

# The Multistate Tax Quandary For Professional Athletes

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This is a great time of year for sports fans, even ones from Buffalo. The NFL season is in full swing, college football is reaching the bowl season, and the NBA and NHL seasons are underway, too. So naturally, our thoughts turn to one issue: taxes.

Among the many statistics associated with professional sports, one of the more interesting, from a tax perspective, is the high salaries paid to the players. And state tax departments have long been watching those statistics. Why? Well, it's not for the love of the game. Rather, professional athletes earn big dollars, and they have highly publicized travel schedules. So tax auditors know what they earn and where they are earning it. Those two facts place sports stars in the limelight, for sure. But it's one that brings with it a fanfare of thorny tax compliance and enforcement issues.

The players, the teams, and those tax practitioners with the good fortune to represent them should be thinking about the sorts of issues we'll be covering in this month's column. As usual, we'll focus on New York's rules, but this is a multistate concern. We'll also focus on professional team sports, but many of these issues can apply just as easily to NASCAR, golf, tennis, boxing, rodeo, wrestling, and so on. So let's play ball.

## Domicile — Which Plate Is Home Plate?

The first issue to arise is residency. We all know that a state can tax its residents on all their income. And if you're a regular reader of this column, you know that it is difficult to determine where an individual resides for income tax purposes.<sup>1</sup> The primary determination of residency is where an individual is domiciled, or in layperson's terms, where an individual's permanent home is located.<sup>2</sup> An individual may have multiple residences, but he can have only one domicile. This can be a confusing and subjective test — creating a playground of sorts for state tax auditors.

But there are unique issues that arise for athletes in these domicile cases. Take the case of Derek Jeter. Besides being one of the most famous baseball players of all time, Jeter is somewhat infamous in state tax circles because of this very issue. In 2007 the New York State Department of Taxation and Finance went after the storied shortstop, claiming that he owed back taxes for 2001-2003. Jeter claimed to be domiciled during those years in Tampa, Fla., where he owned a home near the Yankees' spring training camp and where he spent his time during the off-season. Florida also happens to be one of a handful of states that does not impose a personal income tax on its residents, so this issue comes up a lot, and not just with athletes. The auditors, however, claimed that Jeter was domiciled in New York, where he "worked" and where he owned a multimillion-dollar apartment in the Trump World Towers on Manhattan's East Side. Presumably, the auditors probably also argued that if the shortstop for the New York Yankees isn't domiciled in New York, who is? But after challenging a procedural issue before an administrative law

<sup>1</sup>See, e.g., Timothy P. Noonan and Mark S. Klein, "The Nuts and Bolts of a Residency Audit," *State Tax Notes*, Dec. 22, 2008, p. 793, *Doc 2008-25828*, or *2008 STT 247-3*; Timothy P. Noonan and Elizabeth K. Pascal, "New York Issues New Nonresident Audit Guidelines," *State Tax Notes*, May 10, 2010, p. 457, *Doc 2010-9829*, or *2010 STT 89-8*.

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

judge in New York's Division of Tax Appeals,<sup>3</sup> Jeter reached a private, out-of-court settlement. And though we can only guess what the outcome was, it's clear that New York is going after issues like this.

Domicile issues can arise in other contexts as well. Draft time and trades are exciting for sports fans. But what does all that moving around mean for players when it comes to state income tax obligations? Take, for example, NFL superstar Randy Moss. In the past 10 years, Moss has played for the Minnesota Vikings, the Oakland Raiders, the New England Patriots, the Minnesota Vikings again (briefly), and the Tennessee Titans. He moved three times in 2010 alone (so far), playing for the Patriots, the Vikings, and now the Titans. Is Moss now domiciled in Tennessee? With all those recent moves, will Moss be able to show that he both abandoned his former domicile in Massachusetts (assuming that's what he was claiming) and acquired a new domicile in Tennessee? What are his tax obligations to Minnesota?

The sports world is littered with these types of issues, as players are traded or move as free agents from one team to the next and from one state to another. MLB pitching great Cliff Lee is another example. Within the last three years, Lee has played for the Cleveland Indians, the Philadelphia Phillies, the Seattle Mariners, and now, for the moment, the Texas Rangers. With all that moving around, in what state is a player like Lee domiciled? The location of real property, how much time is spent in a given state, the location of family, business ties to a state, and many other factors, can each play an important role in determining which state (or states) gets to lay claim to a professional athlete's income.

We're often able to take a simple but sensible position in these cases: While the player is running around the country for "work purposes," his domicile reverts back to his initial domicile. Indeed, as mentioned above, a person can have only one domicile, and until he establishes a new one, the old domicile remains. So maybe Lee, who's originally from Arkansas, will remain a domiciliary of Arkansas until he settles down somewhere else. Whatever the case, you can see how difficult and subjective the domicile test can be.

As a final note, let's not forget the biggest sports move of 2010 — LeBron James's move from the NBA's Cleveland Cavaliers to the Miami Heat. Could that move have been motivated, in part, by the fact that Florida does not impose an income tax? Some news sources had speculated that had it not been for high New York state and city income taxes, James might have taken his talents to New York to

play for the Knicks.<sup>4</sup> So those die-hard Knicks fans need not feel so bad: *That's* the reason they have stunk for so many years.

### Statutory Residency — An Instant Replay on Residency

Players have to worry about other residency tests, too. What if an athlete, let's say a member of the New York Giants (the second greatest football team in the nation, after the Bills, of course) who is domiciled in New Jersey, also happens to have an apartment in Manhattan. Not an unlikely scenario. In that case, the athlete, if he is not careful, may well be treated as a resident of *both* New Jersey and New York (not to mention New York City, which imposes its own city income tax). Like New York, most states provide auditors with a second bite at the tax apple — kind of an instant replay of sorts for the residency question. This is known as statutory residency. Different states apply different tests in making that determination.

Under New York's rules, an individual who is not domiciled in New York still can 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, and so on) and spends more than 183 days in New York.<sup>5</sup> This is a two-part test, and both elements must be satisfied. But once they are satisfied, the individual would be subject to tax 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).

So if our hypothetical football player maintains a permanent place of abode in New York, what can he do? Very simple: He must keep a calendar and watch his day count. Statutory residency is triggered if an individual spends more than 183 days in the state. What many people don't realize is that, barring a few exceptions, *any part of a day* counts as a day. And 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, phone bills, flight records, E-Z Pass statements, and so on, trying to reconstruct where an

<sup>3</sup>*Matter of Derek S. Jeter*, Administrative Law Judge (Nov. 8, 2007).

<sup>4</sup>"Local Penalty," *New York Post* (July 1, 2010). ("If LeBron James . . . goes to the Miami Heat instead of the Knicks, blame our dysfunctional lawmakers in Albany, who have saddled top-earning New Yorkers with the highest state and city income taxes in the nation.")

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

individual was on every day of the tax year.<sup>6</sup> All of those records must be used and maintained.

Many other states use the same or a substantially similar test for determining statutory residency.<sup>7</sup> Other states, though, apply slightly different tests. California, for example, broadly 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> California’s regulations explain that the goal of the statute is to include “all individuals who are physically present in this State enjoying the benefit and protection of its laws and government, except individuals who are here temporarily.”<sup>9</sup> In other words, a basketball player who plays for the Los Angeles Lakers but is domiciled in Las Vegas (Nevada, like Florida, does not impose a personal income tax) might well get shut out in a contest against California’s aggressive tax offense.

One final note: If our hypothetical New York Giant played a home game at his team’s home stadium, would that be counted as a New York day? If you answered no, you’d be correct. The Buffalo Bills, we can proudly say, are the only NFL team from New York state, because both the Jets and the Giants play in New Jersey. We might not be able to beat the Giants in a Super Bowl (or the Redskins, or the Cowboys), but at least we have *that* over them.

### Nonresident Athletes — Pay To Play

So far, we’ve been discussing how states tax “residents” and the various ways in which an individual (athlete or otherwise) can be treated as a resident for tax purposes. But states also impose taxes on nonresidents on income derived from sources within their borders.<sup>10</sup> The constitutionality of taxing nonresidents in this manner was blessed a long time ago by the U.S. Supreme Court.<sup>11</sup>

When a professional athlete plays an away game, he’s likely incurred a tax liability in the state he’s just visited.<sup>12</sup> As mentioned earlier, because of the publicity that surrounds professional sports, tax auditors can easily learn how much athletes earn

and where they are when they are earning it. This increased attention by state tax auditors has (somewhat falsely) led the media, the teams, and the fans to believe players are subject to special “jock taxes.” In fact, nonresident professional athletes are subjected to income taxation under the principles generally applied to all nonresidents. They just make way more money than the typical taxpayer, so their issues get all the attention.

Many states have promulgated detailed regulations directed at allocating and apportioning the income of professional athletes. Under New York’s rules, 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>13</sup> Duty days include all team work days, including practices, team meetings, training camp, and so on. The rules also apply to any employee of the team who travels with the team 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>14</sup>

Let’s look at a fairly simple example. On December 26 the Patriots are scheduled to square off with the Bills in Buffalo. Even though, given the Bills’ record, this may be a meaningless game in the standings, it will nonetheless have some consequences — tax consequences, to be exact! The Patriots’ players, many of whom may be residents of Massachusetts, normally pay taxes to Massachusetts. When they travel to Buffalo, each player, along with the coaches and trainers, will be treated as having earned income in New York on December 26. And assuming they get into town a couple days before the game, those pre-game days will also count as New York duty days. Accordingly, Tom Brady and Bill Belichick will be coughing up a portion of their salaries to pay up to New York on that day no matter who wins the game (stop laughing — the Bills *could* win). But the next time Ryan Fitzpatrick, C.J. Spiller, and Jairus Byrd take the field in Foxboro, they’ll be returning the favor to Massachusetts’s tax coffers, paying taxes on the percentage of time spent in the state on duty days.

<sup>6</sup>Timothy P. Noonan, “Day Counts and the Importance of Testimony in Statutory Residency Audits,” *State Tax Notes*, Apr. 28, 2008, p. 317, *Doc 2008-8845*, or *2008 STT 83-26*.

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

<sup>8</sup>Calif. Revenue and Taxation Code section 17014(a)(1).

<sup>9</sup>Calif. Code Regs. 17014(a).

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

<sup>11</sup>*Shaffer v. Carter*, 252 U.S. 37 (1920).

<sup>12</sup>*See generally* Charles Delafuente, “Which Worksheet Is for the Away Games?” *The New York Times* (Feb. 10, 2008).

<sup>13</sup>20 N.Y.C.R.R. section 132.22(a)(1).

<sup>14</sup>*See generally* Leslie A. Ringle, “State and Local Taxation of Nonresident Professional Athletes,” 2 *Sports Law J.* 169 (1995). (Ringle (now Mrs. Kellogg) is currently a partner in the tax department at Hodgson Russ.)

For players who play in lots of different states, compliance is a real concern, because most states have a similar sort of duty day rule. Thus, professional athletes will generally be responsible for filing tax returns in perhaps a dozen or more states, and their tax returns will be as thick (and as difficult to follow) as a legal treatise. That makes compliance difficult and complex, to say the least. Some states, like New York, try to ease the administrative burdens by allowing 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>15</sup> Even so, professional athletes need the assistance of competent tax advisers.

One final note on these nonresident allocation issues: Often we've found creative ways to structure a player's signing bonus to minimize the applicable state taxes. That has been increasingly important in recent years, because teams have tried to use signing bonuses both as a way to compensate star players and manipulate salary caps. The planning opportunity arises because many states have a rule like New Jersey's, which restricts its ability to tax a nonresident's signing bonus if some criteria are met. Under N.J. Admin. Code 18:35-5.1(b)(4)(iv), a signing bonus is not included in a nonresident's taxable compensation if the payment of the signing bonus is not conditional on the signer 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 non-refundable. Thus, if a player can structure a signing bonus to cover those criteria, he'll get to keep a much bigger chunk of the bonus.

### Resident Tax Credits — No Harm, No Foul

As if those various rules aren't dizzying enough, because more than one state is entitled to carve up an individual's income, often two or more states end up taxing the very same income. In those circumstances, double taxation is certain to follow. Fortunately, tax laws in each state provide for a credit mechanism that is intended to mitigate instances of double taxation, at least for "earned income," like a player's salary.<sup>16</sup> Accordingly, as a practical matter, an individual can claim a credit in his home state for taxes paid to other states.<sup>17</sup> So, no harm, no foul, right?

In theory, yes. But in practice, it often doesn't work out that way. Because different states charge

different tax rates, and because different states calculate their credits slightly differently, it's not always a wash for the player. Case in point: In 1998 Sammy Sosa of the Chicago Cubs and Mark McGwire of the St. Louis Cardinals raced to break Roger Maris's single-season home run record. Sosa barely lost to McGwire. In 2003 Sosa struck out again, this time against the Illinois Department of Revenue.<sup>18</sup> Sosa had sued the state seeking \$38,000 in tax credits to offset taxes he had paid to other states where the Cubs played in 1998.<sup>19</sup> While battling McGwire, Sosa had played games in, and therefore paid taxes to, California, Colorado, Missouri, New York, and Pennsylvania, in addition to his home state of Illinois. However, because of the manner in which 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. Perhaps that is the price for glory. Or steroids.

### Withholding — The One Holding Penalty That Always Gets Called

Up to this point, we've focused on the personal income tax obligations of the player. But sports are usually a team game, and that is just as true for tax purposes. Although individual players have to be aware of their responsibilities for their own personal taxes, the players' teams also have to be up to speed on every one of those issues as well, because almost all states require some form of personal income tax withholding on the type of wage income usually paid to players. The subject of withholding was recently covered in this column in great detail.<sup>20</sup> But in this context, to properly withhold, all the above issues are important to consider. The team has to know where the player resides from a residency perspective, how to allocate his duty days, how the resident credits are going to work, and so on. And if the team doesn't get it right, that won't be a problem only for the player. The team itself could be subject to additional tax, penalties, and interest if the issues are caught in a state withholding tax audit. So the onus is as much on the team to make sure all those issues are handled correctly.

### Conclusion

Sports and taxes. What a match. We've presented some of the important rules and highlighted some of the critical issues that pertain to state taxation of

<sup>15</sup>20 N.Y.C.R.R. section 151.18(a).

<sup>16</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>17</sup>See, e.g., N.Y. Tax Law section 620.

<sup>18</sup>*Sosa v. Bower*, Dkt. No. 02 L 50670 (Ill. Cir. Ct. 2003).

<sup>19</sup>Manya A. Brachear, "Sosa suit over taxes strikes out in court," *Chicago Tribune* (June 27, 2003).

<sup>20</sup>See, e.g., Timothy P. Noonan, "Multistate Withholding Tax: The Next Big Issue in State Tax Practice?" *State Tax Notes*, June 21, 2010, p. 981, *Doc 2010-12738*, or *2010 STT 118-1*.

professional athletes. But as with everything tax related, these rules are more complicated and detailed than we can cover in just one column. Nonetheless, as states continue to expand their efforts to aggressively conduct residency audits and to export their taxes to nonresidents, professional athletes will undoubtedly find themselves getting dragged into more and more audits. Athletes and teams should be aware of those rules, and they need to take steps to comply with them upfront. Tax practitioners should sit with their clients and — after obtaining autographs — figure out what their clients consider

to be their home state, where they maintain property, where they are traveling, and how often they are traveling there, and then everyone should decide on practical solutions for achieving the best possible compliance on a multistate basis.

Go Bills.

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