

## Full-Court Press: Multistate Tax Issues Facing Professional Athletes

by Timothy P. Noonan and Kelly Donigan



Timothy P. Noonan



Kelly Donigan

Timothy P. Noonan is a partner in the Buffalo and New York offices of Hodgson Russ LLP. Kelly Donigan is a law clerk at Hodgson Russ.

In this edition of Noonan's Notes, the authors discuss the taxation hurdles professional athletes face when earning income in multiple states.

As kids growing up, many of us dreamed of becoming professional athletes. But one thing we didn't dream about is the thorny tax compliance, varying local standards, and enforcement issues professional athletes face when filing and paying their taxes. For the benefits that come along with being a famous athlete, players are often faced with a much greater tax burden than the average American.

For reasons other than winning the office fantasy football league, state tax departments throughout the country have long been paying special attention to professional athletes. Why? Professional athletes make tempting targets for tax departments and lawmakers because their salaries are large and public and their schedules are widely available. With a few clicks of the mouse, tax departments can quickly learn not only

how much money a professional athlete earns, but also where he earns that money.

In this article, we'll focus on the state tax rules that arise for professional athletes, some of which are specific to athletes and some more generally applicable to high-net-worth taxpayers as a whole. As usual, we will focus on New York's rules, but because of the nature of professional athletics, it obviously is a multistate issue. Our discussion will focus on professional team sports, but much of the following can be applied just as easily to golf, tennis, MMA, boxing, NASCAR, and so on.

### Domicile — Home Court Advantage or Disadvantage?

Stop us if you've heard this before, but the first issue tax practitioners should be aware of in this area is residency. We have written numerous times in this column regarding the difficulties associated with determining where an individual resides for income tax purposes.<sup>1</sup> As we all know, a state can tax its residents on all their income. The primary determination of residency is an individual's domicile, or, in other words, the place an individual intends to make his permanent home.<sup>2</sup> An individual may have multiple residences, but he may have only one domicile. Like trying to figure out what is considered a catch in the NFL, trying to figure out where someone is domiciled can be confusing, and it is a subjective test — creating an opportunity for auditors to

<sup>1</sup> See, e.g., Timothy P. Noonan and Daniel P. Kelly, "The Nuts and Bolts of a Residency Audit, Revisited," *State Tax Notes*, Oct. 27, 2014, p. 207; and Noonan and Andrew W. Wright, "A Foreign Language? Residency Rules With an International Spin," *State Tax Notes*, Nov. 30, 2015, p. 661.

<sup>2</sup> See, e.g., N.Y. Tax Law section 605 (b)(1)(A); 20 NYCRR section 105.20(d)(1).

challenge where a professional athlete should be paying his or her taxes.

Derek Jeter, who is one of the most recognizable baseball players of all time, is well-known for winning championships as the captain of the New York Yankees. However, in tax circles, Jeter is also famous for exemplifying the unique issues that athletes face in domicile cases. In 2001 Jeter signed a new contract with the Yankees, which included a \$16 million signing bonus and an annual salary ranging between \$11 million and \$21 million. Not surprisingly, when the New York Department of Taxation and Finance realized it wasn't getting a piece of that contract, it went after the Yankees captain in 2007. Jeter claimed to be domiciled in Tampa, Florida, a state that does not have personal income taxes for residents, because he owned a home near the Yankees' spring training facility and lived there during the off-season. The auditors argued that Jeter was domiciled in New York where he "worked" and owned a multimillion-dollar apartment in the Trump World Towers on Manhattan's East Side. The department must have been thinking, if the face of the Yankees isn't domiciled in New York, who is? However, after challenging a procedural issue before an administrative law judge in the New York Division of Tax Appeals,<sup>3</sup> Jeter reached a private, out-of-court settlement. Although we don't know the outcome of the settlement, it demonstrates the kind of issues facing professional athletes.

Rookie drafts, trades, and free agency are an exciting time for all sports fans, but players moving from place to place can significantly affect their state tax obligations and create a laundry list of compliance issues. Take Bartolo Colón, for example, the Cy Young winning pitcher who has played for 10 teams over the past 20 MLB seasons. From 1997 to 2017, Colón has played for the Cleveland Indians, Montreal Expos, Chicago White Sox, Los Angeles Angels, Boston Red Sox, Yankees, Oakland Athletics, New York Mets, Atlanta Braves, and Minnesota Twins. In 2017 Colón played for both the Braves and the Twins and has expressed an intention to return next season to Minnesota. Does that mean Colón is

domiciled in Minnesota now? With all that moving, could another state claim he is still a resident there? Or, is Colón still a resident of the Dominican Republic, where he was born and raised before his MLB career?

The nature of professional sports creates an endless number of similar issues, as players are traded or move as free agents from one team to another and from one state to the next. NBA star point guard Chris Paul and MLB home run slugger Giancarlo Stanton are two examples. Last summer Paul opted in to the final year of his contract, worth \$24.2 million this season, and was quickly traded from the Los Angeles Clippers to the Houston Rockets. Stanton, and the 10 years remaining on his \$325 million contract, was traded in December from the Miami Marlins to the Yankees. Will Paul be able to successfully argue he changed his domicile from California to Texas, where there is no state income tax, even though his contract guarantees he will be in Texas only for one year? Will Stanton be able to argue he remains domiciled in Florida, even though his contract says he will play in New York for the next 10 seasons? You can bet they both will try.

It's not only the players who are keenly aware of the tax implications of playing in a state with little to no income tax versus playing in a state with high income taxes. The Dallas Cowboys are known to provide a spreadsheet outlining the tax rates of various states and the impact such taxes have on potential players when they are trying to sign free agents.<sup>4</sup> However, for athletes, because you must have the intention to remain in a specific place to establish residency, it isn't always as clear-cut as merely being a domiciliary of whichever state you play in. Nonetheless, athletes and tax departments are often able to take a simple, yet sensible position in such cases: while a player is consistently moving across the country for "work purposes," his domicile reverts to his initial domicile. Indeed, an individual may have only one domicile, and that one domicile remains until he establishes a new one. So, maybe Colón is still a domiciliary of the Dominican Republic until he settles down. And maybe Paul, who grew up and attended college in North Carolina, remains a

<sup>3</sup> *Matter of Derek S. Jeter*, DTA No. 821646, Administrative Law Judge (Nov. 8, 2007).

<sup>4</sup> Stefanie Loh, "How Taxes Affect Free Agency in Pro Sports," *The San Diego Union-Tribune*, Apr. 20, 2015.

domiciliary of North Carolina. Likewise, Stanton, who grew up in California before becoming a professional athlete, may still be a California domiciliary. Whatever the case, you can see how difficult and subjective the domicile test can be.

### Statutory Residency – Throwing the Challenge Flag on Residency

It's not only the domicile test that a professional athlete can get flagged for. There is also statutory residency. Let's say an athlete plays for the New York Giants and is domiciled in New Jersey, but has an apartment in Manhattan. The athlete, if he is not careful, may be treated as a resident of both New Jersey and New York (not to mention New York City, which imposes its own income tax).

Under New York state's and city's rules, for example, an individual who is not domiciled in New York can still be taxed as a resident if he maintains a "permanent place of abode" within the state (which includes any type of dwelling, whether rented, owned, shared, etc.) and spends more than 183 days in New York.<sup>5</sup> That is a two-part test and both elements must be satisfied; however, if both elements are satisfied, the taxpayer is treated as a resident and will be taxed on his entire income by both his state of domicile (New Jersey in our example) and the state of statutory residence (New York in our example). Like New York, most states allow auditors a second chance at taxing non-domiciled individuals – much like winning a challenge on the question of residency. However, different states apply different tests in making that determination.

What should our hypothetical football player, who maintains a permanent place of abode in New York, do to ensure he isn't taxed by both New Jersey and New York? He should make sure that he not only spends less than 183 days in New York, but that he can document and prove that he spent less than 183 days. Statutory residency is triggered if an individual spends more than 183 days in the state, and what many people don't realize is that, barring a few exceptions, any part of a day counts as a day. To make matters even

worse, the burden of proving whether an individual was in or outside the state is on the taxpayer, not the auditor. So, it is critical that the athlete maintains a contemporaneous and accurate day count and stays below that 183-day threshold. A large part of our practice is spent combing through credit card records, cellphone bills, flight records, E-Z Pass statements, and so on, trying to reconstruct where an individual was on every day of the tax year.<sup>6</sup> There is even an app called Monaeo, which can be used to track where an individual is on a daily basis.

Many states use the same or a substantially similar test to determine statutory residency.<sup>7</sup> Other states, like California, apply slightly different tests. California defines a resident as any individual domiciled in California as well as "every individual who is in this state for other than a temporary or transitory purpose."<sup>8</sup> The goal of the statute, as explained by California's regulations, is to include "all individuals who are physically present in [California] enjoying the benefit and protection of its laws and government, except individuals who are here temporarily."<sup>9</sup> In other words, a baseball player who plays for the Los Angeles Dodgers but is domiciled in Las Vegas (Nevada does not impose a personal income tax) might get taken deep by California's aggressive tax offense and will find himself both a Nevada and California resident.

Circling back to our hypothetical New York Giants player – if the Giants were to play at the Buffalo Bills (the greatest team, in our humble opinion, that the NFL has to offer) that trip would count against his statutory day count. However, if the Bills played at the Giants, that day would not count because the Giants and Jets' home stadium is in New Jersey (making the Bills the only true New York NFL team, by the way).

<sup>6</sup>Noonan and Timothy P. Lawrence, "Day Counts and the Importance of Testimony in Statutory Residency Audits," *State Tax Notes*, Apr. 28, 2008, p. 317.

<sup>7</sup>See, e.g., Colo. Rev. Stat. section 39-22- 103(8)(a); D.C. Code Ann. section 47-1801.04; Md. Code Ann. Tax-Gen. section 10-101(k)(1)(i)(2); Mass. Gen. L. section 1(f); N.C. Gen. Stat. section 105-134.1(12); N.J. Rev. Stat. section 54A:1-2 (m)(2); and Pa. Stat. Ann. section 7301(p).

<sup>8</sup>Cal. Rev. & Tax. Code section 17014(a)(1).

<sup>9</sup>Cal. Code regs. 17014(a).

<sup>5</sup>N.Y. Tax Law section 605(b)(1)(B).



### Nonresident Athletes – The ‘Jock Tax’

Now to slightly change gears. Until this point we have discussed how states tax “resident” athletes and the various ways an individual (athlete or otherwise) can be treated as a resident for tax purposes. However, states also impose taxes on income earned within their borders by nonresidents.<sup>10</sup> So, when a professional athlete plays an away game, he has almost certainly incurred a tax liability in the state he’s just visited.<sup>11</sup>

As mentioned earlier, because of the publicity that surrounds professional sports, the amount of money athletes make, and the publicity of their schedules, tax auditors can easily learn how much money athletes earn and where they earn it. The increased attention professional athletes receive from state tax auditors has, falsely, led players, teams, the media, and some fans to cry foul over special “jock taxes.” Nonresident professional athletes are subjected to income taxation under the same general principles applied to all nonresident individuals who earn income in a state. Athletes happen to make easy and public targets for tax departments, and sometimes face unique rules, but all nonresident business travelers are potentially subject to some taxes for income earned.

Many states have in fact promulgated detailed regulations directed at allocating and apportioning the income professional athletes make while playing there. In New York, for instance, the New York-source income of a nonresident individual who is a “member” of a “professional athletic team” is calculated by multiplying the athlete’s compensation for services rendered to the team by a fraction, the numerator of which is the number of “duty days” spent rendering services in New York and the denominator of which is the total number of duty days spent rendering services everywhere.<sup>12</sup> The concept of duty days is common throughout the country and, generally, considers every aspect of an athlete’s contract, including all team work days

such as practices, team meetings, training camp, games, and so on. And it’s not just the players who can be sacked by a state tax department; the rules apply to any employee of the team who travels and performs services on a regular basis. That includes coaches, managers, and trainers. New York’s rules track the uniform rules recommended by the Federation of Tax Administrators and followed by most other states.<sup>13</sup> In fact, the Ohio Supreme Court recently held that part of Cleveland’s system of levying a tax based on the number of games played in the city as opposed to the number of duty days spent in the city was unconstitutional, after the city tried to tax injured players who did not travel with the team.<sup>14</sup>

Let’s look at a fairly simple example. On December 17 the Miami Dolphins came to Buffalo to play the Bills. Surprisingly, the game had some consequences in terms of the standings — the Bills won and, as a result of some further good tidings, made the playoffs for the first time in 17 years! Sorry, we digress. Not surprisingly, the game also had significant tax consequences. The Dolphins’ players, many of whom are residents of Florida, normally do not have to pay state income tax on their earnings. However, because they traveled to Buffalo, each player, along with the coaches and trainers, will be treated as having earned income in New York on December 17. Assuming they got into town a couple days before the game, those pre-game days will also count as New York duty days. Accordingly, Ndamukong Suh, with his average annual salary north of \$19 million, along with the other members of the Dolphins organization, will be handing over a portion of their salaries to New York. That means the Dolphins endured a trip to Buffalo in December, suffered a loss on the field, and will have smaller paychecks. Talk about a poor day at the office.

Have you ever wondered why half of the MLB teams hold spring training in Arizona? The answer: taxes and duty days. Unlike every other state, Arizona temporarily freezes its enforcement of duty days to attract both MLB and the flood of

<sup>10</sup> See, e.g., N.Y. Tax Law section 631.

<sup>11</sup> See generally, Ryan Prete, “NFL Superstars Sacked by Jock Taxes on Away Games,” Bloomberg BNA, Sept. 6, 2017.

<sup>12</sup> 20 NYCRR section 132.22(a)(1).

<sup>13</sup> See generally, Leslie A. Ringle, “State and Local Taxation of Nonresident Professional Athletes,” 2 *Sports Law J.* 169 (1995). (Ringle (now Leslie Kellogg) is a partner in the tax department at Hodgson Russ.)

<sup>14</sup> See generally, Bebe Raupe, “Refund Rush to Follow Cleveland’s ‘Jock Tax’ Fumble,” Bloomberg BNA, Nov. 13, 2015.

tourism spring training brings to the state. Players, coaches, and other team members do not have to allocate a portion of their salaries to Arizona based on practicing in the state; however, once spring training is over, Arizona begins counting duty days.<sup>15</sup>

For players who play in numerous states, compliance is a real concern. Professional athletes may be responsible for filing tax returns in perhaps a dozen or more states, and their tax returns will be as thick, and likely as difficult to follow, as a legal treatise. To ease the administrative burden, some states, like New York, allow nonresident athletes to elect to be included on a group-nonresident return filed by the team — as opposed to filing their own separate nonresident returns.<sup>16</sup> Even so, it is important that professional athletes receive the assistance of competent tax advisers.

One final note on nonresident allocation issues: it is possible to structure a player's signing bonus creatively to minimize the applicable state taxes. Because teams have tried to use signing bonuses both to compensate star players and manipulate salary caps, that has been increasingly important in recent years. The planning opportunity arises because many states have rules that restrict their ability to tax a nonresident's signing bonus if some criteria are met. Under New Jersey law, for example, a signing bonus is not in a nonresident's taxable compensation if the payment of the signing bonus is not conditional on the signer's playing any games for the team, or performing any subsequent services for the team, or even making the team; the signing bonus is payable separately from the salary and any other compensation; and the signing bonus is nonrefundable.<sup>17</sup> Thus, if a player can structure a signing bonus to cover those criteria, he'll get to keep a much bigger chunk of it. We have written about this in more detail previously.<sup>18</sup>

### Resident Tax Credits — No Harm, But Usually Still a Foul

As if athlete taxation wasn't dizzying enough, because more than one state is entitled to a piece of an individual's income, often two or more states end up taxing the very same income. In those circumstances, double taxation could follow. But fortunately, each state provides a credit mechanism intended to mitigate instances of double taxation, at least for "earned income," like a player's salary.<sup>19</sup> Accordingly, as a practical matter, an individual can claim a credit in his home state for taxes paid to other states.<sup>20</sup> That sounds good in theory, but much like a trick play in football, it doesn't always work out as planned. States calculate their credits slightly differently and often charge different tax rates, which can lead to a player's being taxed twice on the same income earned.

Take Sammy Sosa, the retired Chicago Cubs home run slugger. In 2003 Sosa sued the Illinois Department of Revenue seeking \$38,000 in tax credits to offset taxes he paid to other states where the Cubs played in 1998.<sup>21</sup> That year, while playing games in, and therefore paying taxes to, California, Colorado, Missouri, New York, and Pennsylvania, in addition to his home state of Illinois, Sosa lost the race to break Roger Maris's single-season home run record to Mark McGwire.

Ultimately, because of the way Illinois calculated its credit, the court determined that Sosa was unable to get a credit for the full amount of taxes paid to those other states. In the end, like the home run race, Sosa's suit struck out.

### Endorsements — A Question of Allocation

One last thing to think about surrounds endorsement income. Athletes have been endorsing products for decades and the dollar numbers are only growing larger. Michael Jordan built a billion-dollar brand and LeBron

<sup>15</sup> See generally, Sean Packard, "Pro Sports Athletes Need to Plan for Taxes Before Hitting the Field," Bloomberg BNA, May 4, 2017.

<sup>16</sup> 20 NYCRR section 151.18(a).

<sup>17</sup> N.J. Admin. Code 18:35-5.1(b)(4)(iv).

<sup>18</sup> Noonan and Kelly, "Pay to Play? How States Handle Signing Bonuses for Athletes," *State Tax Notes*, June 1, 2015, p. 683.

<sup>19</sup> Unearned income — such as interest, dividends, and capital gains — will generally always be taxed twice if a player is determined to be a resident of two states.

<sup>20</sup> See, e.g., N.Y. Tax Law section 620.

<sup>21</sup> *Sosa v. Bower*, Dkt. No. 02 L 50670 (Ill. Cir. Ct. 2003).

James reportedly signed a \$1 billion deal with Nike in late 2015.<sup>22</sup> For tax practitioners, the question isn't what funny commercial Peyton Manning will appear in next, but rather how to allocate such income.

Most practitioners would generally assume that endorsement income only gets taxed by an athlete's state of domicile. But that might not always be the case. For example, there is an old New York tax case in which singer Tony Bennett was forced to pay additional New York taxes on so-called "royalty income" from a record that was recorded and produced in New York.<sup>23</sup> The crooner tried to argue that the income was nontaxable royalty income, but the state tax commission ruled that the income was for the performance of services in New York (recording the record), and therefore was properly subject to New York tax. Bennett wasn't getting paid for any royalty or intangible ownership rights; he got paid for singing on the record. On the other hand, in a case involving Martha Stewart, New York courts held that she did not owe additional taxes on royalty income from books published by a New York company.<sup>24</sup> The difference? It wasn't because she was getting some form of nontaxable royalty; she just was able to prove that she wrote the books while in Connecticut.

The Bennett case illustrates the primary issue to look out for in the endorsement/nonresident income allocation context. Specifically, the determination turns on what the athlete was paid for. Was the payment for the performance of services, such as doing a commercial shoot in California? If so, it is likely that the athlete will owe California tax on such services, since they were performed in California. If, however, the payment is more for the athlete's "likeness," or his mere endorsement of a product, then the income is more properly sourced to the athlete's state of domicile. So be sure to be on the lookout for this issue, as many athletes increasingly earn this type of compensation as well.

## Conclusion

In this column, we have presented some of the most important rules and critical issues pertaining to the taxation of professional athletes. As with everything we cover, however, these rules are more complicated and detailed than we can cover in one article. Nonetheless, as states continue to need new ways to raise more money, professional athletes will continue to be dragged into the ring on more and more audits. Athletes, and the teams they play for, should be aware of these rules and take the proper steps to comply. Tax practitioners should speak with their clients and, after obtaining pictures or autographs, figure out where their clients are domiciled, where they maintain property, where they travel to play games, how often they travel for games, and the best way to comply on a multistate basis. ■

<sup>22</sup>Emmett Knowlton, "LeBron James' Business Partner Confirms Lifetime Deal With Nike Is Worth Over \$1 Billion," *Business Insider*, May 17, 2016.

<sup>23</sup>*Matter of the Petition of Tony Bennett*, N.Y. State Tax Commission, Nov. 19, 1976.

<sup>24</sup>*Matter of Martha Stewart*, ALJ (Jan. 13, 2000).