Garcia v. Commissioner, 140 T. C. 141 (U. S. Tax Ct. 2013)

In Garcia v. Commissioner, the U. S. Tax Court ruled on the allocation of endorsement income between royalties and personal services for professional golfer Sergio Garcia, as well as the tax implications under the U. S. -Switzerland tax treaty. The court allocated 65% of the income to royalties, which were deemed non-taxable in the U. S. , and 35% to personal services, taxable in the U. S. This decision clarifies the treatment of endorsement income for international athletes and the application of tax treaties in such cases.

Parties

Sergio Garcia, a professional golfer and resident of Switzerland, was the petitioner. The Commissioner of Internal Revenue was the respondent. The case proceeded through the U. S. Tax Court.

Facts

Sergio Garcia, a professional golfer residing in Switzerland, entered into an endorsement agreement with TaylorMade Golf Co. (TaylorMade) in October 2002, effective from January 1, 2003, to December 31, 2009. Under the agreement, Garcia was designated as TaylorMade's "Global Icon," requiring him to exclusively use TaylorMade products and allow the company to use his image, name, and voice for advertising worldwide. In return, Garcia received compensation, which was initially allocated 85% to royalties for image rights and 15% to personal services. Garcia established two LLCs, Even Par, LLC in Delaware and Long Drive Sàrl, LLC in Switzerland, to manage the royalty payments. The Commissioner disputed this allocation and claimed that all income should be taxable in the U. S. , challenging the structure involving the LLCs.

Procedural History

The Commissioner issued a notice of deficiency to Garcia for tax years 2003 and 2004, asserting deficiencies of $930,248 and $789,518, respectively. Garcia timely filed a petition contesting these deficiencies in the U. S. Tax Court. The case involved issues of allocation between royalties and personal services, the taxability of income under the U. S. -Switzerland tax treaty, and the validity of the LLC structure. The standard of review applied by the court was a preponderance of the evidence.

Issue(s)

Whether the payments made by TaylorMade to Garcia under the endorsement agreement should be allocated 85% to royalties and 15% to personal services, as initially agreed upon by the parties?

Whether the U. S. source royalty compensation is income to Garcia or to Long Drive

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Sàrl, LLC?

Whether the U. S. source royalty compensation and a portion of the U. S. source personal service compensation are taxable to Garcia in the United States under the Convention between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (Swiss Tax Treaty)?

Rule(s) of Law

The court applied the rule that payments for the use of a person's name and likeness can be characterized as royalties if the person has an ownership interest in the right. The court also considered the Swiss Tax Treaty, which provides that royalties derived and beneficially owned by a resident of a contracting state are taxable only in that state. Additionally, the court referenced the Treasury Technical Explanation of the Swiss Tax Treaty, which states that income is predominantly attributable to a performance itself or other activities or property rights.

Holding

The court held that the payments made by TaylorMade to Garcia were allocated 65% to royalties and 35% to personal services. The court further held that any royalty income to Garcia was exempt from taxation in the United States under the Swiss Tax Treaty. However, all of Garcia's U. S. source personal service income was taxable in the United States.

Reasoning

The court reasoned that both Garcia's image rights and personal services were critical elements of the endorsement agreement, but the 85%-15% allocation did not reflect the economic reality of the agreement. The court considered testimony from TaylorMade's marketing director, who emphasized the importance of both elements, but found that the allocation should be adjusted based on the specific facts of the case. The court compared Garcia's endorsement agreement to that of another golfer, Retief Goosen, in Goosen v. Commissioner, noting the differences in their status and obligations. The court determined that Garcia's status as a Global Icon and the extent of TaylorMade's use of his image rights warranted a higher allocation to royalties than Goosen's agreement. The court also found that Garcia's personal services, particularly his use of TaylorMade products during professional play, were highly valuable but did not justify the 85%-15% allocation. Regarding the Swiss Tax Treaty, the court held that the royalty income was not predominantly attributable to Garcia's performance in the U. S. and thus was exempt from U. S. taxation under Article 12 of the treaty. The court declined to consider Garcia's argument that a portion of his U. S. source personal service income was not taxable in the U. S. , as it was raised too late in the proceedings.

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Disposition

The court entered a decision under Rule 155 of the Tax Court Rules of Practice and Procedure, reflecting the allocation of 65% of the endorsement income to royalties and 35% to personal services, with the royalty income being exempt from U. S. taxation and the U. S. source personal service income being taxable in the U. S.

Significance/Impact

The Garcia v. Commissioner decision has significant implications for the taxation of endorsement income for international athletes. It clarifies the allocation of income between royalties and personal services and the application of tax treaties in such cases. The decision may influence how athletes and sports companies structure endorsement agreements and manage tax liabilities across jurisdictions. The court's analysis of the Swiss Tax Treaty and its application to royalty income provides guidance for future cases involving similar issues. The decision also highlights the importance of timely raising arguments in tax litigation, as the court declined to consider Garcia's late argument regarding the taxability of certain personal service income.

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