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REG-114125-07

Notice of Proposed Rulemaking Compensation for Labor or Personal Services: Artists and Athletes

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AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Notice of proposed rulemaking.

SUMMARY:

This document contains proposed changes to existing final regulations regarding the source of compensation for labor or personal services. The proposed changes are needed to clarify the determination of source of compensation of a person, including an artist or athlete, who is compensated for labor or personal services performed at specific events. These proposed regulations affect such an individual.

DATE:

Written or electronic comments and requests for a public hearing must be received by January 14, 2008.

ADDRESSES:

Send submissions to: CC:PA:LPD:PR (REG-114125-07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-114125-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-114125-07).

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, David Bergkuist at (202) 622-3850; concerning the submissions of comments and requests for a hearing, Regina Johnson at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments under 26 CFR part 1 under section 861 of the Internal Revenue Code (Code). On July 14, 2005, final regulations that revised and amended §1.861-4 were published in the **Federal Register** (70 FR 40663) as T.D. 9212, 2005-2 C.B. 429. In these final regulations, §1.861-4(b)(2)(ii)(C)(3) was reserved with respect to compensation for labor or personal services performed partly within and partly without the United States by an artist or an athlete who is an employee.

Section 861(a)(3) of the Internal Revenue Code provides that, subject to certain exceptions, compensation for labor or personal services performed in the United States is gross income from sources within the United States. See also §1.861-4(a) of the regulations. Section 862(a)(3) of the Code provides that compensation for labor or personal services performed without the United States is gross income from sources without the United States. Section 1.861-4(b) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States. Section 1.861-4(b)(2)(i) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States by an individual other than as an employee. Section 1.861-4(b)(2)(ii) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States by an individual as an employee.

Under §1.861-4(b)(2)(ii), if an individual performs labor or personal services as an employee, the source of the individual's compensation is generally determined on a time basis, with certain fringe benefits sourced on a geographic basis. An individual may determine the source of his or her compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis if the individual establishes to the satisfaction of the Commissioner that, under the facts and circumstances of the particular case, the alternative basis more properly determines the source of the compensation than the general rules of §1.861-4(b)(2)(ii). See §1.861-4(b)(2)(ii)(C)(1)(i). In addition, the Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee under an alternative basis if such compensation is not for a specific time period, provided that the Commissioner's alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual.

The final regulations at §1.861-4(b)(2)(ii)(C)(3) provided a reservation with respect to the source of compensation for labor or personal services performed partly within and partly without the United States by an artist or athlete who is an employee. The preamble of T.D. 9212 indicated that it was intended that the rule for artists and athletes who are employees, when issued, would require such individuals to determine the proper source of their compensation for labor or personal services on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case, consistent with current law.

Explanation of Provisions

The proposed regulations would set forth a new "events basis" rule in §1.861-4(b)(2)(ii)(G) and make certain other clarifying changes to the existing final regulations. The proposed regulations also would remove §1.861-4(b)(2)(ii)(C)(3), which reserved with respect to artists and athletes.

The amount of income received by a person, including an individual who is an artist or an athlete, that is properly treated as compensation from the performance of labor or personal services is determined based on all of the facts and circumstances of the particular case. Proposed §1.861-4(b)(2)(ii)(G) specifies that the amount of compensation for labor or personal services determined on an event basis is the amount of the person's compensation which, based on the facts and circumstances, is attributable to the labor or personal services performed at the location of a specific event.

The IRS and the Treasury Department have determined that the proper source of compensation received by a person, including an individual who is an artist or athlete, specifically for performing labor or personal services at an event is the location of the event. A basis that purports to determine the source of compensation from the performance of labor or personal services at a specific event, whether on a time basis or otherwise, by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly determines the source of the compensation. This rule applies to situations covered by §1.861-4(a) and (b).

Under §1.861-4(a), the source of compensation for labor or personal services performed wholly within the United States is generally from sources within the United States. Therefore, if a person, including an individual who is an artist or an athlete, is specifically compensated for performing labor or personal services at an event in the United States, the source of such compensation is wholly within the United States because the labor or personal services were performed wholly at an event within the United States. The proposed regulations state that a basis that purports to determine the source of such income on a time basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be a more reasonable basis for determining source of the compensation. The proposed regulations add an example to §1.861-4(c) to illustrate the application of this rule.

Section 1.861-4(b) applies to instances in which a person is compensated for performing labor or personal services at multiple events, only some of which are within the United States, and at least a portion of the person's compensation cannot be specifically attributed to the person's performance of labor or personal services at a specific location. If the person is not an individual who is compensated as an employee, the source of compensation for labor or personal services is determined on the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case. See §1.861-4(b)(1) and (2)(i). If a person is compensated specifically for labor or personal services performed at multiple events, the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case will generally be the location of the events. In addition, a basis that purports to determine the source of such income on a time basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly reflects the proper source of the compensation under proposed §1.861-4(b)(2)(ii)(G).

The Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee under an alternative basis if such compensation is not for a specific time period, provided that the Commissioner's alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual. Compensation specifically for labor or personal services performed at a specific event is not compensation for a specific time period. The basis that most correctly reflects the proper source of that income will generally be the location of the event under proposed §1.861-4(b)(2)(ii)(G). In addition, a basis that purports to determine the source of such income on a facts and circumstances basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not more properly determine the source of the compensation under proposed §1.861-4(b)(2)(ii)(G).

These proposed regulations provide examples to illustrate the event basis for determining the source of compensation of an individual, including an artist or athlete, who is compensated specifically for performing labor or personal services at an event.

The revisions to §1.861-4(b)(1), (b)(2)(i), and (b)(ii)(C)(1)(i) and (ii) which refer to the event basis; the revisions in §1.861-4(b)(2)(ii)(C)(3), (b)(2)(ii)(E), and (b)(2)(ii)(F), (b)(2)(ii)(G), and (c); and new *Examples 7* through *11* of §1.861-4(c) would be effective for taxable years beginning after the date final regulations are published in the *Federal Register*.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comment that is submitted timely to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for a public hearing will be published in the *Federal Register*.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.861-4 is amended by:

1. Removing the heading for paragraph (b)(1)(i).

2. Redesignating paragraph (b)(1)(i) as paragraph (b)(1).
3. In the last sentence of newly designated paragraph (b)(1), adding the language "or on the event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "paragraph (b)(2)(ii)(E) of this section."
4. In the last sentence of paragraph (b)(2)(i), adding the language "or on the event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "paragraph (b)(2)(ii)(E) of this section."
5. In the first sentence of paragraph (b)(2)(ii)(C)(1)(i), adding the language ", including an event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "alternative basis" wherever the language "alternative basis" appears in the sentence.
6. In the first sentence of paragraph (b)(2)(ii)(C)(1)(ii), adding the language "event basis as defined in paragraph (b)(2)(ii)(G) of this section or other" after the language "partly without the United States under an".
7. Removing paragraph (b)(2)(ii)(C)(3).
8. In the first sentence of paragraph (b)(2)(ii)(E), removing the language "individual's" and adding the language "person's" in its place, removing the language "individual" and adding the language "person" in its place, and removing the language "his or hers" and adding the language "such person's" in its place.
9. In the second sentence of paragraph (b)(2)(ii)(F), removing the language "an individual" and adding the language "a person" in its place.
10. Redesignating paragraphs (c) and (d) as new paragraphs (d) and (e), respectively.
11. Redesignating paragraph (b)(2)(ii)(G) as new paragraph (c).
12. Adding a new paragraph (b)(2)(ii)(G).
13. In the introductory language of newly-designated paragraph (c), removing the language "paragraph (b)(2)(ii)" and adding the language "section" in its place.
14. Adding new *Examples 7, 8, 9, and 10* to newly-designated paragraph (c).
15. Redesignating paragraph (b)(1)(ii) *Example*, as new *Example 11* in newly-designated paragraph (c), revising the paragraph heading and removing paragraph (b)(1)(ii).
16. Adding a new sentence at the end of newly-designated paragraph (e) and revising the paragraph heading.

The additions read as follows:

§1.861-4 Compensation for labor or personal services.

(b) ***

(2) ***

(ii) ***

(G) *Event basis.* The amount of compensation for labor or personal services determined on an event basis is the amount of the person's compensation which, based on the facts and circumstances, is attributable to the labor or personal services performed at the location of a specific event. The source of compensation for labor or personal services determined on an event basis is the location of the specific event. A basis that purports to determine the source of compensation from the performance of labor or personal services at a specific event, whether on a time basis or otherwise, by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly determines the source of the compensation.

(c) *Examples.* ***

Example 7. P, a citizen and resident of Country A, is paid by Company Z to make a presentation in the United States in 2009. In 2010, Company Z pays P to make 10 presentations, four of which are in the United

States and six of which are outside the United States. P is compensated separately by Company Z for each presentation. For some presentations P receives a flat fee from Company Z. For the remaining presentations P receives compensation that is based on a formula. Under the facts and circumstances of the particular case, the source of the compensation for each presentation is most correctly reflected on an event basis, as defined in paragraph (b)(2)(ii)(G) of this section. Because P is compensated separately for each presentation, the source of P's compensation from Company Z for the 2009 presentation within the United States and the four 2010 presentations in the United States will be from sources in the United States. The amounts will be determined based on the flat fee or the formula as contractually determined.

Example 8. (i) Facts. Group B, a Country N corporation, is a musical group. All of the members of Group B are citizens and residents of Country N. Group B has an employment arrangement with Corp Y, a Country N corporation, to perform as directed by Corp Y. Corp Y and a tour promoter enter into a contract to provide the services of Group B to perform in musical concerts in the United States and Country M during a 45-day period. Under the contract, Group B performs concerts in 15 cities, 10 of which are in the United States. Prior to entering the United States, Group B spends 60 days rehearsing and preparing in Country N. Under the contract with Corp Y, Group B receives a flat fee of \$10,000,000 for performing in all 15 cities. The fee is based on expected revenues from the musical concerts. Each concert is expected to require a similar amount and type of labor or personal services by Group B. At the end of the tour, an analysis of the revenues from all of the concerts shows that 80% of the total revenues from the tour were from the performances within the United States.

(ii) Analysis. Under the facts and circumstances basis of paragraph (b)(1) of this section, the source of the compensation received under the contract is most correctly reflected on an event basis, as defined in paragraph (b)(2)(ii)(G) of this section, with amounts determined based on the relative gross receipts attributable to the performances within and without the United States. Thus, of the \$10,000,000 of compensation included in Group B's gross income, \$8,000,000 ($\$10,000,000 \times .80$) is attributable to labor or personal services performed by Group B within the United States and \$2,000,000 ($\$10,000,000 \times .20$) is attributable to the labor or personal services performed by Group B without the United States.

Example 9. (i) Facts. A, a citizen and resident of Country M, is an employee of Corp X, a Country M corporation. During 2008, Corp X is contractually obligated to provide A's services to perform in a specific athletic event in the United States. Under A's employment contract with Corp X, A is required to perform at a professional level that requires training and other preparation prior to the event. A undertakes all of this preparation in Country M. Solely as a result of A's performance at the athletic event in the United States, A receives \$2,000,000 from Corp X.

(ii) Analysis. The entire \$2,000,000 received by A for performing labor or personal services at the athletic event in the United States is income from sources within the United States on an event basis as defined in paragraph (b)(2)(ii)(G) of this section. A's compensation is attributable entirely to labor or personal services performed within the United States at the athletic event. It is inappropriate to conclude that the source of A's compensation for labor or personal services is performed partly within and partly without the United States simply because A's preparation for the athletic event involved activities in Country M.

Example 10. (i) Facts. X, a citizen and resident of Country M, is employed under a standard player's contract by a professional sports team (Team) that plays its games both within and without the United States during its season. The term of the contract is for twelve months beginning on October 1. Under the contract, X's salary could be paid in semi-monthly installments beginning with the first game of the regular season and ending with the final game played by the Team. Alternatively, because the regular playing season was shorter than the one-year period covered by the contract, X had the option to receive his salary over a twelve-month period. X elected this option. In addition, during the period of this employment contract, X, as an employee of Team, was required to practice at the direction of the Team as well as to participate in games. During 2008, X participated in all practices and games of Team and received a salary. Team qualified for postseason games in 2008. X also received in 2008 additional amounts for playing in preseason and postseason games for the Team.

(ii) Analysis. The salary paid to X by the Team is considered to be personal services compensation of X that X received as an employee of the Team. The source of this compensation within the United States is determined under the time basis method described in paragraph (b)(2)(ii)(A) of this section and accordingly is determined based upon the number of days X performed services for the Team within the United States during 2008 over the total number of days that X performed services for the Team during 2008. The source of the additional amounts X received for playing in preseason and postseason games is determined under the event basis method described in paragraph (b)(2)(ii)(G) of this section and accordingly is determined based on the location where each such preseason or postseason game was played.

Example 11. ***

(e) Effective/applicability date. *** The revisions in paragraphs (b)(1), (b)(2)(i), and (b)(2)(ii)(C)(1)(i) and (ii) of this section which refer to the event basis; the revisions of paragraphs (b)(2)(ii)(C)(3), (b)(2)(ii)(E), (b)(2)(ii)(F), (b)(2)(ii)(G), and (c) of this section; and *Examples 7 through 11* of paragraph (c) of this section apply to

taxable years beginning after the date final regulations are published in the **Federal Register**.

Linda E. Stiff,
*Deputy Commissioner
for Services and Enforcement.*

Note

(Filed by the Office of the Federal Register on October 16, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2007, 72 F.R. 58787)

Drafting Information

The principal author of these proposed regulations is David Bergkuist, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

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