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## CRISTIANO RONALDO'S MOVE TO ITALY – WAS IT FOR LOVE OF THE GAME OR THE TAX LAW?

In a flurry of tax evasion rulings, Spain has levied substantial back taxes and penalties on high net worth celebrities, including footballers Cristiano Ronaldo and Lionel Messi and singer Shakira.[1]

Early this summer, Cristiano Ronaldo chose to leave Spain and moved to Italy amid speculation that tax penalties were a motive. Ronaldo was fined €18.8 million for tax evasion. Similar to Messi, he was found to be using offshore entities to conceal earnings from image rights. In early May 2017, Lionel Messi and his father were convicted of tax fraud and were forced to pay €4.4 million for unreported income. According to Spanish authorities, Messi and his father used Belizean and Uruguayan entities to conceal earnings from image rights.

Colombian singer Shakira, was also ordered to pay more than €20 million in back taxes to Spain. According to news outlets, she owns a home in the Bahamas and claimed the Bahamas as her tax residence in 2011 through 2014. Spanish authorities prevailed in treating Shakira as a Spanish resident for those years.

In addition to back tax and penalties, the soccer players were sentenced to incarceration, but neither is actually expected to serve time in prison. In Spain, first-time offenders who are sentenced to less than two years can serve the time under probation.

Ronaldo and Messi are not the only soccer players in hot water with Spanish authorities; according to Forbes,[2] Filipe Luis, Diego Costa, Radamel Falcao, and others have been involved in tax disputes with Spanish authorities.

After the hefty penalty, it is not surprising Ronaldo chose to leave Spain. It is anticipated that even with less pay in Italy, Ronaldo will retain a higher net income than when he was in Spain (Ronaldo's deal is worth a reported U.S. $117 million).

In 2017, Italy introduced a new law intended to encourage individuals to move to Italy.[3] This measure has become a useful tool to attract high net worth individuals. Under the law, Italy offers a resident non-domiciled tax regime to wealthy individuals that allows them to pay ordinary taxes on the income generated in Italy and a single,

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1 See "Updates and Other Tidbits," *Insights* 5, no. 3 (2018).

2 Kelly Phillips Erb, "8 Soccer Players At the World Cup Who Have Been Caught Up in Tax Scandals," *Forbes* (June 28, 2018).

3 "Italy Introduces a 15-Year Preferential Tax Regime for Wealthy Individuals Taking Up Tax Residence In Italy," *Insights* 4, no. 2 (2017).

fixed tax payment of €100,000 to cover taxes on non-Italian-source income.

Ultimately, the new Italian law may benefit the country's budget as well as its sports teams by enabling them to attract other foreign star players.

## NEW YORK AND NEIGHBORING STATES BRING ACTION AGAINST THE FEDERAL GOVERNMENT

The Tax Cuts and Jobs Act ("T.C.J.A.") placed a $10,000 cap on the amount of state and local tax ("S.A.L.T.") an individual taxpayer can deduct on his or her Federal income tax returns. The states of New York, New Jersey, Connecticut, and Maryland brought a suit against the Federal government challenging the validity of the restriction on the S.A.L.T. deduction alleging it to be an "unconstitutional assault" on the state's sovereign choices.

The legal argument requires an interpretation of the 10th Amendment, concerning states' rights, and the 16th Amendment, which establishes Federal powers of income taxation. The action argues that the new law effectively overturns a longstanding precedent that the Federal government's income tax power was and would remain subject to federalism constraints. It also argued that the limits on the deduction, and the potential economic damage as a result of its implementation, deliberately seek to compel certain states to reduce their public spending.

The complaint alleged that as a result of the new cap, New York taxpayers will be burdened with an additional $14.3 billion in Federal taxes in the tax year 2018 and an additional $121 billion between 2018 and 2025, the year when the new cap is set to expire. The other plaintiff states will experience similar effects. The plaintiff states argued that they will bear the cost of paying for the new tax cuts and will receive the least benefits from the T.C.J.A. The plaintiff states allege that, by unfairly and disproportionally benefiting taxpayers of other states at the expense of their own taxpayers, the T.C.J.A. has injured their sovereign and quasi-sovereign interests.

***"The complaint alleged that as a result of the new cap, New York taxpayers will be burdened with an additional $14.3 billion in Federal taxes in the tax year 2018."***

The complaint further states that the new cap on the S.A.L.T. deduction is likely to adversely affect the plaintiff's states' real estate market. Under the pre-T.C.J.A. law, homeowners were allowed to deduct the full cost of property taxes on their Federal income tax returns. The new limitation on the deduction will increase the cost of owning a home, which will in turn depress home values.

The plaintiff states further allege that they attempted to take legislative action to combat the harmful effects of the new cap; however, in response to these efforts, the Federal government has signaled that it intends to prevent such action. The complaint contends that the Federal government is not only intentionally targeting the plaintiff states for adverse treatment but is also intentionally seeking to interfere with the states' sovereign authority over taxation and fiscal policy.

## HAPPY ENDING FOR THE HOME OF THE HAPPY MEAL – NO ILLEGAL STATE AID TO MCDONALD'S

On September 19, 2018, the European Commission issued a decision that nontaxation of certain McDonald's profits in Luxembourg was not illegal State Aid.

The decision ends a lengthy saga that began in 2015, when the European Commission alleged that two rulings by the Luxembourg authorities provided McDonald's with a selective advantage.  These rulings enabled McDonald's European subsidiary to pay no corporate tax in Luxembourg despite recording large profits from royalties paid by franchisees operating in Europe and Russia.  According to the first 2009 ruling, McDonald's Europe Franchising did not pay corporate taxes in Luxembourg on the grounds that the profits were subject to tax in the U.S.; McDonald's was required to submit proof every year that the royalties were declared in the U.S. and subject to tax there.  In a second ruling, issued six months later, the Luxembourg authorities removed the requirement to produce proof of tax payment; according to Luxemburg law, McDonald's Europe Franchising had a taxable presence in the U.S.

Article 107(1) of the Treaty on the Functioning of the European Union ("T.E.F.E.U.") identifies illegal State Aid as "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

In the September 19 decision, the European Commission ruled that Luxembourg did not break the E.U. State Aid rule but relied on a double taxation treaty between Luxemburg and the U.S. (the "Treaty").  The benefit was the result of a mismatch under the Treaty, rather than a selective advantage.

The benefit to McDonald's occurred because the definition of permanent establishment is different under Luxembourg and U.S. tax laws.  The Treaty states that Luxembourg cannot tax the profits of a company if it may be taxed in the U.S. because it operates a permanent establishment there.  Under U.S. tax law, the U.S. branch of McDonald's Europe Franchising was not treated as a permanent establishment, and therefore, it was not taxed in the U.S.  However, the same U.S. branch was treated as a U.S. permanent establishment under Luxembourg tax law, thereby exempting its income under the Treaty and resulting in double non-taxation.

While McDonald's appears to have succeeded where other major multinationals (such as Fiat, Amazon, Starbucks, and Apple) failed, the victory is not without consequences.   To prevent future abuse, the Luxembourg government is taking steps to prevent such situations by strengthening the definition of permanent establishment under its tax code.  Once the change is adopted, taxpayers will be required to provide a certificate of residency in the other country to obtain a tax exemption in Luxembourg, thus proving that the other country recognizes the existence of a taxable permanent establishment of the company.

## D.O.J. RESORTS TO UNDERCOVER OPERATIONS TO SECURE FIRST CONVICTION UNDER F.A.T.CA.

Adrian Baron, the former Chief Business Officer and former Chief Executive Officer of Loyal Bank Limited, has become the first person ever convicted for failing to comply with the Foreign Account Tax Complinace Act ("F.A.T.C.A").  Mr. Baron faces a maximum sentence of five years in prison.

Loyal Bank is an offhsore bank with offices in Budapest, Saint Vincent, and the

Grenadines. In June 2017, an undercover agent met with Mr. Baron and explained that he was a U.S. citizen interested in opening several corporate bank accounts. Although the agent would be the true beneficial owner of the accounts, he expressed concern that he did not wish to appear as the account holder on the bank records because the accounts would be used in multiple stock manipulation schemes. Mr. Baron responded that the bank could open such accounts.

One month later, the agent again met with Mr. Baron and described how the stock manipulation scheme operated, including the need to circumvent reporting under F.A.T.C.A. Mr. Baron responded that the bank would not submit a F.A.T.C.A. declaration to regulators unless the paperwork indicated "obvious" U.S. involvement. The bank opened multiple bank accounts and did not request information required under F.A.T.C.A. from the agent.

Mr. Baron was extradited to the U.S. from Hungary in July. He plead guilty to conspiring to defraud the U.S. by failing to comply with F.A.T.C.A. provisions.