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Real Madrid Can Pay Cristiano Ronaldo Taxes, But That Triggers More Taxes

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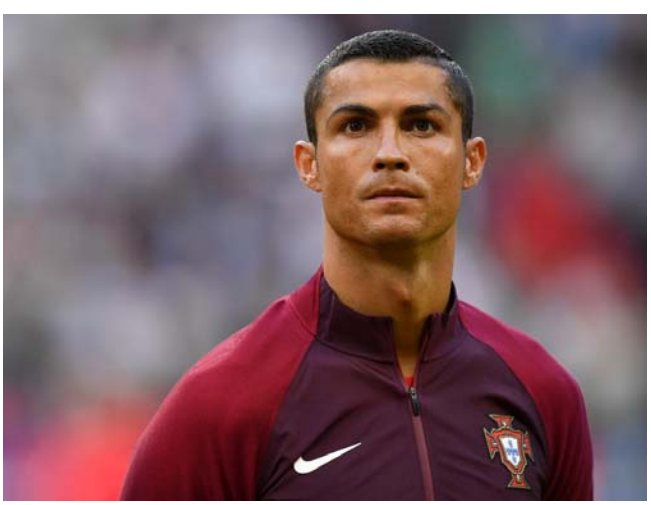
Cristiano Ronaldo, the world's highest paid athlete, has been accused of tax evasion. His team, Real Madrid, has rushed to his defense. But the athlete has suggested that he might actually leave the team and leave Spain. In an effort to keep him, now, Real Madrid may pay his tax bill. If his employer pays more than $16.5 million in taxes for the star, is that even legal? Yes, though paying the bill would not eliminate the pending criminal charges. Besides, it would create another tax problem.

There are some big tax lessons from soccer's Messi & Ronaldo cases. To begin with, prosecutors claim that Ronaldo used an off-shore company to hide income from tax authorities. They claim that Ronaldo filed tax returns understating his income, defrauding the Spanish government out of 14.7 million euros (about $16.5 million). If Real Madrid pays all taxes and penalties, the criminal charges will still be up to Ronaldo to defend. But paying the taxes, interest and penalties would be a good start. Yet Ronaldo might be surprised to find that when someone else pays your taxes, that is income to you too, triggering more taxes.



Suppose that you get hit with a tax bill from the IRS or another taxing authority. Either by contract or in any other circumstance, let's say that another party pays the taxes directly, or reimburses you for them. How is this payment treated for tax purposes? Can the other guy just write you a check for the gross amount and make it all better? In most circumstances, if another party pays your taxes, that too is taxable. If your employer pays, for example, it is treated as additional compensation, and taxable as such.

As a result, where contracts call for an employer or other party to pay any and all taxes that may be due, it is common to ask for a tax gross-up. In essence, this says that any taxes on the tax payment require a second payment. If that sounds circular, it is, and you need a formula to calculate it to the penny. If Real Madrid does make the payment, Ronaldo might want to also ask not only for the tax payment, but also on having this tax payment ”grossed-up” to account for taxes on the tax.

Most tax gross-ups occur under contracts with corporate executives, and in corporate transactions in which there is some question whether a particular tax will be payable. And there are occasionally circumstances where one can argue that the payment of the tax should not trigger more taxes. But those circumstances are rare. The IRS has been consistent in saying that the receipt of a tax payment by someone else, or a tax indemnity payment, is taxable income.

Sometimes, a plaintiff in a lawsuit seeks not only damages from a defendant, but also reimbursement for taxes on those damages. Usually, the argument is that the taxes would not have been payable, or would have been less, had the defendant not mistreated the plaintiff in the first place. It is hard to do, but sometimes you can get additional damages for adverse tax consequences. Yet even in that context, such tax payments can mean even more taxable income.

Not everyone agrees with this harsh tax treatment. Some people claim otherwise on their tax returns. Some people even litigate this tax issue with the government, but the IRS usually wins. Taxpayers have generally cited some very old authority for the proposition that a tax payment by someone else should not be income. See *Clark v. Commissioner,* 40 B.T.A. 33 (1939), *nonacq. sub nom.*, 1939-2 C.B. 45; *acq.* 1957-2 C.B. 4. But the authority is old. Besides, the IRS has made no secret of the fact that despite it, the IRS considers such tax payments to be fully taxable. See *Old Colony Trust* and Treas. Reg. § 1.61-14(a).

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.