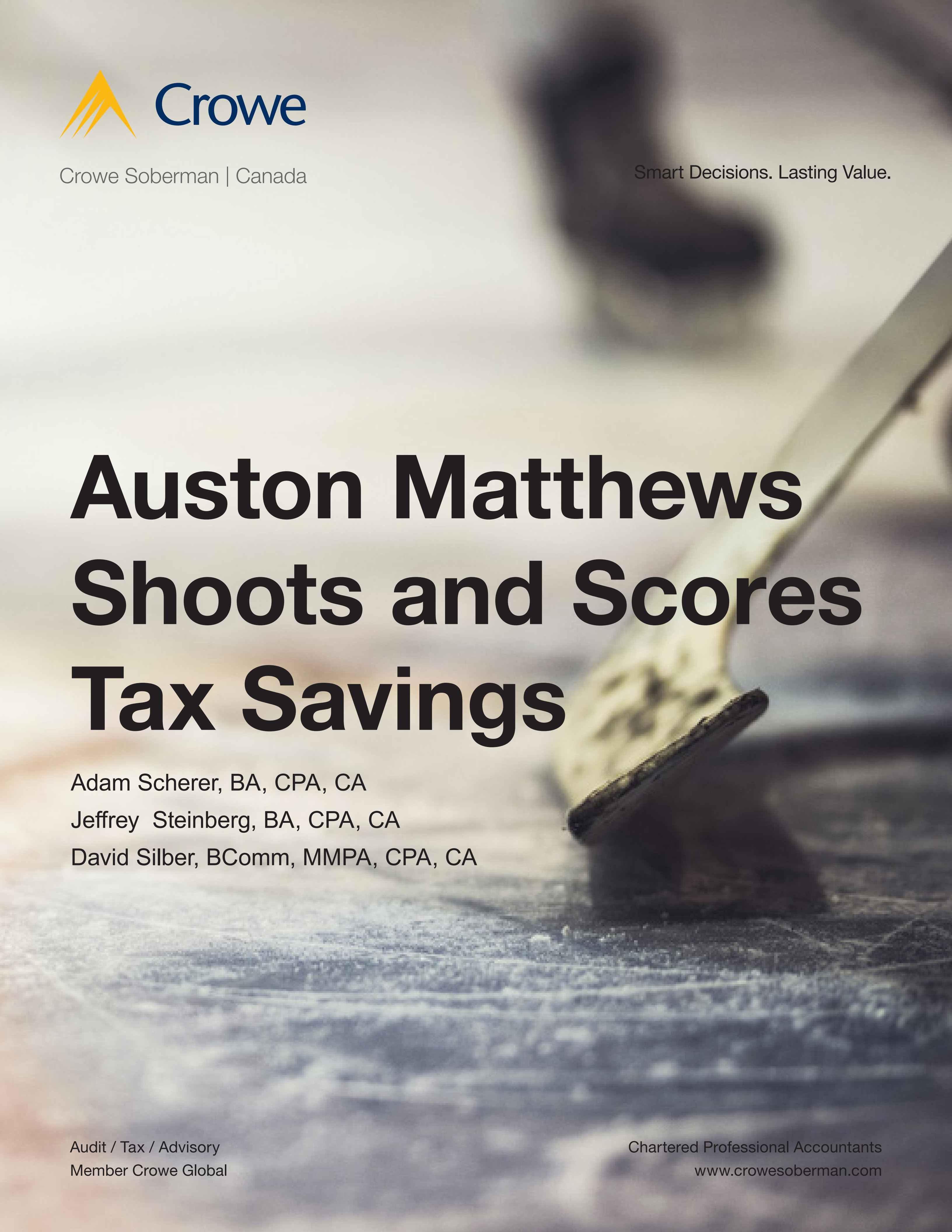

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Auston Matthews Shoots and Scores Tax Savings

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Fans of the Toronto Maple Leafs have reason to be thrilled today. Canadian taxpayers may have reason to be a bit irritated.

On February 5, Auston Matthews signed a five-year contract extension with the Maple Leafs for $58.15 million. Only $3.65 million of that sum is in the form of regular salary. The rest: $54.5 million, is in signing bonuses.

There may be CBA (collective bargaining agreement) or salary cap reasons for structuring his contract this way, but the tax implications are the exciting stuff!

To refresh your memory on athlete taxes in Canada, the main factor in determining how much Canadian income tax a player pays is based on his residency. While many factors can affect the determination of where a player resides for tax purposes, most foreign-born players, like Matthews, can likely structure their affairs to avoid triggering Canadian residency rules.

Why is residency important? Sticking with the Maple Leafs example, players who are residents of either Canada or the United States are taxed on their entire salary in their home country. Those who are considered residents of the U.S. must also pay tax in Canada – but only to the extent of time on Canadian soil. (A quick glance at the team's schedule tell us this amounts to approximately 73 per cent of players' salaries.) Credits are available in the U.S. for taxes paid in Canada, meaning effectively that a player pays the higher of either the Canadian tax rate or the U.S. tax rate on his Canadian income – so he's not paying twice, just once in each country.

Since 2016, Canadian income tax rates have been higher than all U.S. states'. So, the ultimate cost to a U.S.-resident athlete playing in Toronto is the difference between his U.S. tax rate (between 37 and 50 per cent, depending on the state) and his rate in Ontario, which tops out at 53.5 per cent. This delta between Canadian and U.S. tax rates has been an oft-used argument by some players and agents to avoid signing with Canadian teams.

Enter the concept of signing bonuses. These have become popular in professional sports, especially in the National Hockey League. A signing bonus is defined as a sum of money paid to an employee as an enticement or incentive to join a particular organization or sign a new contract. Exactly what an athlete might need to convince him to join a Canadian team like the Leafs.

From a tax perspective in Canada, a signing bonus is simple: the amount of the bonus is treated as ordinary employment income, and is taxable in the year received. But, when a U.S.-resident athlete receives a signing bonus to play in the NHL for a Canadian team, a special quirk of the Canada-U.S. income tax treaty kicks in.

The treaty provides that a signing bonus paid by a Canadian NHL team to a U.S.-resident player would be taxable in Canada – but that tax may not exceed 15 per cent of the gross amount of the payment.

Assuming the player's U.S. tax rate exceeds 15 per cent (it does, remember the 37-50 per cent), the bonus would effectively be taxable at a combined rate equal to his normal U.S. rates. And so, there is no Canadian tax cost disadvantage on the signing bonus amount.

Let's run some quick numbers – does the signing bonus put an end to a common argument against playing in Canada? At the same total dollars, but without a signing bonus, Auston Matthews's salary in the first year of his contract would be approximately $15.9 million. Based on his number of work days in Canada, $11.6 million of that would be subject to Canadian tax. Imagine for a second he was debating playing for the team in Arizona instead – his U.S. tax on that income would be 41.5 per cent. So comparing the two scenarios, playing in Canada would trigger a 12 per cent tax cost on the Canadian portion of the income, equaling $1.4 million. But with his signing bonus contract, only $700,000 is ordinary salary and $500,000 would be taxed in Canada. The signing bonus drops his cost of playing in Canada to a mere $60,000 for year one. If the debate was between a team in Canada and a team in New York or California, this number would drop even more, since those states' tax rates are much closer to Canada's. So, it is possible that by signing this type of contract, Matthews has saved almost $1.3 million in combined taxes in Canada and the U.S. in the first year alone! Seems like enticement or incentive to me.

Let's run more quick numbers – what does all this mean for tax coffers in Canada? Assuming again the same total dollars but without the signing bonus, $15.9 million salary would have meant the Canadian government would collect $6.2 million from Matthews in the first year of his contract. Instead, thanks to the signing bonus structure, they'll collect only $2.5 million. Over the life of Matthews's contract, Finance Canada will be down approximately $13 million.

Taxpayers shouldn't worry too much about it though – with Matthews's help and a little luck, all the ancillary revenues generated from the Leafs' future Stanley Cup runs will more than make up the difference!

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