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by Max Reed

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Will John Tavares Have Double Tax Trouble?

by Max Reed

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In this article, Reed explains how the decision to front-load a signing bonus by an NHL player moving from a U.S. to a Canadian team saved him upfront Canadian tax but did not help his overall tax situation.

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National Hockey League player John Tavares's well-publicized[1] litigation pending before the Tax Court of Canada demonstrates the principle that resolving cross-border tax disputes in a purely domestic fashion can be problematic. The facts of the case are straightforward and worth discussing briefly. Before getting into the substance, my intent is not to evaluate the substance of Tavares's case. That will be done elsewhere. Rather, I'm more focused on the cross-border tax aspects of the dispute and the process.

From 2009-2018 Tavares played for the New York Islanders. During this time, it is safe to assume that he was a U.S. federal tax resident and a New York state tax resident. New York has very aggressive rules regarding residency. For the purposes of my analysis, I do not assume he was a New York City resident.

On July 1, 2018, he signed with the Toronto Maple Leafs. Tavares became a Canadian tax resident in September 2018 and stopped being a U.S. tax resident after that tax year. On signing the contract, he was paid a signing bonus of C $15.25 million, less an escrow payment of about C $1.75 million. He paid a 15 percent tax to Canada on the signing bonus under Article XVI(4) of the Canada-U.S. tax treaty.[2] He reported and paid U.S. federal tax on the full signing bonus and presumably paid state tax to New York. In 2022 the Canada Revenue Agency re-assessed Tavares for over C $6.84 million, representing tax on the full amount of the signing bonus as a Canadian tax resident, along with about C $1.2 million of arrears interest. Tavares filed a notice of objection, which the CRA never responded to, and then filed a Notice of Appeal in the Tax Court of Canada.

The dispute raises a number of interesting observations about cross-border tax and dispute resolution.

First, though a great deal of media commentary has focused on how Canada's high tax rates and CRA's challenge of the Canada-U.S. treaty-based signing bonus tax reduction will dissuade athletes like Tavares from playing in Canada, in Tavares's case his original filing position likely had a relatively small tax benefit. In 2018 the highest applicable combined tax rate for a resident of Ontario was 53.53 percent. The highest effective rate for a New York tax resident that year was 45.82 percent (comprising 37 percent federal tax and 8.82 percent New York state tax that was effectively not deductible against the federal). The differential between the top Canadian and U.S. rates was therefore just 7.71 percent. As applied to the signing bonus, this means Tavares saved approximately C $1.3 million of overall tax. This is about equal to the arrears interest that CRA is now imposing.

Second, aggressively front-loading the bonus significantly increased the risk of double taxation

[1] *See, e.g.*, The Canada Press, "Maple Leafs Captain John Tavares Taking CRA to Court in $8M Tax Dispute," CBC Radio-Canada, Feb. 7, 2024.

[2] *Convention With Respect to Taxes on Income and on Capital*, U.S.-Can., Sept. 26, 1980 (as amended by the Protocols signed on June 14, 1983, Mar. 28, 1984, Mar. 17, 1995, July 29, 1997, and Sept. 21, 2007).

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if the CRA is successful in the litigation. From the Notice of Appeal,[3] it seems the plan was to have a large signing bonus to take advantage of the reduction of Canadian tax under Article XVI(4). This exposed the signing bonus to full U.S. and New York state tax. Had Tavares simply been paid a salary, he would have presumably paid only Canadian tax because he would no longer have been a United States or New York tax resident.

There is a risk of double taxation between the U.S. federal system and Canada. Assume for the sake of argument that Tavares loses his Tax Court case and any subsequent appeal, including a potential appeal to the Supreme Court of Canada. It is entirely possible that the litigation drags out over a five-year period. By then Tavares will owe the CRA the C $6.8 million in reassessed tax and several million in interest payments. He would have to go and try to get a refund from the United States. The interest represents a net economic cost to Tavares because it cannot be used as a credit against U.S. federal tax. While a U.S. refund may also come with overpayment interest, the interest paid by the IRS may be at a lower rate than the interest paid to the CRA, and the refund interest is subject to tax at ordinary income rates in Canada.

Thankfully for Tavares, there is a 10-year statute of limitations under the IRC for refund claims related to foreign tax credit adjustments.[4] In theory, that gives Tavares plenty of time to file his claim for refund. But the Canadian litigation could drag out beyond the statutory period. Also, the determination by a Canadian court does not bind the United States in the application of its domestic law or its interpretation of the Canada-U.S. treaty, so any change in characterization or sourcing for Canadian tax purposes could create a mismatch with the U.S. treatment that could interfere with the ability to claim FTCs in one or the other country.

New York state also presents a double tax risk. Front-loading the compensation likely exposed it to New York state tax when it would not have otherwise been. New York only offers an FTC for income sourced and tax paid to a Canadian province.[5] This presents the same potential sourcing problem as in the federal system and at best a credit is only available for the portion of the tax that is paid to Ontario. Worse for Tavares, in New York, a claim for credit or refund of an overpayment of income tax must be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever is later.[6] That means he is currently out of time for a New York adjustment and New York will not refund the tax (even if it is creditable).

In short, Tavares's downside risk related to his CRA challenge is not just the Canadian tax. It is the arrears interest (not creditable in the United States), potential U.S. federal tax (because of expiry of the refund claims period or a sourcing conflict), and the New York state tax (where a refund claim is closed). All this needs to be weighed against the potential upside of C $1.3 million of total U.S.-Canada tax savings. Readers can form their own opinion as to the wisdom of taking an aggressive position on the signing bonus for a total U.S.-Canada tax savings of C $1.3 million, in relation to a total contract of over C $70 million, weighed against these downside risks.

Third, the Notice of Appeal suggests a purely domestic approach to what is fundamentally a cross-border dispute. Under Article XXVI of the Canada-U.S. treaty, there is a process called the mutual agreement procedure. That process obliges the CRA and the IRS to try and negotiate a resolution to the application of the Canada-U.S. treaty to a specific taxpayer's case. For a number of reasons, it would have been very wise for Tavares to seek assistance under MAP.

First, it is possible that a negotiation between the CRA and IRS would have moved the CRA off its audit and assessment position because the Canadian competent authority would have the sole determination to reach an agreement with the IRS and could have overruled the audit report.

Second, even if Canada's position prevailed in the negotiations, but the IRS agreed with it, an automatic U.S. refund would flow from that process without worry about the source or credit

[3] Tax Court of Canada court number 2024-212(IT)G.

[4] IRC section 6511(d)(3).

[5] N.Y. Tax Law section 687(a).

[6] N.Y. Tax Law section 620(a).

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questions raised above. Finally, even if the CRA and IRS could not agree on the taxation of the signing bonus, the litigation position in Canada would be significantly enhanced compared to the current position. As the Canadian Supreme Court put it in *Crown Forest Industries Ltd. v. Canada*,[7] unlike a domestic statute, the Canada-U.S. treaty is to be interpreted to give effect to the parties to it. At the conclusion of the MAP process, the IRS's position would be reported to Tavares. Presumably, this would be that the United States believes the signing bonus was governed by Article XVI(4). Having the written opinion of one of the parties to the Canada-U.S. treaty is a powerful argument to deploy against the CRA in litigation. Indeed, one struggles to think of a Canadian or U.S. tax treaty case in which a court in either country reached a conclusion that is opposite to the position of the other party to the treaty.[8] Without MAP, Tavares doesn't have this.

All in all, by aggressively front-loading his compensation toward a signing bonus, Tavares saved himself a lot of Canadian tax, but much less overall tax than you might think. In taking a position that was highly likely to invite CRA scrutiny he exposed himself to considerable risk of double taxation if he is not successful. The failure to seek relief under MAP in order to involve the IRS only worsens his double tax exposure. The Tavares case provides a stark reminder that cross-border issues deserve a cross-border perspective. ■

[7][1995] 2 SCR 802. *See also Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49 at para. 37; *United States v. Stuart*, 489 U.S. 353, 365-366 (1989).

[8]*See, e.g.*, in the United States, *National Westminster Bank PLC v. United States*, 512 F.3d 1347 (2009); *North West Life Insurance Co. of Canada v. Commissioner*, 107 T.C. 363, 379; and in Canada, *Sifto Canada Corp. v. The Queen*, 2017 TCC 37.

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