significant.

The Reassessment

The CRA reassessed Tavares' 2018 income tax return, by notice dated November 2, 2022 (the "Reassessment"). The result of this reassessment is that, six years later, Tavares now owes the CRA over $8 million. On January 1, 2024, Tavares filed a Notice of Appeal (the "NOA") with the Tax Court of Canada (the "Court"), arguing that the CRA miscalculated the income tax owed on his 2018 signing bonus.

The Significant Issues to be Determined

This dispute comes down to one single question: Should the 2018 signing bonus be taxed at a rate of 15% or 38%? So, why is there such a stark difference in the positions of Tavares and the CRA?

The Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital (**the "Treaty"**) sets out an important rule relevant to this issue. Section 4 to Article XVI states that:

an amount paid by a resident of a Contracting State to a resident of the other Contracting State as an inducement to sign an agreement relating to the performance of the services of an

athlete…may be taxed in the first-mentioned State, but the tax so charged shall not exceed 15 per cent of the gross amount of such payment.

This rule effectively creates an exception for income that constitutes an "inducement" from being taxed as conventional employment income or wages and instead being capped at a more favourable rate of 15%.

In response to the NOA, the Attorney General of Canada (the "**AGC**") argues that: (i) on July 1, 2018, Tavares was a resident of Canada for tax purposes, and therefore, the Treaty does not apply to Tavares, and (ii) if the Treaty does apply, the signing bonus paid to Tavares was not an inducement within the meaning of Article XVI of the Treaty. These two issues are currently before the Court.

Residency Status

Prior to signing with Toronto, Tavares was a member of the New York Islanders. This case may fall on certain factual determinations, such as whether or not Tavares was in fact a United States resident prior to July 1, 2018, when and if his status changed to Canadian resident, and his status on the date that the signing bonus was received (July 1, 2018).

Several factors are generally considered in determining an individuals' residency status, such as: location of real property, location of the individual's spouse and/or dependents, social ties, economic ties, etc. The professional sports context will make this an intriguing analysis for the Court to undertake. Professional athletes often travel between Canada and the United States with regularity, spend the entire off-season away from their place of work, and sometimes even have arrangements where their family lives in a separate country on a full-time basis.

This issue was not addressed in the NOA. However, the Court will be required to determine Tavares' residency status on the date in question in accordance with the evidence submitted by the parties.

Interpretation of an "Inducement"

"Inducement" is not defined in the Treaty or the Income Tax Act. In the NOA, Tavares appears to rely on the definition of the term in the ordinary sense, in that the signing bonus was an integral factor persuading him to sign in Toronto. In fact, Tavares noted that he had competing offers from a US team that, on its face, was for a significantly greater financial sum.

In 1998, the CRA interpreted a signing bonus to be:

an amount paid simply to induce an athlete to sign a player contract. In other words, the signing bonus is to induce the athlete to sign, and to become bound by, a player contract to play for the team paying the bonus and, by doing so, the athlete agrees not to enter into a player contract with any other team. The payment of the signing bonus should not be dependent on the athlete actually playing for the team and it should not be subject to conditions other than the signing of the player contract.

In 2020, with specific regard to the Treaty, the CRA took the position that a signing bonus is not "an inducement to sign an agreement" where there are conditions in the contract, beyond the mere signing of the agreement, where the athlete would not be entitled to the full amount of the signing bonus. In support of its interpretation, the CRA referenced the Court's decision in *Nikolai Khabibulin v Her Majesty The Queen*, [2000 DTC 1426], as case pertaining to similar issues involving a former NHL goaltender. In that case, the Court concluded that the amount received was not a true signing bonus because the athlete would not be entitled to further installments if he refused to perform employment services for the team.

The Court will be tasked with determining whether or not the signing bonus paid to Tavares on July 1, 2018, was a true inducement. To do this, the Court will analyze the terms and conditions contained in Tavares' contract and the surrounding circumstances. The NOA provides some insight into the contractual terms at play. Specifically, if "Tavares breaches the Contract, voluntarily retires, withholds his services, or leaves his club without consent, Tavares shall only be entitled to retain a *pro rata* portion of the signing bonus."

We anticipate that the AGC will argue that facts pertaining to Tavares' contract warrant the same result as in *Khabibulin*.

Implications for the Canadian Sport Industry

Generally speaking, from a tax perspective, Canadian professional sports franchises are already at a disadvantage in terms of attracting marquee talent as compared to their American counterparts. Tavares asked the Court to confirm the legitimacy of a negotiation strategy that was once predictable: relying on the ability to negotiate a signing bonus to safely lower tax liability. The CRA has effectively placed doubt on the outcome of this strategy. Thus, the Court's decision will directly impact the number of high-profile free agents that will decide to take their talents north of the border.

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Tyler's practice is in labour, employment and sports law. Prior to joining Blaney McMurtry, Tyler had years of experience in the sports industry. While attending Western Law, Tyler was a Program Manager at the Sport Solution Clinic, where he regularly advised national and Olympic athletes on sport-related disputes. Prior to law school, Tyler earned a bachelor's degree in Sport Management at Brock University and subsequently worked at the Sport Dispute Resolution Centre of Canada. Tyler's interest in sport developed at a young age through playing hockey, baseball and golf, as well as cheering on Toronto's sports teams.

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