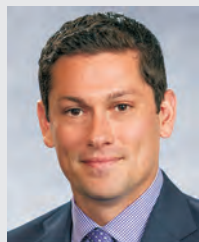


Establishing Residency for Professional Athletes

by Jack Trachtenberg and Jason Feingertz



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In this edition of *The Taxpayers' Advocate*, Trachtenberg and Feingertz discuss the unique tax considerations for professional athletes, particularly those regarding residency.

I. Introduction

Many states aggressively audit and seek to tax individuals who work or have other ties to the state but claim to live elsewhere. When a state succeeds in taxing an individual on the basis of residency, it can tax the person's entire income, even if the income was earned in another jurisdiction.

Residency audits are extremely intrusive, often resulting in inquiries about a taxpayer's homes, business and family ties, the amount and nature of time spent in the state, and even the location of the taxpayer's personal belongings. Residency audits are also highly subjective, as state tax officials will weigh these objective factors to decide if the individual's true intent was to reside outside the state.

Taxpayers with complex lives, such as those with multiple homes, extensive travel, or an ability to commute long distances, are particularly vulnerable to erroneous or unreasonable residency determinations by state tax officials. Often, states will force those under audit to prove that their true homes are elsewhere given their continuing contacts with the states.

This column focuses on state tax residency issues as seen from the perspective of professional athletes. However, most of the issues and concepts discussed apply to any high

income individual with multiple homes or whose business or profession involves extensive travel or frequent changes of employer or work location.

II. Professional Athletes

Unlike traditional professions in which an individual may work and live in the same state for extended periods, professional athletes are constantly on the move. They rarely spend more than a few years working in the same cities and often make their off-season homes in different states than the ones they work in.

As any athlete will tell you, professional sports is a business, and athletes are treated as assets, constantly on the move from franchise to franchise. There are very few professions in which an individual can be relocated across the country without any input into the decision and then be expected to move overnight to work in the new city. That can and does happen to athletes, who can be traded to a team in another city at a moment's notice.

Athletes present a unique set of tax considerations when determining their true homes. That leads to a lot of questions and opportunities when considering their residencies for state tax purposes. For example, athletes may be able to change their residencies from state to state throughout their career depending on the teams they play for, or view their true homes as the places they spend their off-seasons, irrespective of where their teams are located. When athletes change teams, they may have opportunities to revisit their residency status, which can have significant tax implications. Indeed, all athletes should give serious thought to their residency status during two critical moments of their careers: when they are drafted and the first time the player reaches unrestricted free agency.

III. Why Does an Athlete's Residency Matter

Like all taxpayers, athletes must pay income tax to their states of residence, unless the state (such as Florida, Texas, and Nevada) does not impose an individual income tax. Because resident taxation subjects the individual to taxation on his or her worldwide income, one's residency status is important, especially for athletes, who may become subject to tax not only on the income they receive from their team contracts but also on their endorsements and other income.

Generally, there are two ways a state can seek to tax an individual as a resident. First, an individual may be taxed as a resident if he is domiciled in the state. In this context, the

word “domicile” generally refers to the individual’s “permanent” home — that is, where the individual intends to reside for the indefinite future.¹ A person can *reside* in multiple locations but can have only one domicile. Moreover, an individual’s domicile continues until a new one is established, which requires the individual to take up residence in a new location with the intent to make that new location his permanent home.

In some states, an individual can also be taxed as a resident — irrespective of domicile — if he satisfies the requirements to be taxed as a statutory resident. For example, in New York, a non-domiciliary may be taxed as a resident if he maintains a “permanent place of abode” in the state for substantially all of the tax year and spends more than 183 days in the state during the tax year.² Thus, even if an athlete were to successfully establish domicile in Florida, he could be taxed as a resident in New York if he kept an apartment in the state and was present in the state for more than 183 days.

III. Do State Taxes Really Have an Impact?

Yes! State taxes can significantly affect a player’s income. For example, compare California and New York, with their roughly 13 percent and 12 percent respective tax rates, with Florida, Texas, and Nevada, which have 0 percent tax rates.³ As athletes’ salaries continue to skyrocket, the potential state tax burdens increase. For players trying to maximize their contract value, it is important to consider the impact of state tax planning in any decisions they make.

IV. Draft and Free Agency: A Time for Choosing?

Young athletes are often drafted into professional sports leagues and have no input on whom they play for. Once an athlete is drafted, his only option is to sign a contract with the team that drafted him or to not play professionally in the United States. Not only does the player have no choice about which team or city to play for, but he is typically expected to fly to his new city immediately after being drafted so that he can meet the leadership of the new team.

It is often assumed that a young athlete should immediately establish his home in the city of the team that drafted him. The athlete may be told that the city is his new home, and there is mutual hope that he will stay there for his entire career. However, that is rarely the case, and an athlete can find himself traded just a few weeks after being drafted.

An athlete should not assume that he is required to treat himself, for tax purposes, as being domiciled in the state of the team that selected him in the draft. While that state may be one of the states where he performs services for work

purposes, it may not be the state where he wants to live or consider home. This is especially true if the athlete anticipates his relationship with the team will be temporary. In other words, draft time presents a perfect opportunity for an athlete to make a reasoned determination regarding state tax residency and to take steps to document that determination in the event of a future tax audit. It may, for example, be appropriate for the athlete to continue claiming residency in the state where he grew up or went to college or in the state where he maintains a home in the off-season.

Obtaining free agency status presents similar opportunities. With free agency, the athlete finally has the opportunity to choose the team he wants to play for and to enter into a long-term contract. When a free agent signs a long-term contract with a new team, the rhetoric around the signing often includes statements about how both sides are excited about a long future together. This could present an opportunity for the athlete to claim the new team’s state as his domicile. However, more often than not, the player will be traded before the contract expires, often without any input in the decision. For this reason, the athlete should take the opportunity presented by free agency to consider establishing residency in a more tax-friendly jurisdiction.

V. Examples

A. Free Agency

Consider the career of Tyson Chandler, a 14-year veteran of the NBA who just signed as a free agent with his sixth NBA team. Chandler was born and raised in California before entering the NBA draft directly from high school. He was drafted second overall by the Chicago Bulls, where he played from 2001 to 2005 before becoming a free agent. As a free agent, Chandler signed a six-year, \$64 million deal with the Bulls, but after playing with the team for the 2005-2006 season, he was traded to the New Orleans Hornets. Chandler was later traded to the Charlotte Bobcats in 2009 and to the Dallas Mavericks in 2010, all the while honoring the original contract he signed in 2005. In 2011, as a free agent, Chandler agreed to a four-year, \$55 million deal with the New York Knicks. However, three years into that contract, Chandler was traded back to the Mavericks. This summer, Chandler signed a four-year, \$52 million contract with the Phoenix Suns.

Because of his personal history of being traded mid-contract multiple times, Chandler may be understandably cautious about establishing his home in Arizona, and he may be in a unique position to establish his residency in a lower-tax or no-tax state. Moreover, his frequent moves to different teams may have allowed Chandler to be proactive about his state residency planning, which could be beneficial in light of his \$185 million in career earnings. Depending on his particular facts and circumstances, Chandler’s multiple moves and fleeting affiliation with the Knicks may even mean he is entitled to a refund of any taxes he paid to New York.

¹ See, e.g., N.Y. Tax Law section 605(b)(1)(A).

² N.Y. Tax Law section 605(b)(1)(B).

³ The 12 percent New York tax rate assumes the athlete is living in New York City, which imposes its own personal income tax at a rate of about 4 percent.

B. Draft

D'Angelo Russell is a 19-year-old NBA player who, similar to Chandler, was selected with the second highest draft pick. He was drafted in 2015 by the Los Angeles Lakers and signed a four-year, \$23 million contract. Russell was born and raised in Kentucky, where he lived through his freshman year of high school. He then transferred to a basketball academy in Florida to play his final three years of high school ball. Russell attended Ohio State University for his freshman, and only, year of college. However, Russell was in college only from August 2014 through April 2015. Russell is now preparing to play in Los Angeles, while understanding that his time with the team could end at a moment's notice.

As they were both number two overall picks in their draft classes, Russell can reasonably expect to have a career similar to Chandler's, earning almost \$200 million over the next 15 years while playing for multiple franchises. If the appropriate steps are taken and it is consistent with his intent, Russell could claim a Florida domicile given his historical connection to the state and the uncertainty of his future in California. While Florida has a 0 percent income tax rate, California's highest personal tax rate is 13 percent. Alternatively, if his moves to Florida, Ohio, and Los Angeles are all viewed as temporary, it may be appropriate for Russell to claim residency in Kentucky. Kentucky's top income tax rate is 6 percent, which is still considerably lower than California's top rate.

VI. How Can Players Properly Plan?

Given the unique nature of professional sports, athletes often have flexibility in establishing their residencies for state tax purposes, particularly when they are drafted or switch teams through free agency. At the same time, athletes are particularly susceptible to audits by state taxing authorities that may seek to use the players' multiple points of contact in different states to question their residencies.

Take, for example, Derek Jeter, who was caught up in an audit by the New York State Department of Taxation and Finance regarding his residency status for the 2001 through 2003 tax years. During those years, Jeter owned a home in Tampa, Florida, where he lived during the off-season. Jeter claimed to be domiciled in Florida, but New York disagreed, noting his expensive apartment in Manhattan and the time he spent in the state as a member of the New York Yankees. Ultimately, Jeter reached an undisclosed, out-of-court settlement with New York.

Athletes should seriously consider the state tax savings of appropriate residency planning. Particularly at the time of the draft and free agency, athletes should consult with experienced state and local tax counsel to determine where to claim residency. Counsel should provide an analysis of the relevant states' residency rules and assist in developing an action plan so that, given the particular athlete's facts and desires, he can take concrete steps to demonstrate the intended domicile. Athletes should also obtain advice on what records to maintain so that they can mount a robust defense in any future tax audits. ☆