Linseman v. Commissioner, 82 T. C. 514 (1984)

Sign-on bonuses for nonresident aliens are to be allocated to sources within and without the United States based on the number of games played during the season in each location.

Summary

In Linseman v. Commissioner, the U. S. Tax Court determined how to allocate a sign-on bonus received by Ken Linseman, a Canadian hockey player, from the Birmingham Bulls, a U. S. team. The court rejected Linseman's attempt to allocate part of the bonus to Canada due to potential liabilities from his previous contract. Instead, it ruled that the bonus should be allocated based on the number of games played by the Bulls in the U. S. and Canada during the 1977-78 season. This decision emphasizes the importance of considering the location of services when allocating income for tax purposes.

Facts

Ken Linseman, an 18-year-old Canadian hockey player, signed a nonrefundable $75,000 sign-on bonus with the Birmingham Bulls of the World Hockey Association (WHA) in 1977. At the time, Linseman was under contract with the Kingston Canadians in Canada, but believed this contract was unenforceable due to his minority status. The sign-on bonus was intended to induce Linseman to sign with the Bulls, despite the WHA's rule against drafting players under 20 years old. Linseman received $59,667 of the bonus in 1977. The Bulls played 86 games in the 1977-78 season, with 16 in Canada and the rest in the U. S.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Linseman's 1977 federal income tax and an addition to tax for late filing. Linseman petitioned the U. S. Tax Court, challenging the allocation of his sign-on bonus, the deductibility of certain business expenses, and the addition to tax for late filing. The Tax Court heard the case and issued its decision in 1984.

Issue(s)

1. Whether the sign-on bonus paid to a nonresident alien should be allocated to sources within and without the United States based on the number of games played by the team in each location during the season.
2. Whether certain business expenses claimed by Linseman are deductible.
3. Whether Linseman had reasonable cause for failing to file his tax return on time.

Holding

1. Yes, because the primary purpose of the sign-on bonus was to induce Linseman to

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play for the Bulls, and the allocation should reflect where those services were performed.
2. Yes, because $645 of the claimed expenses were ordinary and necessary business expenses.
3. No, because Linseman's belief that he owed no tax due to his allocation method did not constitute reasonable cause for late filing.

Court's Reasoning

The court rejected Linseman's contention that part of the bonus should be allocated to Canada due to potential liabilities from his previous contract with the Kingston Canadians, as he failed to prove this allocation was reasonable. Instead, the court found that the sign-on bonus was primarily to induce Linseman to sign with the Bulls and should be allocated based on the location of games played. The court considered the bonus as akin to a payment for a covenant not to compete, but focused on the underlying purpose of inducing performance. The court also noted that the sign-on agreement required Linseman to enter into a playing contract with the Bulls. The court upheld the deductibility of certain business expenses as ordinary and necessary, but found Linseman's late filing was not excused by his belief in his tax liability.

Practical Implications

This decision provides guidance on allocating sign-on bonuses for nonresident aliens, particularly in professional sports. It underscores that such allocations should reflect where the services related to the bonus are performed, rather than other factors like potential liabilities. Legal practitioners advising athletes or other professionals receiving sign-on bonuses should consider the location of services when planning tax strategies. This ruling may influence how teams and leagues structure contracts and bonuses for international players. Subsequent cases involving similar issues, such as Stemkowski v. Commissioner, have applied this principle, though with variations in allocation methods based on specific facts.

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