

Touring the USA and Centralized Withholding Agreements



This is a general briefing guide to the US Centralised Withholding Agreement (CWA) arrangement for managers of UK acts who intend to tour the USA. It is a practical guide and not a definitive statement of practice or the law. The practice of the law in respect of CWA's is constantly changing depending on all number of circumstances. Before embarking on a tour in the USA it would be prudent to take advice from someone experienced in this area of tax law. Prager Metis International is unable to take any responsibility for any action or lack of action taken in respect of the information and guidance contained in this briefing guide.

INTRODUCTION

This is not a statement of the law but a guide as to how the IRS has implemented the CWA. There have been and will be anomalies in the way the IRS apply the rules but they are seeking consistency in their treatment of visiting musicians to the USA. So the past is not necessarily going to be a good guide as to how the IRS deals with CWA applications now. As the IRS become more experienced at the application and consequences of the rules so we expect practises to change. In addition to this it is quite likely that there will be changes in the interpretation of the rules so it would be wise to check before embarking on a tour of the US. It is also quite likely that for the future the IRS will seek to extend the application of the CWA to other areas of the entertainment industry such as films, theatre and television.

NOT NEW LAW

Many managers will find the CWA rules new and not what they have experienced from tours in the past. Since 1986 US domestic legislation has provided for payments of income to non resident aliens to be subject to a deduction of equal to 30% of the payment being made. This is not a deduction of tax but a payment in respect of tax which can be claimed back once the US Tax Return has been submitted. So this is not new law merely enforcement of the law.

The withholding tax rules permitting a 30% deduction are subject to the UK/USA Double Tax Treaty but to invoke the Treaty in respect of say exempting merchandise copyright income from US taxation the individual must first prepare and submit a US Tax Return. This will only remove the merchandise income from mainstream US tax not the withholding CWA arrangement. If a claim is successful any merchandise or other Treaty income withheld has to be repaid by the IRS to the individual concerned.

Performers who work in the USA are required under both domestic US and international treaty law to pay taxes on that income in the USA. The withholding is a payment on account of this mainstream tax liability. It is a mechanism to enforce compliance with the mainstream tax reporting requirements.

In the past musicians have to a significant extent ignored their US tax filing and payment requirements. In order to rectify matters the US government have sought to enforce the withholding tax rules more rigorously. Musicians always had a liability to US tax so again this is nothing new.

The law in the UK has remained the same and tax suffered in the US can, subject to certain limits and criteria, be used to offset UK taxes on the same income. So UK musicians are not being taxed twice on the same income.

HOW THE WITHHOLDING WORKS

All persons, including promoters and venues, who have control of US sources of income such as payment for performing fees for non US resident musicians are required to deduct tax at 30% from the gross fee and account for it to the US tax authorities the Internal Revenue Service (IRS).

The IRS is enforcing the rules with regard to live music venues and so promoters are forced under pain of penalty to deduct the 30% required.

All non residents are caught by the withholding rules. The rules do not apply to US resident aliens nor to US citizens and green card holders who are required to render US Returns anyway.

HOW THE CWA WORKS

It is possible for a non resident alien to submit a CWA application under which the amount of tax withheld is reduced to an amount estimated to be the anticipated tax due after the tour has completed. Where a tour overlaps two separate calendar years then two sets of CWA applications have to be submitted. After the tour the musicians are required to submit their US Tax Returns in respect of US source income for the calendar year. At this stage any Treaty protection can be invoked and repayments claimed if required. If a US Return is not submitted the IRS will not agree to a CWA for future years. So it is important for musicians to have their US tax affairs up to date, Returns filed and taxes paid.

An application for a CWA should be made at least 45 days before the first event or tour date. The IRS has indicated that where late applications are made they will be dealt with at the discretion of the IRS. Even though an application has been made tax has to be deducted at 30% from any payments until such time as the CWA is actually agreed by the IRS.

A CWA is only applicable to a natural person or individual and is not applicable to a limited company or other entity. Where a corporation is controlled or owned by the musician then the IRS deem the corporation to be acting as an agent for the musician and without a CWA in place the 30% deduction must be applied by the payee. In the past musicians have used various corporate entities to avoid US taxation, generally these corporate structures no longer work. This is not to say that US corporate structures should be abandoned wholesale, in the right situation and for the right reasons they are part of every taxpayers legitimate tax reducing armoury.

A designated withholding agent is appointed and they are required to collect the tax due under the CWA and account for it to the IRS.

Once the CWA is agreed then the promoter/venue is informed that a CWA is in place and they can make payments to the musicians.

Once an application has been made for a CWA it has to be signed off up to the date of the first event and if not agreed by then the 30% deduction from gross applies. So it is possible in the period between the application and the first event to provide more information to the IRS, amend information and try to negotiate a better reduced rate. The earlier the application the more time there is to negotiate a reasonable rate but beware IRS agents have considerable experience of touring and attempts to unreasonably weight expenses will only result in the IRS refusing to agree the CWA.

A CWA can be applied for by the individual or by an agent authorised by the individual and recognised as being in one of the categories accepted by the IRS. Each application has to nominate what is called a 'designated withholding agent' who must have a US bank account and be enrolled in the Electronic Federal Tax Payment System, they must also be an independent third party unrelated to the non resident alien making the application. An individual's US accountant will generally qualify as a designated withholding agent. The reason for the restrictions on the designated withholding agent is that they are party to the agreement and agree to withhold and account for the tax according to the terms of the CWA. The designated withholding agent has to provide a final accounting of the income and expenses that were projected in the CWA and deposit any additional withholding tax required as a result of the CWA.

APPLYING FOR A CWA

In addition to the 45 day rule the IRS will require a fair amount of information including names and addresses of all non resident aliens to be covered by the CWA, copies of all contracts regarding performances, a

comprehensive tour itinerary, copies of recording, publishing, merchandise and other contracts giving rise to US source income.

Most importantly the IRS will want to see a copy of the proposed tour budget which will need to show all the estimated income from all sources including tour support. The IRS agents will be quick to spot unreasonable tour costs, they have a great deal of experience with reviewing tour budgets and probably see more tour budgets than most tour managers or accountants so do not underestimate their ability to spot a bit of adventurous cost budgeting.

Even though tour support from the record company is an advance on record royalties and will be recouped from the royalty stream this will still be included in determining the CWA reduced rate. Once the tour is complete it is open to the musician to submit a US Tax Return invoking the UK/USA Tax Treaty removing the tour advance from the US tax net. For the purposes of the tour the IRS will include the tour support as income for CWA purposes – this is not the same as including it for mainstream tax purposes.

The IRS are sympathetic to costs incurred prior to arriving in the USA so for example rehearsal costs may be amortised against US source income but it has to be on a reasonable basis. If it's part of a worldwide tour then the rehearsal costs have to be amortised over the whole tour and not apportioned solely to the US leg of the tour. Management and agents commission are all acceptable costs but again the IRS are aware of market rates and anything outside of this will require some pretty convincing documentary evidence. Remember the IRS does not have to agree a CWA it is a voluntary agreement by the musician with the IRS.

If a musician is not up to date with their US Tax Return filing and tax payments the IRS will refuse to agree a CWA. It is important to remember that the IRS does not have to agree a CWA it is a voluntary arrangement. The IRS can refuse to agree an application and merely wait for the 30% deduction to be paid and eventually the US Tax Return. In only a few limited cases will it be cash flow advantageous not to apply for CWA remember the 30% is on gross income not on net income.

The IRS will check that the last three years Tax Returns are up to date for musicians prior to agreeing any CWA application. If the last three years are not up to date it is the practise of the IRS to review the past six years. The IRS have access to back records and are able to research whether a particular band and musicians played in the USA in the past. If there is no requirement to file or Tax Returns are up to date then the IRS will enter into discussions regarding a CWA.

The IRS are known to take a strict view on whether a musician has a tax filing requirement. Even small, one off and promotional gigs for developing bands at such places as Sx by Sx appear on the IRS radar and will make the band members liable to submit a US Return – even if it's a nil profit Return. If the band tries to return to the US and apply for a CWA they will most likely be refused because they failed to render a Tax Return for the period they were in the US before.

Under the US rules musicians will need to apply for a Social Security Number (SSN) in order to be refused so that they can then apply for a Taxpayer Identification Number (TIN) which will be required in order to submit a US Tax Return. The reason for this rather cumbersome method is to force the musicians to register with another agency outside of the IRS so that they can be vetted for homeland security purpose. The IRS cannot pass details of individuals to other government agencies but the Social Security can.

Undoubtedly some inventive minds will try to develop arrangements that seek to circumvent the CWA rules. Beware there is anti avoidance legislation that prevents abuses. For example a payment by a US resident to another US resident where the payer knows that the payee is acting as the agent of the non US resident entertainer is subject to the withholding tax at 30%. The failure for misconceived schemes is not only the tax but penalties as well.

TOUR CREW

In preparing a CWA application the IRS will want to have details of amounts being paid to crew. Where payments are being made to non US resident tour crew the IRS will expect these individuals to be US tax compliant. This means that if the tour crew members worked in the US in previous years they must have submitted US Tax Returns in respect of those years. Where the IRS are aware that tour crew are not US tax compliant they may not agree the deduction claimed in the tour costs in reckoning the reduced withholding tax payable. In short the featured artist has to pay tax on behalf of the tour crew. It is, therefore, quite important that tour crew are US tax compliant otherwise the featured artist suffers the tax!

CAN WE HELP?

Yes we can. As a firm of UK/US accountants we have considerable experience of musicians working in both countries and around the rest of the world. We are able to advise on how best to present a CWA application to the IRS. We have a great deal of experience of how the IRS operate and can use that to our client's best advantage. We can advise on budget costs that the IRS will accept thus reducing the amount of CWA deducted. We are used to dealing with international groups and bands comprising members of different countries and how that affects their tax liabilities. We also deal with a tour accounting and can advise on the appropriate tax structures to use.

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