



## College Athletics – Teamwork, Dedication, Talent and....Taxes?



*The question of whether student athletes in big-time college programs should be considered students who play sports or athletes who attend college is nothing new.*

Along with the various social and economic questions often raised by this issue, last year's case of *O'Bannon et al. v. NCAA* has added taxation to the list of uncertainties that surround the debate.

In *O'Bannon*, a federal court for the Northern District of California ruled that NCAA regulations prohibiting payments to student athletes violate antitrust laws. The lead plaintiff, former UCLA basketball star and member of the 1995 UCLA national championship team Ed O'Bannon, filed suit in 2009 after discovering that his likeness was being used in a video game without his consent. In finding for the plaintiffs, the court ruled that colleges with Top 10 conference football teams and colleges with Division I men's basketball teams may offer recruits a share of:

1. Revenues from the use of the athlete's name, image and likeness while they are in school. This amount may be capped by the NCAA while the athlete is still in school so long as the cap is not less than the full cost of attending school.
2. Licensing revenue to be deposited annually into a trust for the athletes' benefit and paid once the athletes leave school or their athletic eligibility expires. The NCAA can cap this amount as well so long as it is not less than \$5,000 per year per athlete. Schools can also individually choose to pay lower amounts.

The decision, which has been appealed by the NCAA, becomes effective July of 2016, meaning the new rules will not apply to anyone enrolling in college before July 1, 2016. From a tax perspective, *O'Bannon* is significant because these amounts can be in addition to what would be considered a full grant-in-aid (i.e. full scholarships).

As was discussed in the September issue of *For the Record* in "[Student-Athlete/Athlete-Employee: Tax Consequences, For Sure](#)," athletic scholarships are not considered income if they are "qualified." Under Sec.117 of the Internal Revenue Code, for a scholarship to be qualified, the recipient must be a degree candidate at an eligible educational organization and the scholarship must be used for qualified expenses. Qualified expenses are defined as tuition, fees, books, supplies and other equipment required for coursework. Note that room and board are not considered qualified expenses. In addition, with limited exception, if the student is required to perform services in exchange for the scholarship, the funds received attributable to those services are considered taxable wages.

Revenue Ruling 77-263 further provides that if the amount awarded to the student-athlete exceeds the amount of accepted educational expenses (including room and board), it will no longer be considered a scholarship, but instead compensation for participation in intercollegiate athletics. The ruling also specifies that a school may not require the student to participate in a certain sport nor require participation in any other activity in lieu of such sport. Failure to meet these requirements would not only cause the scholarship amount to be taxable, but, under NCAA rules, could potentially disqualify the student-athlete from further participation in college athletics as well.

Of the most immediate tax implications, given that the *O'Bannon* ruling itself refers to a student-athlete's share of potential revenue from use of his or her likeness as compensation, it may be hard to define this revenue as anything but taxable income. In addition, if a school pays licensing revenue by contributing annual deposits in trust for an athlete's benefit, such income would also likely be considered compensation. That a student-athlete may not withdraw any of these funds while still in school does not necessarily mean the student would not be immediately taxed on such funds, thereby giving rise to phantom income.

Further, if the annual trust deposits are indeed compensation for services, the implication is that such payments are contingent on the athlete participating in the sport. Since qualified scholarships cannot require participation in an athletic program, such interpretation may cause the entire scholarship to be considered unqualified and therefore taxable. Although these issues were not addressed by the court, they clearly have far reaching implications for both schools and student-athletes alike.

While there is little doubt that college sports is big business, the role of the student-athlete in that business remains up for debate. For those who argue that these athletes should receive some economic benefit over and above a scholarship for their efforts, *O'Bannon* is likely seen as a victory. However, once all the implications of this case are realized, star college athletes like Ed O'Bannon may find they get more than they bargained for, namely a tax bill from Uncle Sam.



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## Crowdfunding: Good for the Crowd, or Just an Elite Few?



*As we detailed in [Crowdfunding: an Alternative to “Traditional” Fundraising](#), crowdfunding has grown tremendously in recent years, tripling since 2011 to more than \$5.1 billion in 2013. This growth and success continued in 2014.*

For example, Oculus Rift, a technology company that created a virtual reality headset for immersive gaming, was purchased by Facebook for \$2 billion only 18 months after raising \$2.4 million using crowdfunding. Lending Club, a crowdfunding lender, successfully raised over \$1 billion in an initial public offering. The success stories go on, but so do the less publicized failures.

Though social media has provided the enabling force, crowdfunding as an industry has been constrained by restrictive securities laws, particularly with respect to [equity crowdfunding](#). Although the SEC loosened some of these restrictions in 2013 by allowing general solicitation over social media, because it was only open to accredited investors, equity crowdfunding remained limited. Since then, only wealthy investors and institutions have been able

to invest this way. However, once the SEC issues its long awaited Title III regulations, equity crowdfunding may become available to a much broader range of investors.

## Participating in Equity Crowdfunding

Currently, in order to participate in equity crowdfunding offerings, an individual must be an Accredited Investor under the Securities Act of 1933. An Accredited Investor is defined as one having a minimum net worth of \$1 million (exclusive of primary home equity) or meeting a minimum income requirement (\$200,000 earned in each of the last two years or \$300,000 combined with a spouse, and an expectation of income at that level in the current year). Unlike traditional private placements, crowdfunded offering issuers must take steps to verify an investor's accredited status, which may require a potential investor to divulge sensitive information such as tax returns or bank statements.

To expand the range of investors who could participate in equity crowdfunding, as part of Title III of the Jumpstart Our Business Startups Act (JOBS Act), the SEC has proposed new rules that would allow non-accredited investors to invest in limited amounts. Under the regulations, investors with annual income or net worth of less than \$100,000 could invest the greater of \$2,000 or 5% of their annual income or net worth. In addition, investors with annual income or net worth more than \$100,000 could invest up to 10% of annual income or net worth, not to exceed \$100,000 per year. Among other requirements, the issuers of such offerings would be limited to raising \$1 million per year, must offer through a registered funding portal or broker-dealer and would have to disclose financial and certain other information.

While these rules do reduce some restrictions, many commentators have said that the SEC's proposed rules do not go far enough and will hinder small businesses from raising capital successfully through crowdfunding. It remains to be seen if the SEC will loosen its final rules. Meanwhile, several states are also promulgating their own crowdfunding rules, so there may be separate requirements or limitations for investors to navigate as well.

## Equity Crowdfunding Advantages and Disadvantages

Equity crowdfunding platforms change the market for investors and start-up companies alike in two significant ways. First, crowdfunding gives greater access to startup investments. In addition, it also typically permits lower minimum investments. The crowdfunding format connects startups to more investors than ever before, and connects investors to thousands of startups. Non-accredited investors can now invest in startups by giving small amounts to multiple companies with potentially lower transaction costs to the investor and the startup. Lower entry costs and greater access to companies raising funds enable more of the estimated nine million Accredited Investors in the United States (according to *Crowdfunder*) to invest in companies in earlier phases of growth.

Though the potential reward is great, investing in startups is highly risky. For every Oculus Rift success story, there are many more crowdfunded projects that have failed to deliver promised goods or failed to even raise enough capital to get started. Because companies do not have to provide as much information about their business as they would in an initial public offering, there is more room for error, inaccurate data, misleading facts or even fraud. Additionally, when concepts are pitched to investors earlier in the process, entrepreneurs may have invested less money and time in their own unproven idea, potentially creating a less refined business model or a substandard product. Also, because crowdfunded investments have no secondary market, they are illiquid and could be problematic if investors have cash needs.

Finally, be careful when you invest with a relative's business, even if you do it through a crowdfunding vehicle. You

want to make sure that your investment is documented and treated as such, so that IRS does not recast it as a gift.

## Conclusion

Although equity crowdfunding and relaxed SEC rules have created new investment opportunities for many individuals, investors should proceed with caution. Given some of the risk inherent with this type of investing, prudent investors should study their options, consider their risk tolerance, and seek professional advice regarding the implications of their investment. If you have questions about your crowdfunding activity, please contact your Andersen Tax advisor.



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## Addressing International Tax Planning in the Changing BEPS Landscape



*The Organization for Economic Co-operation and Development (OECD) is an international economic organization of 34 countries founded in 1961 to stimulate economic progress and world trade, with the United States being a founding member.*

Today OECD provides a platform for its members to identify and coordinate domestic and international economic policies.

In response to a number of highly publicized governmental hearings regarding how certain multinationals (e.g., Apple, HP, Starbucks, etc.) achieve low effective tax rates on their foreign earnings, in 2013 the OECD undertook a major review of international tax policy and best practices via the Base Erosion and Profit Shifting (BEPS) Project.

Some results of BEPS include:

- Implementation of controlled foreign corporation rules by Chile, effective October 1, 2015
- Denial of the participation exemption in Japan for foreign dividends where the dividend was tax deductible by a paying subsidiary, effective for tax years beginning on or after April 1, 2015
- Abolishment of the *Double Irish* structure effective from January 1, 2015
- Implementation of a General Anti-Avoidance Rule in India, now proposed to be effective from April 1, 2017

Although by no means complete, these results give a small insight as to the BEPS principles and action plan adopted by the OECD and the G20 countries in 2013 to combat perceived abuses in international corporate taxation.

### BEPS – What is it?

To be clear, not every tax holiday, tax incentive, or reduced tax rate is or should be immediately suspect in the developing world of BEPS. BEPS is not intended to address tax avoidance or evasion by individuals (legislation such as the US FATCA or the OECD Common Reporting Standard tackle these issues). Nor is BEPS intended to castigate international tax competition that provides fair incentives to attract businesses to a particular country or locale, such as a reduced taxation in return for building local infrastructure or factories.

Rather, at its heart, BEPS addresses *instances where the interaction of different tax rules leads to double non-taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place.* It attacks aggressive and/or artificial planning by corporate multinationals that takes advantage of the interaction of different taxing systems and allows profits to go untaxed.

BEPS Timeline 2014/2015		
SEPTEMBER 2014	SEPTEMBER 2015	DECEMBER 2015
Action 1 – Digital Economy	Action 3 – Controlled Foreign Corporations	Action 4 – deductions (Phase II)
Action 2 – Hybrid instruments	Action 4 – Interest deductions (Phase I)	Action 5 – Harmful tax practices (Phase III)
Action 5 – Harmful tax practices (Phase I)	Action 7 – Permanent establishments	Action 15 – Multilateral instruments (Phase II)
Action 6 – Treaty abuse	Action 8 – Transfer pricing of intangibles (Phase II)	
Action 8 – Transfer pricing of intangibles (Phase I)	Action 9 – Transfer pricing: risks & capital	
Action 13 – Transfer pricing documentation	Action 10 – Other high risk transfer pricing	
Action 15 – Multilateral instruments (Phase 1)	Action 11 – BEPS data analysis	
	Action 12 – Disclosures re aggressive tax planning	
	Action 14 – Dispute resolution	

This graphic illustrates the BEPS action plan, including timeline and 15 focus areas.

The final recommendations would then be implemented on a country-by-country basis.



## BEPS – Country by Country transfer pricing reporting under Action 13

While a full explanation and discussion of all 15 BEPS work streams is beyond the scope of this article, one key work stream that has picked up speed much faster than first anticipated and is indicative of BEPS goals is the country-by-country transfer pricing reporting required under Action 13.

On February 16, 2015, the OECD released much anticipated guidance on the implementation of country-by-country transfer pricing documentation. Under this proposed reform to current transfer pricing policies, large scale multinational corporate groups (annual group revenue  $\geq$  €750M) would be required to file and maintain a single *master file* with their home jurisdiction tax authority that describes the group's structure, business, intangibles, financial activities and certain financial and tax positions. With respect to the latter, the template published by the OECD would include a wide list of metrics, such as revenues, earnings before tax, income taxes paid, number of employees, tangible assets, etc. Such master files would be available to other tax authorities upon request via exchange of information provisions. Locally, multinationals would be required to maintain smaller *local files* that document the arm's length nature of transactions with the local affiliate.

The guidance proposes such reporting to be required for a multinational group's first fiscal year beginning on or after January 1, 2016 and to be filed within 12 months of the end of such year. This timetable may be tighter than it first seems, as the reporting requirements go beyond what is currently required under international transfer pricing rules and may require internal IT systems changes and/or enhancements to be able to understand, collate and analyze the required data to be reported. As a result, starting to address these rules sooner rather than later is recommended.

### BEPS – How should U.S. Multinationals react?

Going forward, one should expect global tax planning to become more linked to a company's business activities and accordingly more difficult to execute independently of business strategy. In addition, global tax reporting and documentation will increase and many multinationals may find it difficult to maintain an effective tax rate on foreign earnings as low as in previous years. While the United States may itself enact certain reforms in line with BEPS, the majority of the legislative effort is expected to occur in non-U.S. countries and will affect many *traditional* international tax planning strategies used by U.S. multinationals, including hybrid financing arrangements, use of tax treaties, and transfer pricing. Accordingly, going forward U.S. multinational groups will need to:

- Monitor BEPS legislative developments over the short to medium term
- Analyze the impact of BEPS legislation on existing tax planning and plan accordingly
- Consider go-forward global tax profile and strategy in respect of BEPS
- Understand and plan for increased tax reporting and tax examination of cross-border activity
- Create more flexibility and exit options with global tax planning strategies

Andersen Tax is well equipped to assist companies to address the above questions and consider and implement their global tax strategies on a go-forward basis.



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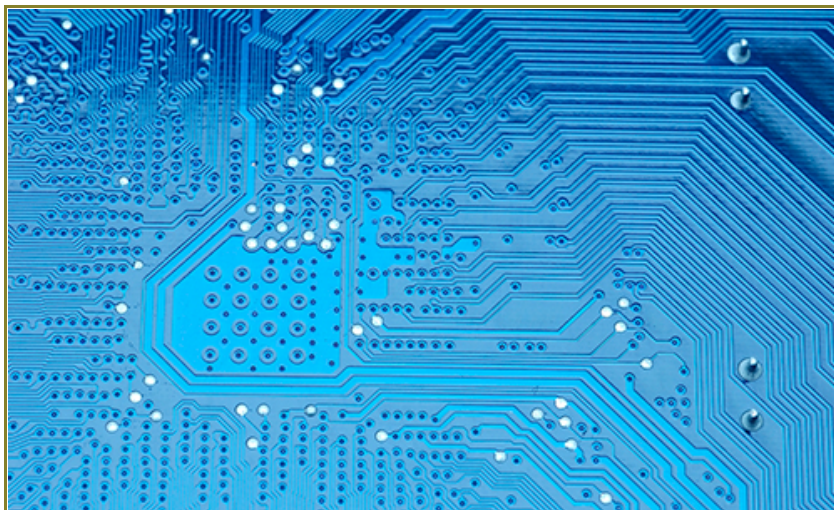
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## Some Clarity For Software Developers: Research Credit Regulations Issued for Internal Use Software



*Entities engaged in research activities are entitled to a tax credit set forth in Sec. 41. The credit is a percentage of qualified research expenses that exceed a base amount, and can be carried back one year and carried forward 20 years.*

Having been available since 1981, the research credit has provided a significant tax benefit for companies developing new or improving upon existing products and processes. Nevertheless, the ability to claim the research credit for software development has been a controversial topic since the credit's inception. Earlier this year, IRS issued long-anticipated proposed and final regulations that provide guidance on credit eligibility for research and experimentation on computer software that is developed by the taxpayer primarily for its own internal use.

In general, research related to internal use software (IUS) is not considered to be qualified research for purposes of

the credit unless the research satisfies an additional high threshold of innovation tests. However, computer software plays a very different role today than it did when IUS was originally excluded from the definition of qualified research in 1986. Because of its evolving function in business activities across a wide array of industries, the Treasury has provided additional guidance on how taxpayers can qualify certain IUS-related development costs as eligible for the research tax credit. The proposed regulations, generally seen to be favorable for most taxpayers, provide the following:

- Definitions and examples of IUS and non-IUS
- Eligibility of certain IUS research if it satisfies the high threshold of innovation test
- Definition of dual function software, which is software developed for both internal and non-internal use
- Safe harbor for determining whether any research expenditures related to dual function software can be included as QREs

The proposed regulations define IUS as software that is developed for use in the taxpayer's general and administrative functions (limited to financial management functions, human resource management functions and support services) that support the on-going operations of a taxpayer's trade or business. The functions that constitute general and administrative functions under the proposed regulations are intended to include back-office functions of a taxpayer that most taxpayers would have regardless of their industry. The regulations also clarify that IUS includes products that provide services such as banking, accounting and consulting. In prior regulations, these were respectively identified as computer and non-computer services. The proposed regulations however, remove this distinction. In short, software developed to be used by the taxpayer that is not commercially sold, leased, licensed, or similarly marketed to unrelated third parties is IUS.

Non-IUS is defined as software developed to be commercially sold, leased, licensed, or similarly marketed to unrelated third parties. This definition is expanded in the proposed regulations to include software that allows a taxpayer to interact with third parties, or allows third parties to access data or initiate functions within the taxpayer's system. The regulations also provide examples of software that would be considered non-IUS software. Such examples include software that allows third parties to:

- Order and track products online
- Upload and modify photographs
- Bid for ad placement and set prices for ads on taxpayer's website
- Execute banking transactions
- Search a taxpayer's inventory for goods
- Purchase tickets for transportation or entertainment
- Receive services over the internet

The regulations also address computer software that supports the delivery of goods and services to a third party, such as tracking inventory to enable the taxpayer to deliver its inventory to third parties. While IRS does not consider this part of a production process, the regulations note that this type of software might not be considered IUS if the taxpayer can show that the software provides the taxpayer the ability to interact with third parties, or conversely, allows third parties to access data or initiate functions within the taxpayer's system.

The most significant element of the proposed regulations is the inclusion of dual function software, which is considered to be developed for the taxpayer's internal use, serving both general and administrative and non-general and administrative functions. Under the proposed regulations a taxpayer could identify subsets of dual function software that specifically allows the taxpayer to interact with third parties, making that portion of the software

development eligible for the credit. To the extent a taxpayer cannot break the dual function software into discrete subsets, a safe harbor allows for 25% of the costs of the dual function software to be included in the credit calculation if the taxpayer can show that at least 10% of the subset's use is anticipated to interact with third parties.

The proposed regulations may be relied upon for tax years ending on or after January 20, 2015. IRS will not challenge return positions consistent with these proposed regulations for tax years ending on or after that date.

If your company is involved in developing new products, processes, or technologies, or improving on existing ones, let Andersen Tax help you maximize your research tax credit claims. We can help you assess whether your research activities qualify under Sec. 41, calculate any unclaimed credits, and amend returns for prior periods to claim these credits.



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