

## **Alert** | Equine Industry Group/Tax



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### **U.S. Tax Issues for Equine Professionals**

Welcome to the United States! Now it is time to pay your taxes. Equine professionals such as jockeys, showjumpers, trainers, or horse owners who travel to the United States to work or compete may be unaware of the U.S. tax implications of their activities. The failure to comply with U.S. tax laws can result in significant tax liabilities, penalties and interest, so it is important to pay attention to these issues early.

#### **Taxation Depends on Tax Residency Status**

An equine professional's tax residency status will dictate his or her U.S. tax filing requirements. Although U.S. immigration law identifies multiple categories of immigrants (*see Part I and Part II* of previous GT Immigration/Equine Alerts), U.S. tax law only distinguishes between "resident aliens" and "nonresident aliens." The distinction is important because resident aliens and nonresident aliens have different tax filing obligations. An individual is treated as a resident alien where he or she: (i) obtains a green card to stay in the United States permanently; or (ii) maintains a substantial presence in the United States. Generally, all other individuals are treated as nonresident aliens.

Whether an equine professional has substantial presence depends on a complex formula that considers not only the time spent in a current year but also the time spent in the preceding two years. Therefore, they should consult with a U.S. tax advisor to determine their residency status each year. That status may change in a given year depending on how much time the equine professional spends in the United States, so it must be reviewed on an annual basis. Maintaining good records is essential to recording the number of days the equine professional is present in the United States. For purposes of applying the substantial

presence test, the day count will not include the time a professional athlete spends in the United States competing in charitable athletic events, but generally includes all other days (and fractions of days).

### **Filing Requirements for Resident Aliens**

Equine professionals who are treated as resident aliens have the same federal tax filing requirements as U.S. citizens. This means they are required to report and pay tax on their worldwide income, not just income sourced to the United States. This is a trap for the unwary, because most countries have territorial tax systems that only tax income earned in that country. A resident alien's filing requirements may include: (i) Form 1040, U.S. Individual Income Tax Return; (ii) a gift tax return to report substantial gifts made during the year; (iii) FinCEN Form 114 (FBAR) to report ownership or signatory authority over bank, brokerage, or other financial accounts maintained outside of the United States; and (iv) various foreign information returns to report interests in or transactions involving corporations, partnerships, trusts, or other entities outside of the United States. The failure to comply with the reporting requirements can result in significant penalties. The IRS often aggressively pursues these penalties regardless of an individual's familiarity with the U.S. tax system. An equine professional may also have state tax filing obligations in the states where they are living, providing services or participating in equestrian events. Therefore, they should carefully consider what reporting requirements apply to them.

### **Filing Requirements for Nonresident Aliens**

Nonresident aliens must report on a Form 1040-NR: (i) income effectively connected with a U.S. trade or business, which is subject to graduated rates of tax; and (ii) U.S. source income, which is subject to a flat 30% tax rate (unless a lower rate applies under a tax treaty). U.S. source income may include wages, prizes or awards, commissions, compensation for performances, endorsement income, royalties, income from the sale of horses, stud fees, and racing purses. A nonresident alien should carefully evaluate what income should be reported and whether they are entitled to benefits under a tax treaty.

### **Employer Withholding Requirements**

U.S. employers who hire equine professionals from abroad should also be cognizant of their U.S. reporting and withholding obligations. Whether a U.S. employer has a withholding obligation depends on whether the equine professional is an employee or an independent contractor. Generally, U.S. employers are required to withhold income tax, withhold and pay social security and Medicare taxes, and pay federal unemployment tax on the wages paid to any employee. The withholding requirements will differ depending on multiple factors, including: (i) the employee's status as a nonresident alien or resident alien; (ii) the type of visa the employee holds; and (iii) whether a tax treaty applies. The failure to properly withhold and pay tax to the IRS on wages can result in significant penalties. Employers will have similar withholding responsibilities under state law. The state reporting requirements become more complex where the services are provided in multiple jurisdictions, as is common in the equine industry. Therefore, U.S. employers should confirm that they are withholding properly.

### **Conclusion**

There are significant opportunities for equine professionals in the United States. Whether they come here permanently or periodically, they need to pay close attention to their tax residency status and applicable federal and state filing requirements. The U.S. reporting requirements may appear to defy common sense for individuals accustomed to territorial tax systems. The often overlapping and inconsistent state reporting requirements add to the burden. To avoid a costly and time-consuming audit, equine professionals and employers should carefully evaluate how the U.S. and state tax law affects them.

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