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Business
Pity The Celebrity Taxpayer
Brian Wingfield, 07.17.08, 12:30 PM ET



In Pictures:
Celebrity Tax Troubles

These days, the [Internal Revenue Service](#) is shining its unwanted spotlight on some marquee celebrities.

National Treasure star Nicolas Cage is contesting the government's claim that he improperly wrote off \$3.3 million in personal expenses. In April, a federal district court sentenced "tax protester" Wesley Snipes to three years for failing to pay taxes on \$13.9 million in income from 1999 to 2001.

Is the IRS singling out celebrities? Not exactly, but it is targeting more high-earners as part of an effort to close the \$290 billion "tax gap" between what it's owed and what it collects (that number comes from a three-year IRS study of 2001 returns).

In Pictures: Celebrity Tax Troubles

In 2007, audits of people who earned more than \$1 million increased 84%. And last October, the government launched a program to get foreign golfers, tennis players and musicians to pay taxes on their U.S. tournament winnings and music sales.

Of course, celebrities are subject to the same [tax laws](#) as everyone else, but their high visibility makes them valuable targets.

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"The IRS likes celebrities because they get the most bang for their buck in terms of publicity," says Alan Straus, a New York tax attorney who chairs a committee on IRS relations for the state's Society of Certified Public Accountants. "If you bust a Wesley Snipes, that's going to get press all over the place, and theoretically scare the public into complying."

It's hard to weep for celebrities with tax problems. After all, their troubles often begin with their attempts to avoid paying the full taxes on their considerable incomes--even though they already can, without cheating, write off many expenses that ordinary people can't.

But they also have tax headaches most of us would never need to consider. A big one: paying local income taxes in all the many states and cities where they perform. Think the Massachusetts Department of Revenue doesn't notice when the [New York Yankees](#), with a 2007 player payroll of \$253 million, show up in Boston to take on the Red Sox?

"The states have been in budget shortfalls for a number of years, and this is an easy way to grab a substantial amount of revenue," says Ryan Losi, an accountant who has many athletes among his clients at Piascik & Associates in Glen Allen, Va.

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Theoretically, every taxpayer who earns income outside his home state must file a return in each of those other states. It's hard for the tax man to keep track of multistate earnings for most people--but not so hard when the taxpayer is an entertainer or athlete with widely published earnings and performing schedules.

The multistate issue ensnares more than ballplayers and rock stars, as comedian Al Franken, who's now running for the U.S. Senate in Minnesota, recently found out. After his political opponents claimed he had cheated on his taxes, Franken announced in April that he had just paid \$70,000 in back taxes owed in 17 states, an error he blamed on his accountant. A spokeswoman for Franken declined to let Forbes interview the candidate about the issue.

Carol Savoie, director of private client advisers with Deloitte Tax LLP in Los Angeles, says her clients, who include Oscar, Emmy and Grammy award winners, have to deal with international complexities.

"It's similar to the multistate issue," she says. "If they withhold U.K. tax, then the celebrity has got to make sure they're going to get credit for that U.K. tax on their U.S. return."

A common frustration for accountants is keeping track of what types of income a star earns abroad. Does the revenue derive from a service performed, or from, say, a reproduced likeness? Each country has its own tax peculiarities. In Sweden, the top income tax bracket is 60%. In Canada, where U.S. stars frequently perform, there are provincial and local taxes on top of national rates. "It's just kind of a headache to educate the client," Savoie says.

Because governments realize how daunting international tax issues can be, many international tax treaties give exemptions for artists, entertainers and athletes who perform in foreign countries for a short period. But in the U.S., every foreign performer must complete a special IRS form to claim that exemption. Otherwise, he or she is subject to the standard 30% withholding rate on U.S. wages earned by foreign workers.

That said, canny celebrities know how to take advantage of international tax disparities. In 2006 Irish rock band U2 moved its music publishing business to the Netherlands to benefit from that country's lower taxes on royalty income.

The group's leader, Bono, has been accused of thereby cheating Ireland out of tax revenue even while he lobbies governments to increase their funding for international development aid. (Full disclosure: Bono owns a stake in Forbes Media LLC through private equity firm Elevation Partners.)

Royalty payments and endorsements give celebrities tax complications that most wage earners never face. To deal with that, many try to keep their revenue streams separate by running their affairs through a limited liability company or a corporation. Joe Geier, a Maryland accountant whose firm handles tax issues for many current and former Baltimore Orioles baseball players, including Cal Ripken Jr., says he often sets up LLCs to handle endorsement contracts for his clients.

Having a separate business entity, though, creates another briar patch at tax time. If the holding company is not arranged (like a partnership) as a flow-through, the taxpayer runs the risk of getting double-taxed on the same income (35% corporate rate plus 35% personal rate), all the while losing the favored rates for small corporations because "personal service corporations" are not eligible.

Personal service corporations are especially tricky. They are used to paying a star's legitimate business expenses, with what's left going to the celebrity as income taxable at an uncomfortable 35% corporate rate.

There's sometimes a blurry line between claimed expenses that are business-related and ones that are personal. In Nicolas Cage's case, the IRS says he used his company, Saturn Productions, to wrongly write off meals, nonbusiness travel and a Gulfstream jet.

What expenses are legit? Training and workout equipment for athletes, stage costumes for actors and instruments for musicians. But the cost of bodyguards, personal trainers, hair stylists and anything that might help a star create an image usually can't be deducted. "The inherently personal nature of the expense and the personal benefit far outweigh any potential business benefit," says an IRS document on the matter.

Two years ago, the IRS clarified that gift bags, or "swag," distributed at the Academy Awards and other such gatherings must be reported as

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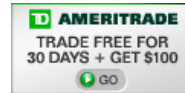
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income on a 1099 form. The tax collectors quickly quashed a rebuttal that the bags were simply gifts, observing that they are hardly given "solely out of affection." Athletes are required to report the value of cars and other noncash prizes they win. The solution: donating the car to charity, offsetting one's income with a corresponding contribution.

Celebrities' tax problems don't generate much sympathy in Congress. Rep. Hank Johnson, D-Ga., has sponsored a bill that would make taxpayers pay out-of-state taxes only if they worked in a particular state for at least 60 days--but it wouldn't apply to athletes, performers or entertainers. "They have the financial capacity to keep up with the rules of the various states," he says.

Johnson's bill has little chance of moving forward; it has too much opposition from revenue-hungry states. But other proposed changes in the tax code could add to the burden for celebrities and other high earners.

Congress' chief tax writer, Rep. Charles Rangel, D-N.Y., has proposed a plan that would eliminate the alternative minimum tax, a controversial shadow tax system put in place 38 years ago to ensure the wealthiest citizens pay something. To offset the lost revenue, Rangel's plan would raise taxes on those making more than \$150,000 by as much as 4.6%.

Republicans say this, together with expiration of the Bush tax cuts, would have the effect of raising rates for the wealthiest earners--celebrities included--from 35% to 44%. That increase would also hit private equity and hedge fund managers.

Still don't feel sorry for celebrities and their tax headaches? At least you can take comfort from the fact that, thanks to their high incomes, almost none of them received that economic stimulus check from the government this year.

In Pictures: Celebrity Tax Troubles

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Posted by margucia | 07/18/08 07:14 AM EDT

Please check your facts as concerns Nicolas Cage. He dind't use his company to write off personal expenses. I quote WENN, the news agency distributing this wrong piece of news: On 20 February, 2008,

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