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## Is the Biggest Offer the Best Offer?

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## Is the Biggest Offer the Best Offer?

### Abstract

Many people strive to be professional athletes because of the respect and accomplishment it receives. You make a lot of money, it can be glamorous, you are in commercials and magazines, and sometimes even movies. However, there are some things people do not think about when it comes to professional athletes. One of the biggest is taxation! There are so many different things athletes must think about and do because of taxes so they can take home the most amount of money possible. Athletes must be careful about who they hire to help them with their taxes because they want to be sure they get someone who will help them get the most out of their money. So many things come into play when someone is looking at taxes for a professional athlete. Athletes can be taxed for the games they play in different cities, for their endorsements, commercials, etc. In other words, athletes pay taxes just like you and me, it is just much more complicated.

### Keywords

Tax, Professional Athletes, contracts, jock tax, income, IRC, section 162

# Is the Biggest Offer the Best Offer?

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## I. Introduction

Many people strive to be professional athletes because of the respect and accomplishment it receives. You make a lot of money, it can be glamorous, you are in commercials and magazines, and sometimes even movies. However, there are some things people do not think about when it comes to professional athletes. One of the biggest is taxation! There are so many different things athletes must think about and do because of taxes so they can take home the most amount of money possible. Athletes must be careful about who they hire to help them with their taxes because they want to be sure they get someone who will help them get the most out of their money. So many things come into play when someone is looking at taxes for a professional athlete. Athletes can be taxed for the games they play in different cities, for their endorsements, commercials, etc. In other words, athletes pay taxes just like you and me, it is just much more complicated.

## II. How Professional Athletes are taxed

### A. Generally

Taxation is the application of tax rates to taxable income during a given tax year.<sup>1</sup> In general, income must be taxed to him who earns it.<sup>2</sup> This is true for professional athletes however there are different ways to classify the income that may affect their taxes. *Lucas v. Earl* states that he who earns income may not avoid taxation through anticipatory arrangements no matter how clever or subtle.<sup>3</sup>

To determine an athlete's taxable income, one must calculate gross income attributed to the athlete during the taxable year minus deductions.<sup>4</sup> Gross income is all income from whatever

source derived.<sup>5</sup> Once taxable income is calculated it is used to determine the athlete's tax liability by application of rates.<sup>6</sup>

Athletes derive income from many different areas, bonuses, prize money, the value placed on interest free loans, endorsements, sportswear companies' gifts, gifts for radio or TV appearances, etc.<sup>7</sup> An athlete's gross income is where many of their expenses can be deducted.<sup>8</sup> This is when section 162 comes into play which will be discussed later. Athletes generally should maintain some system of record-keeping of expenditures to maximize their business expense deductions and to monitor if the expenses are excessive.<sup>9</sup> This requires a lot of planning on behalf of the athlete which usually means hiring someone to help them maximize their income.<sup>10</sup> There are a few methods athletes can use to lessen taxes.

Some athletes attempt to avoid realization of income by assigning a portion of that income to a third person.<sup>11</sup> This helps to reduce tax liability because they are distributing the income to another person who is in a lower tax bracket.<sup>12</sup> This can work in some circumstances however the athlete must abide by the assignment of income doctrine.<sup>13</sup>

In *Lucas v. Earl*, the court stated that the fruits cannot be attributed to a different tree from that on which they grew.<sup>14</sup> Meaning that income from services is taxed to the party who performed the services.<sup>15</sup> Therefore, a taxpayer cannot assign income to relieve them from liability of that income. There must be a legitimate basis for the other person to receive the assigned income.<sup>16</sup> This can be done by showing that the recipient performed valuable services which aided in the production of income.<sup>17</sup> However, some would say this is probably more complicated to achieve than it is worth it.

Another thing an athlete occasionally does is deferrals. This is done to lessen tax liability by prolonging the taxation from the years in which the income is earned to a time in the future.<sup>18</sup> This can be accomplished through contracts or arranged separately by the athlete's agent.<sup>19</sup> When done by contract it is included in the standard players contract and it will specify that the payment of income will be extended over a period of years.<sup>20</sup> It can also be done by pension plans. This can be individually negotiated or through the collective bargaining agreement.<sup>21</sup> The plan will include benefits deferring the income to later years to the extent of the employer's contributions, making the employer's contribution deductible, and tax deferring the pension income.<sup>22</sup>

An additional way an athlete uses deferrals is with substantial non-vested property.<sup>23</sup> This is property that is transferred in connection with the performance of services and does not have to be included in income until the first time its interest becomes substantially vested.<sup>24</sup>

Players can form a personal services corporation as long as it has other purpose than merely avoiding taxes.<sup>25</sup> Contracts are generally negotiated in such a way to clarify who is to be taxed under different circumstances. However, occasionally it can be confusing, and courts must decide whether an athlete or someone else is to be taxed, like the team they play for, or the corporation they formed.

In *Leavell v. C.I.R.*, a professional basketball player formed a personal service corporation and agreed to provide his services to his corporation.<sup>26</sup> The corporation then executed a player contract with the Houston Rockets to provide the player's services.<sup>27</sup> The court looked at whether the money paid to the players corporation, from the Houston Rockets, was includable in his gross income.<sup>28</sup> It noted factors such as the right to control the manner and means by which the individual service provider renders the services for which compensation is

being paid.<sup>29</sup> Furthermore, it stated that the individual service provider who is an employee of the recipient of his services cannot transfer control over his activities to his personal service corporation, because he cannot transfer something which he does not have.<sup>30</sup>

The court also looked to whether the individual player was an employee of the Houston Rockets, as opposed to being an employee of his personal service corporation.<sup>31</sup> The primary consideration for determining whether an individual is an employee of one organization, or another is which of the two has the right to control the activities of the individual person whose status is in issue.<sup>32</sup> The court concluded that the Rockets did have the right to control the way the players personal services were performed.<sup>33</sup> Therefore, he was an employee of the Rockets and the money paid to his corporation was attributable to his gross income.<sup>34</sup>

To sum up, a player cannot form a separate corporation just to avoid taxes. They must form the corporation with some other purpose.<sup>35</sup> The code prohibits anyone from avoiding taxes and courts will usually uphold this when faced with that issue. It makes you wonder why they would even try to do any of these things because it can be so complicated. It is likely they are trying to maximize their income because a lot of it ends up being taken away with other taxes.

## B. Income Tax States vs. No Income Tax States

Athletes can be taxed differently depending on where they are domiciled. They are taxed in their domiciled state and also states they play in and sometimes even cities they play in.<sup>36</sup> Different states tax sports differently so that comes into play as well.<sup>37</sup> The most important issue for athletes and taxation is their domicile.<sup>38</sup> A domicile is a person's permanent place of dwelling.<sup>39</sup> They must reside there and have intent to remain there.<sup>40</sup> The reason this is so important for athletes is because some states have income taxes and others do not. It can be



beneficial for an athlete to be domiciled in a no income tax state because states with state income tax can greatly affect how much the athlete is able to take home. Generally, athletes that play for teams live in the city where their team is located but they may have a residence somewhere else usually for tax purposes.<sup>41</sup> Obviously, athletes would prefer to live in no income tax states and not have to be taxed when in other states but unfortunately that is not the case.

A great example is a comparison between a few of the top paid basketball players. Here, we will only look at the gross salary and take out federal, state, and local taxes. Players are also taxed when they play and earn income in other cities however, I will be discussing that later. The three players we will look at are Steph Curry, Russell Westbrook, and Chris Paul.

Steph Curry's gross salary is \$40.2 million. Athletes are subject to an income tax rate of 37% at the federal level.<sup>42</sup> Thus, Curry will pay roughly \$14,874,000 in federal taxes. He plays in California and they have a state income tax of 13.30% and San Francisco, where his team is located, has a 1.50% city income tax. Therefore, Curry will pay roughly \$5,949,600 in state and local taxes. Bringing the his net income in this case to \$19,376,400.

Russell Westbrook and Chris Paul have the same gross salary at \$38.5 million. They both will pay roughly \$14,245,000 in federal taxes. Russell Westbrook plays in Houston, Texas. Texas does not have a state income tax and Houston has no local income tax so he will not have to pay anything other than the federal taxes. Chris Paul, however, plays in Oklahoma. Oklahoma has a 5% state income tax so he will pay roughly \$1,925,000 in state income taxes. Oklahoma City has no local tax so he will not have anything else to pay. This brings Russell Westbrook's net income to approximately \$24,255,000 and Chris Paul to \$22,330,000.

So, after doing a lot of math we can see what the players net roughly based solely on taking out federal, state, and local taxes. Russell Westbrook comes out with the most at \$24,255,000, then Chris Paul with \$22,330,000, then Steph Curry with \$19,376,400. This is pretty shocking at first glance because Steph Curry has the highest gross salary but ends up third in the net. Then you notice that Chris Paul and Russell Westbrook started at the same gross salary, but Russell Westbrook ends up with more money because he does not have to pay state or local taxes. In short, the biggest offer may not always be the best offer.

When looking at all of this, it is interesting to consider if this affects where athletes choose to play. Some of the biggest and best teams are in states with very high income tax, but is it worth it to athletes to play there instead of a state with no income tax. There is not a right or wrong answer in this circumstance. It is all about personal preference.

States define resident or domicile differently and this can affect where the athlete lives or how they go about splitting time between residences. Some contracts require the athlete to spend their offseason at their domicile home.<sup>43</sup> However, sometimes this does not help the athlete because some states do not require domicile, they just require a certain number of months or days in the state.<sup>44</sup> Thus, it is crucial for the athlete to be aware of how many days they are spending in a state if they are trying to claim domicile elsewhere.<sup>45</sup>

Think of a scenario where you are a baseball player wanting to play professional baseball. You have the option to play for the New York Yankees or the Houston Astros. Both teams have been top contenders in the past years. The Yankees are of course one of the most well-known sport teams in the world. You have to decide which team you want to play for. For some people this may be very easy because they want to play for a popular team. But others may look at different factors to help them make the decision. One factor they look at is taxation. The

Yankees are located in the state of New York which has an 8.82% income tax rate as well as a 3.88% tax rate in New York City. The Houston Astros are located in Texas which has no state or local income tax. Either team would be great to play for, so you must consider this when deciding where to play and how to negotiate your contract. Some people may just want to play for the most famous team in baseball, some people may want to play for the most amount of money possible, some people may want to play in a specific state because there are no income taxes, some people may want to play for a great team. My point is everyone has different reasons about where they want to play their sport but almost every reason must consider the taxes imposed upon them. Think about what you would choose to do and what you might consider in making that decision.

Everyone has their own personal preference and there is no right answer on where to domicile. Depending on what they want to accomplish income taxes can make or break where they play. The main point is that players should be aware of the income taxes where they are domiciled so they can take this into account.

### C. Traveling Expense Section 162 and How That Affects Domicile

Section 162 of the Tax Code says there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.<sup>46</sup> In *Commissioner v. Flowers*, the Supreme Court stated the three statutory requirements for a traveling expense deduction, (1) the expense must be a reasonable and necessary traveling expense, (2) the expense must be incurred “while away from home”, and (3) the expense must be incurred in pursuit of business.<sup>47</sup>

Playing sports is a professional athlete's business.<sup>48</sup> Therefore, they are able to deduct expenses they incur that are ordinary and necessary in carrying out their business of playing professional sports.<sup>49</sup> They also need to establish that the expenses were paid or incurred during the taxable year.<sup>50</sup> This may mean that the athlete is asked to prove the amount and purpose of the business expenses.<sup>51</sup> Of course, it would be absurd to expect the athletes to log every single thing they purchase on the days while they are traveling so, they can use approximates for purposes of a deduction.<sup>52</sup> There are many things that are deductible for athletes under section 162 of the Internal Revenue Code. These typically include union dues, agent fees, trainer fees, and league fines.<sup>53</sup> Other things like training equipment, nutritional supplements and hot tubs are most likely nondeductible unless the athlete can prove it is ordinary and necessary to stay in good physical condition as required by their contract.<sup>54</sup>

When a player is not domiciled where the team is located it can be really hard for them to deduct the travel because it is not a business necessity.<sup>55</sup> The code looks at whether the trip is temporary or indefinite.<sup>56</sup> The code differentiates because if the player is planning to stay in a place that is not their tax home for an indefinite period of time then their tax home would likely change to the place where the center of business activity is.<sup>57</sup> This means that it is not deductible.<sup>58</sup>

In *Kroll v. Commissioner*, the petitioner was a child actor who lived with his mother in New York City while he starred in a musical production.<sup>59</sup> He originally lived in Connecticut but he and his mother moved to New York City for the duration of the production.<sup>60</sup> Petitioner wanted to deduct the expenses incurred from living in New York City.<sup>61</sup> The court noted that it has consistently held that "home" as used in section 162 means the vicinity of the taxpayer's principal place of employment and not where his personal residence is located, if such residence

is located in a different place from his principal place of employment.<sup>62</sup> Additionally, the court also notes that when a taxpayer maintains a residence away from the vicinity of his non-temporary principal place of business, that residence is not his home within the meaning of section 162, and meal and lodging expenses incurred at his principal place of business are not deductible under that section.<sup>63</sup> The court notes that the purpose of the provision is to help ease the burden on the taxpayer who must maintain two places of abode and incur duplicate expenses.<sup>64</sup> It asks the question whether it is reasonable to expect the taxpayer to maintain a residence near his business to incur only one set of expenses.<sup>65</sup> If it is reasonable and taxpayer still chooses to live elsewhere then he must pay double the expenses.<sup>66</sup>

Some players try to make their domicile somewhere that there is no state income tax, but they play in a state with income tax. This is where they may have issues because of section 162 and the previously stated case. A court might say that it is not necessary for the player to be domiciled elsewhere because his principal place of business is where the team is located, and where he spends the most time. When a player signs a contract with a team it typically is not considered temporary, so it gives more reason for that city to be their tax home.<sup>67</sup> It is very difficult for athletes who play in team sports to be domiciled in a place other than where the team is located.<sup>68</sup> However, it has been done before.

Clayton Kershaw plays for the Los Angeles Dodgers and has played for them for many years. The team is located in California, but he is domiciled in Texas. It is pretty surprising that he has been able to keep his Texas domicile for so long because of the domicile rules in California. Basically, he must be aware of how many days he is spending in California so that he is not deemed a resident on accident.<sup>69</sup>

For athletes that do not play on a team you would think it would be easier because they can live wherever they want and they are pretty much always on the move so they do not have to worry about being somewhere indefinitely. In some ways this is true but in others it is far from that.

In *Henderson v. C.I.R.*, Henderson lived with his parents in Boise, Idaho and worked as a stagehand for Walt Disney's World of Ice traveling show.<sup>70</sup> He traveled most of the year for his job but claimed Boise, Idaho as his tax home.<sup>71</sup> So, the court looked at whether he could claim Boise, Idaho as his tax home even though his work was almost entirely for a travelling ice show.<sup>72</sup> The court concluded that Boise was not his tax home because his choice to live there had nothing to do with the needs of his work.<sup>73</sup> The court concludes this because a taxpayer may have no tax home if he continuously travels and thus does not duplicate substantial, continuous living expenses for a permanent home maintained for some business reason.<sup>74</sup> Additionally, if he has no home for tax purposes, then he cannot deduct under section 162 for expenses incurred "away from home."<sup>75</sup> The court concludes that a taxpayer only has a tax home and can claim a deduction for being away from that home when it appears that he or she incurs substantial, continuous living expenses at a permanent place of residence.<sup>76</sup>

On the contrary in *Hall v. Commissioner*, Hall was a professional ice skater who travelled for work, but her home address was in Spokane, Washington.<sup>77</sup> She filed her taxes there so the court had to decide whether she was entitled to any deduction for traveling expenses while away from home, paid and incurred in connection with her performance of services as an employee.<sup>78</sup> The respondent claimed that because her services were rendered in 21 different cities, she is precluded from having a home and the expenditures were not incurred away from home because her home was wherever she happened to be, and they are nondeductible personal expenses.<sup>79</sup>

However, the court concluded that her home city for business purposes as well as the place of her residence was Spokane, Washington.<sup>80</sup> The court further stated that she was employed to appear temporarily in the cities as a member of the cast of the show, thus her absence from Spokane was temporary.<sup>81</sup>

These two cases are very similar because the petitioner travelled to many cities for work but filed their taxes in one specific place. The outcomes differ for small reasons. Courts generally look at three factors to determine whether a taxpayer has a tax home or is an itinerant. They are (i) the business connection to the locale of the claimed home; (ii) the duplicative nature of the taxpayer's living expenses while traveling and at the claimed home; and (iii) personal attachments to the claimed home.<sup>82</sup>

In Henderson, the court came to their conclusion because Henderson had no business reason for his tax home to be in any location because he constantly traveled, and he did not have substantial continuing living expenses in Boise.<sup>83</sup> In Hall, the court noted that these factors helped in making a conclusion, she did not abandon her permanent home in Spokane, she contributed to its maintenance, she intended to return to Spokane whenever possible, and for business purposes her home was Spokane.<sup>84</sup> The main difference is that Hall had the home in Spokane for business purposes and she had ownership interest.

These cases show the difficulty that individual athletes who do not play on teams can face with domicile because of section 162. The issue is generally the "away from home" element because they need to be able to establish that they have a home to be away from. Key factors for individuals to consider is having a longstanding connection with the place they call home or a substantial financial investment in real property in the place they call home.<sup>85</sup>

#### D. Jock Taxes

Jock taxes are the taxes players must pay when they play in cities other than where their team is located. The jock tax charges athletes income tax for every day they work in a state in which they do not reside.<sup>86</sup> Jock taxes have been going on for years but did not become very publicized until an appeal out of California was decided.<sup>87</sup> California wanted to enforce taxes on a San Diego Charger who was not a resident of California.<sup>88</sup> They wanted to know how much income they could claim to be earned in their state by a nonresident playing games in their state.<sup>89</sup> The conclusion was that California could tax the athlete on the percentage of income he earned in California. The calculation for this is  $[(\text{Working Days in California}) / (\text{Total Working Days})] * \text{Annual Income}$ .<sup>90</sup>

After this happened there was an NBA finals game in Los Angeles.<sup>91</sup> The Los Angeles Lakers lost the game to the Chicago Bulls.<sup>92</sup> After the game, California wanted to collect taxes from the Chicago athletes for playing in their state.<sup>93</sup> This enraged Illinois and caused them to create their own jock tax law to target visiting athletes from other states with jock taxes.<sup>94</sup> This started a trend and now many states have incorporated jock tax laws. This has been controversial over the years because some people think it is cruel to tax athletes in other states and others think that it is no big deal because they get so much money anyway. There is not a right or wrong answer here.

There are a few pretty interesting instances of litigation in regard to jock taxes. In *Hillenmeyer v. Cleveland Bd. Of Review*, a former NFL player challenged the method by which Cleveland used to impose income tax on his earnings.<sup>95</sup> Cleveland used the “games played” method, the taxable portion of an athlete’s income is based on the number of games the athlete played in Cleveland in relation to the total number of games played that year.<sup>96</sup> The court held



that Cleveland has the right to tax the compensation earned by a nonresident professional athlete for work performed in Cleveland, but the city's application of the "games played" method violates the due process rights of players.<sup>97</sup> This case was a very big deal because it affects how states can enforce the jock taxes. They should base the tax on the number of days the athletes work each year and not the number of games they play each year.<sup>98</sup>

Soon after the litigation in Ohio came some crucial litigation in Tennessee.<sup>99</sup> They had a unique jock tax imposing a flat tax of \$2,500 per game on any NBA and NHL player who played games in the state.<sup>100</sup> They put a three-game cap per year, totaling to \$7,500 per year.<sup>101</sup> This amount of money may not seem like much for big name athletes who make millions, but it can be a lot for players who make the league minimum.<sup>102</sup> In addition, the money did not go to the Tennessee government, it went to the Memphis Grizzlies and Nashville Predators.<sup>103</sup> This would generate millions of dollars a year for these two clubs.<sup>104</sup> The players associations for the leagues disputed this and Tennessee repealed the tax.<sup>105</sup> This resulted in players getting refunds of about half of what they had paid in Tennessee.<sup>106</sup>

There is more current litigation in Pennsylvania where athletes are suing Pittsburgh claiming the jock taxes are discriminatory and violate both the state and U.S. constitutions.<sup>107</sup> Pittsburgh charges non-residents a 3% earned income usage fee for their publicly funded venues and charges residents 1%.<sup>108</sup> Pittsburgh also uses the games played method for computing jock taxes.<sup>109</sup> Remember that this method was deemed unconstitutional in the case above from Ohio. The case has not yet decided but it looks as though the players have a pretty good argument.

When looking at these cases, I found a quote by the attorney who helped a lot of these players and players associations, Stephen Kidder. The quote says, "Professional athletes have come to realize that this (jock taxes) is a part of the landscape for them. When they object, it's

when they're being treated completely differently from other taxpayers. That's what was happening in Cleveland, that's what was happening in Tennessee."<sup>110</sup> This quote stood out to me because it shows the recurring theme in these cases is that the players were being treated differently from other taxpayers. This brings me to the pros and cons of jock taxes.

Some pros are that it helps the states and cities that athletes play in. For example, California has the highest rate in the country at 13.3%. This means that California can make so much money off players playing in their state that are nonresidents. California no longer compiles statistics of how much money is generated from jock taxes, but to give an idea, in 2013 California jock taxes generated more than \$229 million from all sports.<sup>111</sup> This year has been a weird year for sports because of a global pandemic shutting down everything. That has severely hurt the economy and some states are hurting more than others for income. California will make about \$73 million from the MLB starting back up at the end of July<sup>112</sup> This helps their economy tremendously, and the money can be used for various reasons. Some states use the money to support the venues where the sporting events are played.<sup>113</sup> Many people believe that taxing the athletes is a small price for them because they make so much money anyway.<sup>114</sup> Some even believe that taxing the nonresident athletes is a more politically acceptable alternative than raising taxes on people within their states.<sup>115</sup>

There are also many cons to jock taxes. The athletes must pay a substantial amount of money in jock taxes. For example, during the 2018-2019 season, Steph Curry paid about \$945,000 and Chris Paul paid about \$1.3 million in jock taxes.<sup>116</sup> This is a large amount of money that athletes are paying because of the jock taxes being imposed on them for playing in a state where they are not residents. There are also arguments about taxation without representation.<sup>117</sup> Many people also argue that it is unfair to the athletes because it makes them

easy targets for money.<sup>118</sup> They are considered easy targets because it is easy for the states to track where the athletes are and when they are there because of their schedule.<sup>119</sup> Some reports show that states are expanding the jock tax to include other types of nonresident income that does not relate to athletes at all.<sup>120</sup> The Tax Foundation states that the jock taxes are poorly targeted, arbitrary and impose unrealistic administrative burdens.<sup>121</sup> One of the biggest arguments against jock taxes is that it is such a huge administrative burden because they have to file in so many different states.<sup>122</sup>

There are only seven states with no income tax, Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.<sup>123</sup> Tennessee does not have a state income tax, but they do tax interests and dividends.<sup>124</sup> Only four of these states have professional sports teams, Florida, Texas, Washington, and Tennessee. Nevada is about to be the fifth because the Los Angeles Raiders are relocating there.

If you look at the NFL, MLB and NBA it is pretty obvious which divisions are more tax-friendly than others with regard to state income taxes and jock taxes.<sup>125</sup> In the MLB, the AL West is comprised of the Houston Astros, Oakland A's, Seattle Mariners, Los Angeles Angels, and Texas Rangers.<sup>126</sup> Three of these five teams are in no income tax states but the other two are in California. Overall, this is a pretty tax-friendly division. Scott Boras says, "There's a significant boost to players' earnings being in the A.L. West vs. the N.L. West."<sup>127</sup> In the NFL AFC South division, the teams are the Houston Texas, Indianapolis Colts, Jacksonville Jaguars and Tennessee Titans.<sup>128</sup> Two of these are in no income tax states so that helps make it a little more tax friendly. In the NBA, the most tax-friendly division is the Southwest Division of the Western Conference including the Houston Rockets, San Antonio Spurs, Dallas Mavericks, Memphis Grizzlies and New Orleans Pelicans.<sup>129</sup> Four of these five teams are located in no

income tax states so this greatly helps these players avoid a lot of jock taxes. However, with all of these sports keep in mind the teams play many games outside their division, so they are hit with jock taxes. Tax-friendly divisions add to the factors for players to consider when deciding where they would like to play.

Athletes that do not play on teams are also affected by jock taxes.<sup>130</sup> For this reason, many individual athletes will domicile in no income tax states, as stated above, to try and limit their tax consequences. This may not always work out but a lot of the time it can help.

With all of this in mind, think of the baseball scenario from earlier. Does knowing about jock taxes now change your decision at all? Or does it make your decision easier because you are more aware of the tax consequences that arise?

### III. Teams Moving to New States and The Tax Consequences on Players

Teams relocate to new cities every once in a while. The NFL constitution allows the league and its owners to make the decision to relocate a team without the consent of the NFL players.<sup>131</sup>

In 2016 the Rams football team moved from St. Louis to Los Angeles.<sup>132</sup> This was a huge deal for players and other employees because of the obvious impact of taxes.<sup>133</sup> The state income tax in St. Louis was 6% with a 1% city income tax.<sup>134</sup> When the team moved to California the players in the highest bracket were taxed at 13.3%.<sup>135</sup> This is a substantial amount of money that players will lose just because of the decision to move the team from one state to another.<sup>136</sup>

Currently, the Los Angeles Raiders are relocating to Las Vegas, Nevada. This is huge for the players because it means they are going from a state with the highest state income taxes,

13.3%, to a state with no income taxes. For example, Derek Carr, the quarterback for the Raiders, will save about \$8.7 million in taxes just from the team moving states.<sup>137</sup> This is unbelievable for these players! It makes you wonder how much taxation comes into play when the league and its owners decide to move teams to a different state.

#### IV. International Athletes Playing in The United States and Tax Consequences

Athletes who are domiciled somewhere internationally still have to pay taxes when they play in the United States because nonresident aliens engaged in a U.S. trade or business are taxed on income that is effectively connected with the conduct of that trade or business.<sup>138</sup> Engaging in a U.S. trade or business includes any business activity in the United States that involves one's own physical presence.<sup>139</sup>

In *Goosen v. Commissioner*, a professional golfer, a resident of England, entered into a few endorsement agreements with sponsors.<sup>140</sup> The court needed to determine how much of his income was U.S.-source income and whether he was eligible for any treaty benefits.<sup>141</sup> It stated, in the case of U.S.-source income that is effectively connected with a U.S. trade or business, a nonresident alien will be subject to the graduated tax rates applicable to U.S. residents.<sup>142</sup> Additionally, in the case of U.S.-source income that is not effectively connected with a U.S. trade or business and consists of rents, dividends, royalties or other fixed or determinable annual or periodic income, the nonresident alien will be subject to a flat 30-percent withholding tax.<sup>143</sup> In other words, the court determined the character and source of the income and whether such income was effectively connected with the playing in the United States.<sup>144</sup>

To do this it looked to royalty income. Royalty income paid for the right to use intangible property generally is sourced where the property is used or is granted the privilege of being used.<sup>145</sup> For example, royalty income received for the use of trademarks in making foreign sales is sourced outside the United States.<sup>146</sup> Therefore, the court looks at where the player's name and likeness were used or would be used to determine the source of player's royalty income.<sup>147</sup> But, generally courts have allocated all the royalty income to the United States if the contracting parties failed to make a reasonable allocation, unless the taxpayer can show there is a sufficient basis for allocating the income between U.S. and foreign sources.<sup>148</sup> A sufficient basis exists when a taxpayer establishes that he or she has property rights outside the United States and furnishes evidence on the value of those rights.<sup>149</sup>

The court concluded that a large percentage of income was U.S.-source income and he was subject to taxes on that income.<sup>150</sup> Additionally, the court held that he was not eligible for any treaty benefits.<sup>151</sup> The U.S.-U.K. tax treaties provide that the U.K. will tax a U.K. Resident, non-domiciliary on non-U.K. source income only to the extent the income is remitted to or received in the United Kingdom.<sup>152</sup> In this case, the United States may not subject the U.K. resident to tax on specified kinds of income to avoid double taxation.<sup>153</sup> The fundamental purpose of a tax treaty is to avoid the uncoordinated taxation of an individual's income by two different countries.<sup>154</sup> Tax treaties seek to avoid double taxation as well as prevent fiscal evasion.<sup>155</sup> The Code applies with due regard to any applicable treaty obligation of the United States.<sup>156</sup>

It can get very complicated for international athletes playing in the United States. In a nutshell, if you are a foreign athlete performing independent personal services in the United States, you generally must pay U.S. income tax on your U.S. source income.<sup>157</sup>

## V. Taxations Effect on Negotiation of Player Contracts

Taxes can play a big role when negotiating contracts. It may not be the determining factor for someone, but it is definitely something to consider. Let us revisit the scenario from earlier. If you chose to play for the Yankees, would you try to negotiate a little bit higher contract because you know that more taxes will be taken out? If you chose the Astros, how would your negotiation of the contract differ? Does your decision put you in a place that makes you vulnerable to contract negotiations with teams? For instance, if they know you are choosing the Astros for no state income tax will that cause the team to negotiate a lower contract because they know you will not go elsewhere? There are so many different questions that you can come up with when looking at taxation and contract negotiation.

The agent wants to get the best deal for their client.<sup>158</sup> The more money up front and the more money in the signing bonus the better.<sup>159</sup> Something really important that must be done is to include the correct language to be sure the player gets the best deal.<sup>160</sup>

State income taxes can be minimized by properly drafting the signing bonus agreement.<sup>161</sup> A signing bonus does not relate to a player's performance.<sup>162</sup> It is considered compensation for entering into a contract as well as an implied promise that the player will not play for any other team during the duration of the contract.<sup>163</sup> Therefore, it is taxed only where the athlete resides.<sup>164</sup> This can provide a considerable tax savings opportunity especially if you are in a no income tax state or a low-income tax state.<sup>165</sup> A signing bonus is not subject to state apportionment if it meets the following conditions: the bonus is not conditional on playing any games for the team, is payable separately from any other compensation, and is not refundable.<sup>166</sup>

Timing of payment for the bonus is important in negotiation to help get the most out of your money.<sup>167</sup> The payments are usually split 50/50 and paid over 2 years, and this helps to reduce the tax liability.<sup>168</sup>

It can be easier for teams in no income tax states to negotiate a contract with a player because it is more desirable to have no state tax.<sup>169</sup> On the other side, it can be hard for teams in states with high income tax to negotiate a contract because they may end up having to overpay a player to match what the teams with no state income tax offer.<sup>170</sup> In the Los Angeles Times, Agent John Boggs said, “I’ve had players in the past say they don’t want to go to certain states because they’re going to get hammered by taxes. Obviously, that affects the bottom line.”<sup>171</sup> The players must look at state taxes in regard to gross dollars and net dollars to help them negotiate.<sup>172</sup>

Last year Bryce Harper signed a contract with the Philadelphia Phillies, turning down the Dodgers and the Giants.<sup>173</sup> His agent, Scott Boras, stated that “The Giants, Dodgers and Padres are in the worst state income tax jurisdiction in all of baseball.”<sup>174</sup> It was reported that part of his reason for turning down the Giants was because he wanted more compensation for California’s tax hits.<sup>175</sup> This is a big deal because it shows how this can be such a huge consideration when negotiating a contract because of how much it affects the player’s net salary.

When an athlete considers the income tax consequences during the contract negotiation, they potentially are able to avoid a great amount of dollars in income taxes.<sup>176</sup> Robert Raiola had a great quote saying, “If they aren’t considering how taxes affect the offer before they sign, then it’s too late.”<sup>177</sup> This quote really helped make this situation much clearer because even though the taxes are not determinative, it can greatly impact a player if they do not consider the tax



consequences. The last thing these players want is to leave money on the table for not properly considering the tax consequences of their agreement.

## VI. Conclusion

In conclusion, taxes can play a huge role when players decide what team to play for and where to live. Athletes pay federal taxes, state taxes and taxes for many games or events in states they do not reside, in addition to other taxes on endorsements, bonuses, prize money, etc. It is very beneficial for a player to find someone to help them with their taxes. A majority of athletes do not have the time to sit down and look at all of this information so having someone to help them plan financially is extremely beneficial. The right person will help them plan in a way that minimizes their income tax burden as best they can.

A beneficial way to minimize tax burden for some players is to play in a state with no income tax or to play in a “tax-friendly” division. Of course, this is easier said than done because you do not always get the option to pick and choose which team wants you to play for them. Also, not everyone even cares about this, they may just want to play for the best team possible regardless of tax consequences. Additionally, sometimes the team you play for moves to a different state that can positively or negatively impact you with regard to taxes.

Keep in mind that individual athletes do not have it much easier than team athletes because it can be difficult for them to establish a domicile if they travel so often. The key is to keep some sort of long connection with their domicile or real property where they are domiciled. This can help prove they have a domicile, or home to be away from when traveling.

Furthermore, international athletes are taxed on their U.S.-sourced income when performing independent personal services in the United States. There are also tax treaties with other countries to help avoid double taxation of taxpayers.

All of these topics discussed affect contract negotiations. While taxes are most likely not the most influential factor when players consider their contracts, it should be pretty high on the list because it affects how much money they take home. If they do not consider the tax consequences, they could leave a large amount of money on the table, and nobody wants to do that. So, the next time you see breaking news about the player with the biggest contract known to man, consider all of the negotiations and drafting that went into that deal. Then remember that professional athletes have to pay taxes just like you and me. The biggest offer is not always the best offer.

## Endnotes

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<sup>10</sup> *Id.* at 56-57.

<sup>11</sup> *Id.* at 57.

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<sup>18</sup> *Id.*

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<sup>50</sup> *Id.* at 440.

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