Good News–Bad News: Expanded International Participants Means Expanded Compliance Issues for Tracks

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Moderator: All right. Okay, we’ll kick off our last panel before lunch. Good News – Bad News: Expanded International Participants Means Expanded Compliance Issues for Tracks. You heard, in our international simulcasting panel this morning that we discussed horse owners from Korea and certainly from China. That’s great news for our racing and for our racing companies, but, for people who have to deal with that, it creates an extra layer of compliance for them.

It’s not a sexy topic, but it’s a really important one to not get in trouble in this area. We’re very happy to have two gentlemen from KPMG today. Just another sponsor shout-out: This was sponsored by CHRIMS, and the Stronach Group sponsored the beverage break. I will give it over to Robert Stoddard, who’s the managing director of business and tax services at KPMG.

Robert Stoddard: Thank you. Good morning, everyone. As Liz mentioned my name’s Bob Stoddard. I’ve been with KPMG for about 15 years serving clients in a bunch of different industries, but I do have several racing and gaming clients. This is an issue that I’ve actually dealt with a good chunk of my career. With me today is Chris Riccardi, who’s a senior manager with our Washington National tax practice. Chris is instrumental in our inbound
taxation group and dealing with a lot of withholding issues under Chapter 3 and 4 FATCA issues with non-USPs. Chris graciously agreed to join me for this session today.

Christopher Riccardi: Well, we’re both glad to be here, and we’re both glad all of y’all are here as well. Let’s just start with a basic overview of Chapter 3. All Chapter 3 is is a withholding mechanism that’s aimed at payments to foreign persons. It’s easier, I think, to understand Chapter 3 and its basic mechanisms if we try to compare it with something that I think a lot of us are very familiar with, which is wage withholding. Like wage withholding, there’s a payment that triggers the obligation to withhold. For wage withholding, it’s obviously a payment of wages to the employee. For Chapter 3, it’s a payment of U.S. source FDAP, and we’ll get into what that term really means here in a minute to a foreign person. Anyways, there’s a payment, and that triggers the obligation to withhold. The person responsible for the withholding is the person making the payments. Like wage withholding, the employer would be responsible for deducting the withholding and depositing that with the IRS.

In Chapter 3, it’s what we call a withholding agent, but it’s essentially the same thing. It’s the person who’s making the payment—person or company—to the foreign person. They’re tasked with withholding the amount due and depositing it with the IRS. Similar to wage withholding, there’s a reconciliation mechanism at end of the day. For wage withholding, we send out W-2’s to the payee and to the IRS. It has the amount of the payment on it, the amount of the withholding that was taken out of the payment and deposited with the IRS that’s sent to both the payee and the IRS. The IRS matches that up with the payee’s tax return that they file at the end of the year.

With Chapter 3, there’s a similar mechanism, just different forms. For Chapter 3, it’s the 1042-S. That goes to the payee and to the IRS, has the amount of the payment, has the amount of the withholding and the reason for the reduction of any withholding. Potentially, if the withholding isn’t correct, the foreign payee would file a return with the IRS, pay additional tax, or more likely collect any refund. In the non-resident alien context, it’s a 1040NR. If it’s a foreign corporate it’d be an 1120-F. Also, similar to wage withholding, there’s a form that the payee can provide to the withholding agent or the employer to reduce the amount of the withholding.

Generally, under wage withholding, there’s a schedule, depending on the amount of the wages. There’s a table, and the employer will follow that table and deduct the right amount of withholding. That can be reduced by the
employee by providing a foreign W-4. You add exemptions, and you can reduce your ultimate amount of withholding. For foreign persons, it’s the same W series. It’s a W-8, and there’s different flavors of this form. Essentially, the payee can provide that to the person making the withholdable payment, and the withholding agent can reduce the amount of the withholding. It’s really similar mechanism between these two regimes. They’re just aimed at different items of income and different payees.

Robert Stoddard: What we’ve found, just from an overall industry perspective, is, obviously, I think most tracks are very familiar with the W-9, W-8 collection process dealing with the non-U.S. horse owners. My discussions with some of the bookkeeper accountants at a couple tracks—racing presents some unique challenges. We’ll go through those a little bit in a little bit. It’s very hard, often, to get these forms. You’re chasing down payees who may only be in the U.S. a couple days a year. It’s constantly a battle to even get the documentation that you need, deal with it from a relationship perspective—foreign owners can often be very challenging, particularly ones who are prominent in the industry. Quite frankly, they may be getting conflicting advice from non-U.S. tax advisors as to what their potential obligations are. That advice may not always be accurate.

We’ve seen that in the past, including even dealing with some of our own member firms around the world. The U.S. rules around whether or not you have a U.S. trader business and you’re subject to U.S. income tax, there’s almost never a bright-line test. When you deal with owners who aren’t here all that often, they don’t understand why they have to file a U.S. return why they’re subject to U.S. tax at all, much less losing 30 percent of their purse, potentially. That creates an inherent friction with the racing operations managers and the teams that actually run the tracks and wanting to attract high-end foreign owners, the popular high-end race horses to be at your tracks.

What we’ve also seen is there’s also some level of inconsistency across the industry as well. Hopefully, what we’d like to get outta this is just facilitative conversation not only with us, but also amongst the different tracks around the country and have some level of consistent—because we don’t want track A, B, and C having three different approaches to foreign withholding, especially with the IRS paying more and more attention to this. If anything, we’d like to have a consistent approach. Maybe it’s not ideal, from a horse owner perspective, but at least everybody’s consistent across the industry. If we want them to be mad at anybody, we want them to be mad at the IRS, not at you guys.
Christopher Riccardi: Okay, so we’re gonna do some tax speak, but we’re gonna do it real quick, and then we’re also gonna break it down into plain English here. Chapter 3 applies to U.S. source FDAP income. What the hell is that? Effectively, FDAP is all income. If you actually look at the definition of FDAP, fixed determinable annual or periodical income, it’s defined as all income within the meaning of Section 61, which just means it’s all gross income.

There’s certain exceptions that we—minor exceptions that we don’t need to get into here cuz they’re probably just not applicable to y’alls factual scenarios. Just think of FDAP as all gross income. And then what’s U.S. sourced? Well, we have sourcing rules in the U.S. We look at where, effectively, the economic activity is occurring, and we assert our taxing jurisdictions on foreign persons based on the fact that the activity and the economic benefit is coming from within our borders. If you have U.S. sourced income—income from racing occurring in the U.S., stabling occurring in the U.S., jockeying occurring in the U.S. —all of those payments, when they’re made to foreign persons, you have to think about Chapter 3 withholding.

Robert Stoddard: The one thing we’ve done here, too, is we have focus primarily on the foreign horse owners. We haven’t really covered much on jockeys or trainers in this slide. They do present some of their own issues. Obviously, if anybody does have any questions around how to deal with non-U.S. trainers that are in the U.S., outta the U.S., jockeys that are coming here periodically—they have some different rules to consider—we’re happy to talk about that, too. It’s just not really covered in the slides, but feel free to chime in with any questions there are well.

Christopher Riccardi: Right. In plain English, if someone’s coming to the U.S. and making money in the U.S., and they’re a foreign person, Chapter 3 withholding can’t apply, and the IRS in an ‘84 ruling, has specifically stated that purse winnings are U.S. sourced FDAP. Okay, so what’s the rate of tax? With wage withholding, we have a rate schedule. For Chapter 3, it’s easier. It’s 30 percent. Thirty percent of the gross amount of the payment is the withholdable amount. Now, that can be reduced, and we’ll get into the reasons for that later.

At the outset, absent anything from the foreign payee reducing the amount of the withholding before the payment goes out, you should deduct 30 percent and deposit that with the IRS. There’s breaks that the U.S. has negotiated with foreign countries. If you have a company that owns the horse treaty jurisdiction, then it’s possible the rate can be reduced. In this
context, the rate is likely zero or 30. It’s not always the case. The treaties are an item by item income basis. It’s not too relevant here. If you were paying interest, the rate might not be zero, so just don’t wanna leave you with the idea that, if there’s a treaty, the rate is zero.

For purse winnings, at least, it’s gonna be 30 percent if you don’t have documentation, and 0 if you do have valid documentation. We went over this earlier. The withholding agent is the technical term, but it’s, effectively, anyone who touches the money before it gets to the person who it’s owed. If you’re paying the money, you are withholding agent. If you send it to an intermediary and they’re not the ultimate payee, you and the intermediary are withholding agents, and so on down the line until it eventually gets to the person who’s “the beneficial owner”. That’s the person who economically owns the item of income.

Robert Stoddard: Yeah, and that can come up if you have an instance where you’ve got a domestic pass-through entity that owns a race horse but that pass-through entity is controlled by foreign owners itself, so the beneficiary of that income is foreign.

Christopher Riccardi: There’s good and bad news here. We have multiple withholding agents, so who has to withhold, and can the withholding be greater than 30 percent? Ultimately, only 30 percent need be withheld. As long as one person’s withholding 30 percent, you’re fine. I’m assuming you don’t have any documentation to reduce the amount of withholding. The problem is, how do you know what the other person’s doing? If you’re the person holding the money, you’re gonna try to protect yourself by going ahead and withholding, whether or not they do, and that could ultimately make the person receiving the money not too happy.

The good news is you can contractually agree between parties who will withhold. There’s no rules on this. It’s just a matter of contract. If you were making a payment through an intermediary, you could contract with that intermediary to make them responsible for the withholding and then, although your withholding agent and the IRS could come after you, theoretically, for the withholding, you’d have a clause in that contract so that, if you were required to pay money to the IRS, that that person you contracted with would reimburse you for those amounts. You can contract out your withholding agent responsibilities. Not legally, but as a technical matter through contract.

Robert Stoddard: We suspect this may not be coming up all that much, but, certainly, we do see ownership structures around race horses where
they’re in a joint venture type structure. This is more to be aware of than anything else. If anybody wants to chime in, correct me if I’m wrong. I think you’re dealing with a lot of direct owners, at least the majority of the time. Just be aware that, if you have a joint venture owner, that can give rise to this issue.

Christopher Riccardi: The other thing the withholding agent has to do besides withhold and deposit is let the IRS know what’s goin’ on. The IRS wants to know what the amount of the payments leaving the U.S. are and whether the withholding has properly been withheld and deposited. That way, they can come and audit you and collect any money due—we’ll get into this a little bit later—although the person who receives the money is ultimately, primarily liable for the tax. It’s their tax. This withholding mechanism is just backing up an actual tax on these foreign persons, just like us individuals with our wages. We pay tax under Section 1. That’s our tax. Our employer pays as they go, right. They’re withholding, and then we reconcile it at the end of the year. The withholding agent has secondary liability. Because the withholding agent’s in the U.S., guess who the IRS is gonna go after? It’s gonna be you. You have to file these forms: 1042S, which is like the W-2. You’re just telling the IRS, “Hey, here’s the amount that I paid. Here’s the amount that I withheld. Here’s the reason why it’s less than 30 percent of the payment.” Then you also file this form, 1042, so 1042 without the S. That’s your withholding agent tax return.

That’s an actual tax return of the company, just like the 1120 or the 1040 in the individual context, where you reconcile the amount that you should’ve withheld and the amount that you actually deposited. If you haven’t deposited all of the tax that you should’ve withheld, you would then reconcile it and pay over that money. If you over withheld, you would receive, potentially, a refund of the over withheld amount. As I was mention earlier, the U.S. has tax treaties with a lot of our trading partners. Under those tax treaties, the U.S. negotiates with those foreign countries for relief on certain items of income. When we’re dealing with purse winnings, we’re generally talking about what we call business profits, right?

They’re business earnings of an enterprise is the way the treaty would state it. What you might see as a treaty claim, with respect to a horse owner, is that I don’t have a permanent establishment in the United States. All they’re saying there is, under the treaty, our level of activity does not rise to the level—we don’t have enough activity for the U.S. to subject us to tax. That’s a harder determination to make than it seems—or maybe it does seem hard. It’s very facts and circumstances. It’s a hard determination to make. The good news is, as a withholding agent, you don’t need to worry about any of
that. We’ll see here in a minute, it’s all about the documentation that you receive.

We have to think a little bit about the permanent establishment, whether they have one, but we don’t have to think too hard. You have to do something—you can’t give a reduction in the 30 percent unless you have documentation that substantiates that reduction. That’s the form series W-8. There’s a lotta flavors of those. There’s the W-8BEN. There’s the W-8BEN-E. There’s a W-8ECI. There’s a W-8IMY. The W-8BEN and BEN-E are the forms that you’d see if someone was making a treaty claim. It used to be just we had W-8 BEN, and that was it. Now, we have this BEN-E. The BEN is now solely for individuals.

If you receive a BEN from a company, you should reject that form. It’s the wrong form. We have the BEN-E now. The -E stands for entity. The reason we have that form—and it’s a dirty word, and I won’t talk much more about it cuz I don’t wanna scare off our audience here—it’s FATCA. FATCA is the reason we have the BEN-E and why that form is reserved for entities. It serves a dual function, though. It’s got Chapter 4 stuff in it, but it’s also where an entity would make a treaty claim. You might see a W-8ECI.

What the company or person is saying there is, “I have a U.S. trader business, so, under U.S. law, my activities aren’t passive enough, and I’d be subject to net basis tax, generally instead of this withholding regime, which is a separate tax regime—this FDAP regime—that this Chapter 3 is supporting. You shouldn’t have to worry about Chapter 3 withholding because I’m not in that regime. I’m in this net taxes regime. I don’t have a treaty claim, so I’m not in a treaty jurisdiction, or my activities are so high. I have so much economic activity in the United States that I have a permanent establishment, so I can’t claim those treaty benefits.”

At the end of the day, when you receive that W8-ECI, you as a withholding agent, you’re withholding obligation is done. That reduces the amount of the U.S. source FDAP withholding, this Chapter 3 withholding to zero. On the other end, the company is gonna end up filing—or they should file—a form 1120F or another tax return in the U.S. because they’re taxed on a net basis, just like we are. Our gross income less allowable deductions. You might see this IMY. This is an intermediary type form.

If there’s partnerships involved, or even corporations that are acting like pass-throughs, intermediaries, brokers, then you might see an IMY form with some of these other forms attached. That form’s, effectively, to complete the chain all the way from the payor to the ultimate person who,
economically, is owed that money—the beneficial owner. You might see several series of the W-8s all tied together until you finally get to a W-8 series form. The key point is you gotta get these forms as a withholding agent prior to making the payment. That’s the rule.

Let’s say you make a payment, and then you ultimately receive forms that reduce the amount of the withholding to zero, technically, that doesn’t matter. You should’ve withheld because, at the time you made the payment, you didn’t have the form. The good news is you can get these affidavits to relate back the form. At the end of the day, there probably would be only some small penalties for interest and failure to deposit, but no big deal.

Robert Stoddard: Yeah, and speaking with the tracks that are clients of ours, we understand the challenge and that most of these owners are probably not going to give you a W-8ECI. Many of them just don’t want to, don’t understand, or they simply refuse to file a U.S. tax return. We’ll talk about this in a little more detail in a moment, but there are a lotta foreign horse owners out there who probably should be filing U.S. tax returns, quite honestly—the number of races that they’re running, the number of horses, other activities they’re involved in here. The reality is, they probably do have a U.S. trader business and should be filing a return here. I’m guessing you’re not getting a lot of the ECI forms. It’s probably more of a one off, when you do, from an owner. That’s the best-case scenario because it takes—you guys are off the hook for any withholding at that point.

They’re basically representing they’re filing a U.S. return and paying tax. It’s when they’re making a treaty claim, that’s where it becomes a little more factually specific. There are instances where—in our discussion with some of the racing operations folks, depending on what different horsemen policies are at the various tracks, I think some tracks handle this a bit differently. The IRS has, recently, within the last couple years, actually updated Publication 515, which actually asks you to get an affirmative statement from a foreign horse owner that’s giving you a treaty claim, that they’re not conducting more than one race a year in the U.S. That’s a recent edition to this publication.

It’s somethin’ that I only came across a few months ago. They’re taking a much more aggressive point of view on this. That is consistent with prior IRS rulings, I’ll be it those rulings date back to the late ’50s and early ’60s. Their viewpoint really hasn’t changed, and I think, now, they’re putting people on notice on this. There are instances where you should facially disregard a treaty claim because there are, simply, facts that are out there and known
Christopher Riccardi: My guess, at this point, you’re probably sittin’ there sayin’ to yourself, “No matter how much Chris tries—,” and I emphasize try— “to simplify this regime, this sounds like a lotta work, really complicated. What’s really the risk here? What is going to make me try to learn these rules and apply them the way the IRS wants me to? The reason is the secondary liability. If you make a payment, and you don’t do any of this, one, you’re liable for the withholding tax. We’ve got a chart here in a minute. What if you don’t file the information returns? There’s penalties for that. What if I don’t deposit it? There’s penalties for that. We break down here in a minute.

Effectively, every dollar you spend or send out, you’ll pay another dollar to the IRS, so you’re gonna double your cost. The worst part about all of this is you have no income. This isn’t your income. You’re not actually subject to tax on any of this. It’s the foreign person who is subject to tax. You’re just the IRS’ agent in collecting this tax. This is the stick the IRS uses to force withholding agents to comply. Chapter 3’s been around a long time. It hasn’t gotten a lot of attention probably until FATCA really came into play. The IRS started looking at the lack of compliance in this area and how much tax revenue—not necessarily from withholding agents cuz they don’t really wanna collect from withholding agents that they’re missing out, but on the ultimate foreign payees, the actual tax that foreign payees weren’t paying. That’s their fair share of tax.

They started to focus on this four or five years ago, started auditing very heavily and actually assessing a lot of these penalties. As Bob just mentioned, the IRS has updated their publication 515, which is the publication that just generally goes over these rules, supposedly in plain English so that non-tax folks can try to understand their withholding obligations. The main point here, though, is there’s now a specific paragraph—and it’s only a couple sentences—on horse racing. The IRS is definitely aware of this in the horse racing context, and they’re clearly paying attention to it. I’m not aware, personally, of any withholding agent audits that are occurring with our clients. Maybe Bob has a better view of that.

Robert Stoddard: I haven’t seen any major ones recently. I have seen recent assessments, and that’s more around the timing of when the income was deemed paid to the horseman, to the owner, and when that withholding payment was ultimately remitted. In a lot of cases, it’s simply that the
withholding payment was remitted much later than it should’ve been based on the reported payment date, and so the system is automatically assessing penalties and interest. That’s normal. It hasn’t been that material where I’ve seen it.

The risk here—I think you can go ahead and pull that slide up. If we mess this up—this is the eye opener. If you have a million dollars in purse money, and you don’t have the forms, you don’t remit withholding, right off the top, you’re on the hook for $300,000.00, just the 30 percent. The problem is the IRS actually considers that $300,000.00 more income. There’s more benefit to that payee because they didn’t get $700,000.00. They got a million dollars, so they’re treating you as having to gross this up.

Christopher Riccardi: The 300,000 is someone else’s tax liability. You paid it for them. When you pay someone else’s liability, that’s income to them.

Robert Stoddard: That’s more income to them.
Christopher Riccardi: That’s tax at 30 percent, but then that amount of tax, you’ve paid for them, and so on and so forth. You get the 428,000.

Robert Stoddard: The $300,000.00 simply becomes 428,000, and then you have—if you go to the extreme lateness, or you just fail to file it, you run a 5 percent per month capped at 25 percent. Each there is another $100,000.00. There’s the failure to deposit penalty, failing to file the informational returns. If the IRS really gets nasty, there’s an intentional disregard penalty on top of that.

If you just stop at the simple penalty calculation, you started at $300,000.00, and you owe almost another 250, and that’s before the IRS whacks you with the penalty for intentionally disregarding the obligation. You can wind up paying almost a million dollars on a $300,000.00 initial liability. We appreciate that it’s an extreme example, but it does get a bit eye opening if you don’t have a lotta these forms, and they’re not being filed on behalf of all the owners that are getting purse winnings.

Christopher Riccardi: Okay, let’s try to just break this down. What do we do with all this information besides diggin’ into all the rules and tryin’ to become Chapter 3 experts? I think we can break this down to, really, two points. Where you’re making a payment to someone that you suspect to be a foreign person, before you make that payment, you outta have one of the W-8 series of forms on file. The second point is, well, which W-8 series form do I get? I’ve seen this ECI. Can I rely on that? What’s this W-8BEN-E, and what’s the treaty claim mean?
Robert Stoddard: By the way, we understand there’s an issue around payment dates and how that’s set with some specifics that relate to the horse racing industry. We’ll go through that as well. There’s some mechanisms that you may be able to consider pulling with the horse owners to tweak the payment dates. We can talk about how, in our experience, the payment dates generally work in the industry and how they might work if you wanna pull a couple other levels and tweak the horseman agreements.

Christopher Riccardi: Right. If you get a W-8, you probably ask, “Well, can I rely on this?” Withhold agents can generally rely on the W-8 series forms unless they know or have reason to know that the form is wrong. If I get a W-8, do I know or have reason to know that it’s wrong? The IRS had, in an ’80s revenue rule, said that one horse race—just one—is enough to cause that owner to have a U.S. trader business. That means the W-8 series is an acceptable form as long as there’s one race. If you get a W-8 series form, and it’s a W-8ECI, and they’re claiming to have a U.S. trader business, that’s great. You don’t have to withhold anything. You still need to do your reporting. You still need to tell the IRS, “Look, I made this ECI payment,” but you don’t have to withhold anything. You don’t have to deposit anything, and you can rely on the form as long as you know they’re racing at your track, which, presumably, is why they’re giving you the form. That’s great. We know we can receive and accept a W-8ECI.

The issue is, from the foreign perspective, they don’t wanna give a W-8ECI cuz what a W-8ECI means is that they do have a U.S. trader business, that they don’t think they qualify for treaty benefits, and that they’re gonna have to file an 1120F if they’re a foreign court or a 1040NR if they’re an individual to pay their U.S. tax liability. There will be a tax liability. It’s just that the foreign person does that to the side. There’s no withholding issue there at all. I don’t know. We were hopin’ to maybe make this conversation all. Do you guys see W-8ECIs a lot, or do you—when you receive them, do you feel comfortable accepting it? Any issues?

Audience: I have a question.

Christopher and Robert: Sure, yeah.

Audience: What if a W-8ECI filled out incorrectly? What would that represent? Do they have to have a U.S. tax ID number?

Robert Stoddard: Yes.
Christopher Riccardi: Yeah, they should.

Robert Stoddard: Actually, we have—

Audience: Then it’s no good.

Robert Stoddard: It’s not a valid ECI, yep. We see a lotta the ECIs with the jockeys, actually, and a lotta the jockeys either have—they’ll either give you an ECI, or they’ll have a central withholding agreement. At least, with the central withholding agreement, that makes things, administratively, a little bit easier. Sometimes the jockeys, if they don’t have a lot of winnings that are paid out to them, they fall under the thresholds, with respect to various treaties. I’ll pick on Ireland and France because I happen to know those treaties. I think Ireland is, if it’s less than $20,000.00, you don’t have to withhold on the jockey because they qualify as an athlete. I think France is—I may have them reversed. I think one is 20,000 and one is 15,000.

Audience: You actually have to withhold ***.

Robert Stoddard: It does depend on what they’re giving you and whether they have—sometimes they will enter into a central withholding agreement with the IRS. That generally streamlines the process. If they don’t, then you have to look at, essentially, the treaty. It’s a country by country—as you can see, Ireland and France don’t even have the same exemption.

Audience: ***.

Robert Stoddard: They have to give a BEN.

Audience: Is it net or gross?

Robert Stoddard: Net or gross on?

Audience: As far as the treaty.

Robert Stoddard: Ireland’s would be $20,000.00 of purse winnings paid to the jockey.

Audience: It’s gross.

Robert Stoddard: It’s gross, yeah. Now, with the horse owners, that’s a great question because one question we’ve had come up several times is whether the withholding on purse winnings is gross or net of entry fees.
There’s not a lot of guidance out there, but there’s some guidance on—I forget the code section, but we believe it’s actually net of the entry fees.

**Christopher Riccardi:** If you think about U.S. source FDAP, what’s gross income? Generally, when you sell product to get—maybe it’s similar to COGS.

**Robert Stoddard:** If you thought about it as, if somebody gives you an ECI and they’re filing a tax return, what would be their net income? It’d be the winnings less their entry fees. It is a little bit different between the owner and then the trainer or the jockey.

**Christopher Riccardi:** Okay, so if we don’t get a W-8ECI, we know, absent anything else, that we’re going to have to withhold 30 percent of the amount of the gross payment. To get a treaty claim, you’d expect to see a W-8BEN if they’re an individual or a W-8BEN-E if it’s an entity. That treaty claim is specific. The treaty claim should say, “Here’s the country that I’m resident in.” It should tell you what article of the treaty they’re claiming and why—brief statement—they satisfy that treaty article. It should also tell you why they meet—treaties have this thing called limitation on benefits. It’s a treaty shopping provision. It’s neither here nor there, but the W-8BEN-E now requires the claimant to specifically identify the section of the LOB, the limitation on benefits, that they satisfy.

Just having that on the form isn’t enough. You have to validate the form. It’s a know or have reason to know standard. When you look at the form, if you get a form with a country that does not have a treaty with the U.S., you should reject it. On the face of it, it’s not valid. That requires you to at least look up—the treasury department has a list of U.S. income tax treaties. At least look and make sure that the country that they claim a treaty with actually has a treaty. You have to—

**Robert Stoddard:** This is where the horseman’s bookkeeper office can be very helpful. The IRS website actually has a list of all of the treaties listed right on the site. It’s very simple to see, “Okay.” The next example is Cayman Islands, right?

**Christopher Riccardi:** Right.

**Robert Stoddard:** There’s no treaty, so that’s just factually incorrect. All they’ve actually done is really confirm that they’re not a U.S. resident. They told you they live in the Cayman Islands, so they’re not a treaty resident.
Done 30 percent withholding, 1 race, doesn’t—1 race, 2 races, 30 races, doesn’t matter. They don’t live in a treaty jurisdiction. You just withhold.

**Audience:** That’s another question. If someone lives in a treaty country, they get one race, what happens on the second race?

**Robert Stoddard:** Single race. It’s—

**Audience:** In a calendar year or forever?

**Robert Stoddard:** If they live in a non-treaty jurisdiction, it doesn’t matter how many races they ran, you withhold.

**Audience:** What about in a treaty jurisdiction?

**Robert Stoddard:** In a treaty jurisdiction, that’s where it becomes the facts and circumstances. The IRS has issued guidances as early as the late 1950s that indicates, okay, one race may be enough. They didn’t establish a bright-line test. I think, when you look at what they’ve done to publication 515 with asking you to get a specific statement that they’re not entering another race, sorta seems like the IRS is on that one race number. They haven’t specifically said it, but when you look at those two things in conjunction with each other, seems like the IRS’ position is one race, okay. Two, withhold.

**Audience:** Is there a copy of the statement included?

**Robert Stoddard:** I don’t think we included a copy of publication 515, but you can actually pull it—if you just Google it, you can pull it up.

**Audience:** So, then it’s up to us as the horseman’s bookkeepers to find out why ***.

**Christopher Riccardi:** It’s know or have reason to know.

**Robert Stoddard:** This is the challenge.

**Robert Stoddard:** This is where we thought there’d be some discussion because this is where the more robust conversation has happened with my clients, on this exact point. It’s really easy to know if they’re running multiple races at your own track, and it’s probably really easy to know if they’re in the big-ticket races. If you’ve got somebody who’s runnin’ the triple crown or runnin’ the breeder’s cup, okay, that’s easy. What about one race in New York, one race in California, and another race in Illinois, and
maybe they’re not big races. That’s a challenge. There is an element here of, I’ll call it, trying to be too helpful and taking on somewhat of an auditing role.

If you’ve seen them on TV, and you know these guys are runnin’ a lotta races throughout the country, honestly, you have reason to know, and you can tell them, “Look, I gotta disregard this.” Our recommendation, even though it probably will create a firestorm, is that you know they’re here a lot. In the IRS’ eyes, that’s enough for them to say, “Look, they’ve got a trader business. They should be filing an income tax return.” If they’re not telling you they’re gonna file an income tax return, the IRS is gonna want you to withhold because you do have the secondary liability.

Christopher Riccardi: Yeah, there’s an element of the IRS putting you in a position of self-preservation. They just give you this vague standard know or have reason to know. I know it’s wrong, what’s on this slide here. The reason to know is gonna come into play when you’re wondering, “Well, is there more than one race at a different track?” Knowing that you have liability like you do, it puts you in a position of, “Well, maybe I’ll search a little bit,” and then you say, “Well, how far do I go?” It just puts you in a position of—

Robert Stoddard: It’s a rabbit hole.

Christopher Riccardi: Right, yeah.

Robert Stoddard: We won’t sugarcoat that. It can be a rabbit hole.

Christopher Riccardi: Right, right. It might be one of those where—I don’t know what people do in the industry as a general matter. If you’re generally looking around to see where horses—you might just go with that standard, whatever folks generally do in the industry as far as tracking races. That might be enough.

Robert Stoddard: It is, and I think that’s where you may get divergent answers from track to track within the industry. I have seen a horseman’s agreement where the particular track specifically says, “If you’re racing more than one race with the same horses or more than one race with different horses, and you don’t give me a W-8ECI, I’m withholding. That’s it.” That’s right in their horseman’s agreement.

From an industry standpoint, that’s probably a best practice because it puts everybody on notice that, look, this is how you’re gonna be treated. I’m not
auditing your other facts and circumstances, whatever you’re doin’ around the rest of the country. I’m not opening up that can of worms. I’m gonna do enough due diligence around what’s going on at our track that I know you’re racing more than once. You either give me an ECI or I withhold. It forces them to make that decision.

Christopher Riccardi: There was—yeah.

Audience: ***.

Robert Stoddard: It’s dollar one withholding, yes, yeah.

Audience: Right. If the horse race was at the track in September and there’s no withhold because under the assumption *** somehow comes back ***.

Robert Stoddard: Well, and that’s where it’s the issue of, could you have reasonably known that?

The answer could well be, you know what, maybe not. They ran a smaller track. It wasn’t well publicized. Could I have dug and searched around and poked through all the racing results? Yeah, but—

Audience: *** in November ***.

Christopher Riccardi: I think you’d be fine on the first payment as long as you didn’t—

Robert Stoddard: You’d be fine on the first one, and then you probably have to look at the second one.

Christopher Riccardi: Yeah. On the first payment, at the time you made the payment, you had documentation—

Robert Stoddard: You had documentation.

Christopher Riccardi: - on which you could rely to reduce the withholding to zero. You didn’t know or have reason to know, at that point in time. Then, later on, when they do the second race, well, now, you know the withholding certificate you have currently—

Robert Stoddard: Is not valid.
Christopher Riccardi: is invalid, and you need to get a new form or withhold.

Robert Stoddard: In terms of the withholding certificates—we do have a slide on this, and I know we’re getting tight on time, so we’ll use it as a reference point—you should get a new version every three years. Within that three-year period, if any key information is changed, meaning somebody’s moved from one country to another—they lived in France, now, they live in Spain—you need to get a new one. That form’s no longer valid. The treaties are different.

Christopher Riccardi: Okay, and I think this is another interesting issue. There’s a question on, or a question comes up all the time of, what is payment? We think, “All right, I actually sent the money. Obviously, that’s payment,” but payment’s broader than that in this context. Payment, in the regulations, is defined—or put another way, there’s a payment if, under the cash method of accounting, the recipient would have income for U.S. federal income tax purposes.

Obviously, if you actually send cash, that’s a payment. Under the cash method, there’s this thing called constructive receipt. Effectively, that is for cash method taxpayers. We can’t just turn our back on an amount of money that we could collect. That’s to prevent folks from, at the end of the year, saying, “I’m not gonna take that check now. I’m not gonna deposit that check now. I’m not gonna withdraw this money so I can push it into next year.”

The IRS isn’t gonna let you do that. In this context, if you have someone who has access to money, even if it doesn’t actually move, they could come and get it. Then there actually has been payment because, under U.S. tax principles, under the cash method, they would have income cuz they have the ability, if they so choose to get the money. That, I understand, can come up a lot in this horseman’s account.

Robert Stoddard: Yeah, and what typically happens, in our experience, is, once the race results are certified, that money goes into the horseman’s account pretty quickly. We’ll talk about drug testing in a second cuz that has some other implications. The money’s in the account pretty quickly. Even if they don’t actually withdraw the money, they have access to it. They can claim a horse in a future race.

They’ve effectively got an unrestricted—or the IRS would view it as an unrestricted ability to use those funds. That point, once they have
unrestricted access to claim a horse, to pull the money out—whatever—that’s when payment’s made. I think what we’ve seen is some people probably have viewed it as when they actually withdraw the money is the payment date. That’s probably not how the IRS will view it. It’s basically when they have an unrestricted access to the money.

**Christopher Riccardi:** To the cash. That can get tricky cuz—

**Robert Stoddard:** It can get tricky cuz—

**Christopher Riccardi:** - nothing’s ever—from your perspective, nothing’s changed. The money’s still in the account, and nothing’s been withdrawn.

**Audience:** What if it was..What if the policy at the track was, “Well—,”

**Robert Stoddard:** Perfect.

**Audience:** - We have the forms. We’re not distributing them.”

**Robert Stoddard:** We’ve worked a lot on this exact point, and I’m glad somebody asked the question. This is where I mentioned earlier there’s levels you can pull to change the payment date. We talk about drug testing here. One thing’s that been contemplated—because if the horse—it’s usually a couple—it’s probably about 10 to 14 days, give or take, for drug testing to clear, and that’s when everything is done. You have no more claw back issue on the purse and redistribution.

We’ve seen companies that have wanted to tie it to drug testing so you can say, “All right, no access to the money until drug testing results are clear. Then you can do whatever the hell you want.” Okay, so, that point, the drug testing clearance date becomes your payment date. If that’s what’s in the horseman’s agreement, we’re very comfortable that that’s a reasonable approach to fixing the payment date because you have this restriction on their ability to get the money. I would just caution that has to include a restriction on them being able to claim a horse with those purse winnings. If they have other prior purse winnings where they’ve cleared, they’re good on those, but each race stands on its own.

**Audience:** What if the restriction is—

**Robert Stoddard:** The form?
Robert Stoddard: That’s another way to do it, and we’ve had that conversation with a couple tracks. You peg it to say, “All right, look, you have no access. You can’t claim a horse. You can’t withdraw any money. The only thing you can pull out is your entry fee cuz you actually paid that in.” That’s not income. The only thing they could access is the entry fee until they give you the form. Again, we’re okay with that because you’re not gonna give them any access until they give you what you guys need to document your withholding obligation.

Christopher Riccardi: Is it fair to say any legally binding restriction—

Robert Stoddard: Legally binding—

Robert Stoddard: These guys are all signing your horseman cards, right? That’s part of registering or entering a horse into the race or setting up a horseman account. That’s definitely a solution. I can’t remember if it’s actually—I think we were going to put it in the slide, and we took it out. To your point, if it crosses over a year, that creates somewhat of an issue. They race, haven’t given you a form, they give you a form—I don’t know—three months after year end, what do I do? Technically, you still don’t have to withhold. You can use that as the payment date cuz they still don’t have the right to the income. What we have seen some tracks do is say, “Look, December 31st, you guys X dollars of purse winnings. You haven’t given me the form. You know what, I’m done. I’m not dealin’ with you. It’s paid. I’m withholding. You want it back, you go file a treaty claim with the IRS.”

What that does, honestly, probably gonna upset the owners, however, they have had several months to give you the form. It also allows your horseman’s bookkeeper’s office to not be tracking this across years. From a bookkeeper’s perspective, I think it might be very helpful. That’s an option. You don’t have to do it. We think it’s a very reasonable approach.

Audience: I would think that would be an option because, otherwise, if you’re not going to deal with it then, what do you do about reporting it?

Robert Stoddard: Exactly.

Audience: On your end, it’s like, well, I can’t report giving them this income withholding because, technically, that hasn’t happened.

Robert Stoddard: I’ll play that question out to an extreme example that actually ties in with another tax issue. What happens if somebody never gives you a form, and you got money sitting there three years later? You
actually have unclaimed property issue now, in a lot of states. You may have to remit that to whichever state you’re in because now it’s fallen into the unclaimed property definition. That’s a nightmare because now you—it’s a little easier when it’s a state resident because they can—people can go on, you have the names, and you can search your own name, see if there’s any unclaimed property that’s been remitted in your name.

Foreign horse owner, that’s a mess. We think that’s probably a good solution to not have to track it across multiple years and not run into an unclaimed property issue. Now, separately, you could have unclaimed property issues anyway if they just let the money sit there and don’t draw it, but the horseman’s account is kind of like a house bank account. You’d argue it’s not really unclaimed property. You’re just holding it on as an agent for them. Oh, absolutely.

**Christopher Riccardi:** We’re at 12:30. Is that right?

**Robert Stoddard:** Yeah, I think we are—you got the tax guys holdin’ you up from lunch. There are a couple more things if you want us to keep goin’. Happy to keep goin’ around some of the challenges we’ve seen, and if there’s some other comments you wanna add to this and have anymore dialogue, we’re happy to keep going. Obviously, I don’t wanna hold people up unnecessarily.

**Christopher Riccardi:** We’ll put it this way: We’ll keep going, and if you wanna go have lunch, won’t hurt our feelings—

**Robert Stoddard:** We won’t be offended if you step out for lunch.

*[Laughing]*

**Robert Stoddard:** Obviously, we’ve alluded to some of them. The racing industry, particularly the non-U.S. owners, does present us with some unique challenges here. Even with domestic owners, there’s a general lack of communication with them or from the. They’re often very hard to track down, reach. They’re not always the best about, timely, giving you the forms. One of your biggest challenges is, if you, honestly, send the cash offshore and find out you didn’t have the form or you have a withholding problem or a claw back, it’s very difficult to get that money back once it goes offshore.

These owners generally don’t understand the U.S. rules. We have really complex permanent establishment rules in the U.S. and trader business.
That creates a misunderstanding. Then there’s the relationship considerations. There’s always the element of, industry-wide, want people to race here in the U.S., and there’s also some level of track to track competition about getting premiere horses.

Best case scenario, there’s some consistency across the industry, so you don’t lose out on having premiere horses that are gonna draw bigger crowds. There’s the relationship issue as well to consider. Those are all challenges that we’ve seen. I don’t know, from your perspectives dealing with the owners, is there any other challenges that you guys are having as well, other than what we’ve listed here?

Audience: [***] —

Robert Stoddard: Yeah, you’d cycle the really great horses back to another event, draw more crowds.

Robert Stoddard: It is. Well, unless they give you a W-8ECI. That’s where it becomes this issue. Again, I think, if, look, somebody were to, practically speaking—if that’s all they did was two races back to back, look, I think the IRS probably would lean on the side of you should withhold. If that’s all it is, a couple races real close to each other and then they’re gone, okay. To be fair, it’s not a bright-line test. Just know that that carries risk.

Audience: Is the risk more for the second?

Robert Stoddard: The risk is much more for the second one, yeah.

Christopher Riccardi: Right, and it’s not the best argument, I’ll admit.

Robert Stoddard: It’s not the best argument to make.

Christopher Riccardi: I was gonna say this: ECI’s not the worst thing in the world. There’s a little bit of administrative inconvenience. You gotta file a form, but you get deductions against your income. It’s worse than no tax, to be sure, but it’s not necessarily the end of the world. You might mention or try to coach them on that point. People instinctively recoil at the idea of filing—especially foreigners—returns with the IRS. Just because you file a return doesn’t mean the IRS is going to unfairly tax you.

Robert Stoddard: Exactly, and especially with an owner that’s here maybe a little more than one or two races. Administratively, I don’t think they’d wanna file return, but they can deduct—there’s a lotta costs associated with
bringing a horse here. It’s everything. It’s the medical, the travel, all the entry fees—everything that goes with that—stabling the horse, paying a trainer to work them out while they’re here, paying the jockey. That’s all deductible on their return. They, effectively, would pay less than 30 percent of their gross purse winnings. They’re already out of pocket for these other costs anyway.

Christopher Riccardi: Right. Yeah, so if someone’s in a treaty jurisdiction, then it would be zero. If they only raced once. Now, you’re in a cost benefit analysis.

Robert Stoddard: Exactly.

Christopher Riccardi: If you’re in a non-treaty jurisdiction, it’s almost a no-brainer cuz, now, you’re gonna get deductions.

Robert Stoddard: Yeah, you’d actually wind up net better by registering and paying the taxes.

Christopher Riccardi: Right, you gotta—

Audience: What can we say to them to convince them? Cuz lotta them do say, “I don’t wanna file a U.S. tax return. I don’t want get a U.S. tax ID number. Who do I go to? Do you know anybody I can go to—,” it’s like, what can we say to help them?

Robert Stoddard: I think some of the conversations we’ve had with a couple of the—we’ve had some interaction with owners, the track clients that I have, and some of it has been us, honestly, explaining the rules to them and to their tax advisors—their non-U.S. advisors. There have been a couple where they’ve had a little bit of an ah-ha moment, and they understood what the issues really were. Some of them are simply abstinent about it. That’s the one that becomes the challenge because they’re probably not going to do it no matter what you say to them because they just don’t wanna register. They don’t wanna file in the U.S. They don’t understand why they’re taxable to begin with.

By the way, we have the same conversation with some of our business clients, too, that probably have a PE here and just wanna stick their heads in the sand about it. I think explaining to them, “Look, the IRS has more recently updated some of their guidance on this. They’re telling us that we have to get a statement from you specifically saying you’re not going to race more than once, or we have to withhold.” You can show them that publication. I do apologize. I wish I had a—the publication’s a bit long. That’s
why we didn’t attach it to the slide deck. It’s about 70 pages long or something like that.

**Robert Stoddard:** The main statement, I think, is in here some—anyway, I’ll see if I can find it. Oh, yeah. It just says something like *definite information contained in a statement filed together with the form W-8 that the owner’s not race or does not intend to enter a horse race in another race in the U.S. durin’ the tax year.” Doesn’t have to be anything special. Just be a piece of paper with that on it—

**Robert Stoddard:** Literally only—

**Christopher Riccardi:** - and sign it.

**Robert Stoddard:** - two sentence attachment.

**Christopher Riccardi:** Yeah, I’d have them sign that statement, maybe put it under a penalties of perjury attached to W-8 on it or something.

**Robert Stoddard:** Yeah, you can literally say, “Under penalties of perjury, I’m hereby certifying that I’m not entering a horse in another race during the current year,” or something like that—or during 2017.

**Christopher Riccardi:** That’s great as long as you don’t have external information that that statement’s wrong.

**Robert Stoddard:** Yeah, as long as you don’t see them, next week, race at Saratoga or somethin’ like that.

**Christopher Riccardi:** Right.

*[Laughing]*

**Christopher Riccardi:** Okay, well—

**Audience:** ***

**Robert Stoddard:** Yep.

**Audience:** If a guy was gonna race two races in a year the first one on *** and the other one’s December, and you wait till the next year *** gotta wait until ***.
**Robert Stoddard:** Do you mean wait it out in terms of restricting his access to the money?

**Robert Stoddard:** I think, if you restrict access to the money—

**Christopher Riccardi:** I don’t think so. I think—

**Robert Stoddard:** I’m not sure if you have a—the problem is, I don’t know if you have a legal—in that scenario, do you have a legal restriction to the money, or is it simply that we’re just holding payment, but it’s in his horseman’s account, and he’s got access to it? I don’t know that we’d be comfortable with that side of it.

**Christopher Riccardi:** I think my analysis might be that the restriction only goes to the timing of the payment, not the character of the payment. In that year, they did race twice, so that might mean you did have a permanent establishment. Despite the fact that the payment was made later, its character is not changed.

**Robert Stoddard:** Yeah. Yeah, that’s fair, yep.

**Christopher Riccardi:** Well, we have a whole bunch of other slides, but they’re more reference material. There’s some FAQs, some general things on codes to put on the 1042-S and that kinda stuff. We weren’t planning on going through it, but you’ll have it as a reference guide. We’re happy to answer more questions.

**Robert Stoddard:** Check the codes every year. The income codes have changed, I think, two or three times in the last six or seven years, yeah.

**Christopher Riccardi:** I check them every time.

**Robert Stoddard:** Yeah, so they have changed. Trainers and jockeys could be two different codes depending on if you have an exclusive contractor relationship or a employment relationship with the horse owner versus them being an independent contractor—two different comes. Jockeys, there’s one with a central withholding agreement. There’s one if they don’t have a central withholding agreement. Honestly, the codes, it’s good to get it right. The bigger issue is the withholding. I don’t think anybody’s really gonna come after you for penalties or interest if you list the wrong code. The critical side of this is more about let’s make sure we’re doing the right due diligence around the withholding aspect.
**Audience:** Just going back to the *, so you think all the owners should be * a percent of the net?

**Robert Stoddard:** That would be domestic. That’s the backup withholding, but, yes. It would still be net of the entry fees.

**Audience:** Let’s say if we have these *** withholding, let’s say, wouldn’t that be on there also?

**Robert Stoddard:** Net of their entry fee? Meaning the purse winning less their entry fee?

**Audience:** Yes.

**Robert Stoddard:** Yes, yep.

**Audience:** Okay, okay.

**Christopher Riccardi:** That makes sense cuz you’re only withholding, on income, the payment of the entry fee is just a reimbursement. Is that how you view it generally?

**Audience:** It’s in the gross.

**Christopher Riccardi:** It’s in the gross purse winnings, but, yeah.

**Robert Stoddard:** I’d have to go back and look at the codes section on that.

**Audience:** You take it out you have to do the net, their portion of the payment is gross.

**Christopher Riccardi:** Or, to put it another way, let’s say the entry fee was $10.00 and you paid them $100.00, from their perspective, I think they’d only report income of 90—

**Robert Stoddard:** Of 90.

**Christopher Riccardi:** - and so you’ve only paid—

**Audience:** ***
Christopher Riccardi: Oh, you’re doing on the full amount.

Audience: Yes.

Robert Stoddard: Okay, that may be over withholding on that, yeah. Again, if you’ve over withheld and it’s a domestic payee, they’re gonna claim that back anyway.

Audience: On the form, you should be doing 30 on the net.
Robert Stoddard: Yes, yep, 30 on the net.

Audience: Our 1042S’s show *. That’s the way we have the system *.

Christopher Riccardi: I would think that, if our analysis is only the net amount as income—

Robert Stoddard: Yeah, you could show them that.

Christopher Riccardi: - you only show the amount of the income that you paid on the 1042s that you would just show the net amount.


Robert Stoddard: Yeah, I think the only other—yeah, some of this is just the FAQs, refreshing the types of forms. Wanted to get them—oh, W-9’s, you don’t need to get a new W-9 unless there’s a name change or a tax ID change or if it’s an entity form change. Those are good, generally, permanently. Then, again, we just talk a little bit about validating. I think that should cover that. In the back, this is where we talk about the actual reporting, the income codes, due dates—things like that.

Audience: How are you gonna tie that into a *** access—

Robert Stoddard: You’re lookin’ at the quarter monthly end date?

Audience: Yeah, yeah.

[Laughing]

Robert Stoddard: Yeah, so depending on what your restriction is and when you set your payment date—let’s just say, for example, you alter your policy, and it’s drug testing. When they clear drug testing, they get access. It’ll be the day they get drug testing, it’s gonna be that date—you have to
look at the closest quarter monthly end date, and then it’s three business days after that date is when that withholding’s due. It all centers around the payment date.

**Audience:** Centers around access to the funds.
**Robert Stoddard:** Which centers around access to the funds, yes.

**Audience:** If I actually just put that owner’s account on hold till I get the form.

**Robert Stoddard:** As long as they can’t do anything with that money, other than get the entry fee that they paid back cuz that’s not income, yeah, you can—

**Audience:** Or claim a horse either—

**Robert Stoddard:** Or claim a horse, yep. They can’t take the money out. They can’t claim a horse until they give you the form. What we’d like to see is that—this is the perfect world, and we know it’s not entirely realistic. It’s not even realistic with the domestic owners to get a W-9. We wanna see them give you the form when they register the horse, when they either set up their horseman’s account or they actually enter a horse in the race. The other restriction—and I hesitate to mention it because it does create more of a relationship issue. You could tell them, “You can’t race until you give me the form.” I don’t think, in the industry, anybody’s going to want to do that. It’s an option. It’s more of a nuclear option, quite honestly.

**Christopher Riccardi:** Okay?

**Robert Stoddard:** Again, we’ll be around the rest of the day. We’ll be around this evening. If you guys wanna chat offline, if there’s any questions—our e-mails are on there as well. Please feel free to reach out to us.

**Christopher Riccardi:** Cool.

**Audience:** Thank you.

**Robert Stoddard:** Thank you very much, everyone.

**Christopher Riccardi:** Yep, thanks. Enjoy lunch.

**Robert Stoddard:** Thank you.