

WHY COME TO TRAINING CAMP OUT OF SHAPE WHEN YOU CAN WORK OUT IN THE OFF-SEASON AND LOWER YOUR TAXES: THE TAXATION OF PROFESSIONAL ATHLETES

I. INTRODUCTION

Professional athletics have long been a part of North American culture. Throughout the United States and Canada, fans have been attending sporting events in the four major sports¹ for decades. However, when your favorite team loses on a last second goal by the opposing team's star player, fans can take comfort in the fact that the opposing player will be paying the price for his success back to the fan in the form of taxes.²

With the increase in players' salaries over the past couple of decades, the "jock tax"³ has been an increasingly popular measure among taxing jurisdictions as an attempt to apply income taxes to the salaries of visiting professional baseball, basketball, hockey, and football players.⁴ In addition,

1. For purposes of this Note, the four major sports include: baseball, basketball, hockey, and football.

2. See Larry Williams & Sean Horgan, *From Rock Icon to Ice King, State Wants Taxes From the Stars*, THE HARTFORD COURANT, Aug. 17, 1995, at A1.

3. The jock tax refers to the "concept of multiple income taxation of professional athletes . . ." Elizabeth C. Ekmekjian, *The Jock Tax: State and Local Income Taxation of Professional Athletes*, 4 SETON HALL J. SPORT L. 229, 230 (1994).

4. See Karen Pierog, *Players on Both Sides Take a Look at the Jock Tax Contest: Taxes on Salaries of Professional Athletes*, THE BOND BUYER, Aug. 14, 1992, at 5. Reasons why athletes are being singled out for taxation include:

1) [t]heir earnings have risen rapidly over the past decade[;] 2) [i]t usually is easy to determine when these well-known athletes are present in a particular taxing jurisdiction[;] 3) [t]here is firm constitutional authority for imposing taxes on athletes who perform in jurisdictions outside their home states[;] 4) [f]or most jurisdictions, imposition of the tax does not require new statutory authority[;] 5) [a]s nonresidents, the athletes cannot express their displeasure in the voting booth[; and] 6) [t]he athletes cannot respond by avoiding the taxing jurisdiction, since the sites at which they play are determined for them. These factors, coupled with the increased fiscal pressures faced by many state and local governments, have led to increased enforcement against athletes of nonresident tax laws that in most instances have been on the books for many years.

Robert Plattner, *FTA Recommendations on Taxing Nonresident Athletes Could Have Wider Application*, 5 J. MULTISTATE TAX'N 36, 36 (1995).

The jock tax has become a selective tax because states that tax nonresident athletes often do not tax other individuals who have greater contacts with the state. See Ekmekjian, *supra* note 3, at 244; Tim Novak, *Tax Penalty for Traveling*, CHI. SUN-TIMES, Mar. 23, 1997, at 21; Earl C. Gottschalk Jr., *Welcome, Traveler: Some States and Cities With Income Taxes Go After Rich Visitors*, WALL ST. J., Apr. 15, 1993, at A1. See generally James Overstreet, *Good News*

baseball,⁵ basketball,⁶ and hockey⁷ also have franchises in Canada. Therefore, the athletes who participate in these sports end up paying income tax to Canada on both the federal and provincial levels as well as to the United States. Taxation in the United States is assessed at the federal, state, and local levels. The tax policy is nearly a century old, but it has not been practiced very much until recently when the salaries of professional athletes began to soar.⁸

The focus of this Note is on the allocation methods used to determine the tax liability professional athletes face in the different tax jurisdictions in which they perform and how athletes can work with these allocation methods to ease some of their tax burden. Part II focuses on residency requirements used to determine whether the athlete is a resident of the United States or Canada for tax purposes as well as residency requirements within the states themselves which are used to determine how the athletes are taxed. Part II also discusses the assessment of income taxes in both Canada and the United States. Part III focuses on the different allocation methods which have been used in the past to allocate the income tax owed to Revenue Canada,⁹ and the United States on the federal, state, and local levels. Part IV focuses on planning tools the athlete can utilize in the form of contract negotiation in order to use the allocation methods to the athlete's advantage and thus decrease the athlete's nonresident income tax liability.

II. RESIDENCY AND TAXATION

A. Canadian Residency

For any taxpayer, the place of residence determines tax rates and which taxing authority has jurisdiction. "The term 'resident' is not defined in the

for Oilers Players and Their Opponents: No Tennessee Taxes, MEM. BUS. J., Sept. 29, 1997, at 1 (discussing selective enforcement of taxation on athletes using the illustration that Federal Express pilots are not being taxed when they land at the airport in a nonresident taxing jurisdiction).

5. Baseball's franchises in Canada include the American League's Toronto Blue Jays and the National League's Montreal Expos. See *ESPN.com: Major League Baseball Standings* (visited Oct. 29, 1998) <<http://ESPN.SportsZone.com/mlb/standings/>>.

6. Basketball's franchises in Canada include the Toronto Raptors and the Vancouver Grizzlies. See *ESPN.com: NBA Standings* (visited Oct. 29, 1998) <<http://ESPN.SportsZone.com/nba/standings/index.html>>.

7. Hockey's franchises in Canada include: the Montreal Canadiens, the Toronto Maple Leafs, the Calgary Flames, the Edmonton Oilers, the Vancouver Canucks, and the Ottawa Senators. See *ESPN.com: NHL Standings* (visited Oct. 29, 1998) <<http://ESPN.SportsZone.com/nhl/standings/>>.

8. See Overstreet, *supra* note 4, at 1.

9. Revenue Canada is Canada's equivalent of the United States Internal Revenue Service (IRS).

Income Tax Act" in Canada.¹⁰ In Canada, residents are liable for income tax on their world income.¹¹ Nonresidents are liable for tax on their Canadian-source income¹² from employment, carrying on of a business, and disposition of taxable capital property.¹³ In Canada, residency is determined in one of four ways: full-time resident, ordinarily resident, deemed resident, or part-time resident.¹⁴

1. *Full-Time Resident*

The first method used to determine whether an athlete may be considered a resident of Canada is based on the idea of "full-time" residency. Full-time residency is determined by examining whether there were residential ties within Canada.¹⁵

Leading case law has established that residence is a "continuing state of relationship between a person and a place which arises from the durable concurrence of a number of circumstances."¹⁶ Considerations for determining a "continuing state of relationship" include: the maintenance of a dwelling suitable for year round occupancy,¹⁷ the fact that a spouse or dependent

10. Revenue Canada, *Determination of an Individual's Residence Status*, IT-221R2, Feb. 25, 1983 as amended by Feb. 20, 1991 (visited Nov. 4, 1998) <<http://www.rc.gc.ca/E/pub/tp/i221r2et/i221r2e.txt.html>> [hereinafter IT-221R2]. "The Courts have held that an individual is resident in Canada for tax purposes if Canada is the place where he, in the settled routine of his life, regularly, normally or customarily lives. In making this determination, all of the relevant facts in each case must be considered." *Id.*

11. See Income Tax Act, R.S.C. 1952, c.148, as am. S.C. 1970-71-72, c. 63 and subsequently Part I § 2(1) (Can.) (1996); DELOITTE AND TOUCHE L.L.P. CANADA 14.01 RESIDENCE AND NONRESIDENCE, PART 7 INCOME TAXES ON INDIVIDUALS, CH. 14 COMPUTATION OF PERSONAL INCOME TAXES [hereinafter DELOITTE AND TOUCHE 14.01]; John Salmas, *Professional Athletes Taxed to Death? Even They Can Strike Out!!!*, 4 SPORTS LAW. J. 255, 256-57 (1997).

12. Source income is defined as the income earned from the place where the services are performed. See Jeffrey L. Krasney, *State Income Taxation of Nonresident Professional Athletes*, 2 SPORTS LAW. J. 127, 132 n.19 (1995); DELOITTE AND TOUCHE 14.01, *supra* note 11.

13. See DELOITTE AND TOUCHE 14.01, *supra* note 11.

14. See Salmas, *supra* note 11, at 257.

15. See IT-221R2, *supra* note 10; Salmas, *supra* note 11, at 257.

16. Salmas, *supra* note 11, at 257 (quoting Thomson v. M.N.R., [1946] C.T.C. 52, 2 D.T.C. 812 (S.C.C.) at 816).

17. An individual will generally be considered not to have severed his residential ties with Canada if he maintained property (vacant or otherwise), leased the property at non-arm's length, or leased the property at arm's length with the right to terminate the lease on short notice. See IT-221R2, *supra* note 10.

remains in Canada,¹⁸ and the existence of personal property and social ties within Canada.¹⁹

2. *Ordinarily Resident*

A second method for determining Canadian residency is whether the individual is "ordinarily resident." Case law considering "ordinarily resident" status looks at "an individual's present habits, regularity and length of visits, ties within the jurisdiction and elsewhere, and permanence of [the] stay abroad."²⁰ Cases have defined ordinarily resident as "the place where in the settled routine of his life, he regularly, normally or customarily lives."²¹

3. *Deemed Resident*

A third method used to determine whether an individual may be considered a resident of Canada for tax purposes is by being deemed resident. "An individual who sojourns²² . . . in Canada for a total of 183 days or more in any calendar year is deemed by the Income Tax Act to be [a] resident in Canada for the entire year."²³ In addition, "the individual must be a resident of another country during the 183 (or more) days in question."²⁴

18. "An exception to this may occur where an individual and his spouse are legally separated and the individual has permanently severed all other residential ties within Canada." *Id.* If an individual maintains a dwelling in support of someone in Canada, after that individual has left Canada, the individual will not be considered to have severed his residential ties within Canada. *See id.*

19. Examples of this include: "(a) provincial hospitalization and medical insurance coverage, (b) a seasonal residence in Canada, (c) professional or other memberships in Canada . . . , and (d) family allowance payments. *Id.* "Where such ties are retained within Canada, the Department of Revenue may examine the reasons for their retention to determine if these ties are significant enough to conclude that the individual is a continuing resident of Canada while absent. *Id.* *See generally* Salmas, *supra* note 11, at 257-58 (discussing the example of Paul Molitor, a professional baseball player who was a United States resident, but would also be considered a Canadian resident based on the "full-time" residency determination).

20. Salmas, *supra* note 11, at 258.

21. *Id.* (quoting *The Queen v. K.F. Reeder*, [1975] C.T.C. 256, 75 D.T.C. 5160).

22. To sojourn means to be temporarily present. *See* IT-221R2, *supra* note 10.

23. *Id.* *See also* Salmas, *supra* note 11, at 259 (stating that an individual must sojourn in Canada for at least 183 days to be deemed resident).

24. IT-221R2, *supra* note 10. However, if after taking up residency in another country in the first half of a calendar year, the individual returns often enough to have sojourned in Canada for a total of 183 days or more during the calendar while a non-resident, he will be deemed to be a resident in Canada for the entire year. *See id.*

4. *Part-Time Resident*

The final method used to determine whether an individual will be considered a resident of Canada is whether he is determined to be a part-time resident. Where an individual enters Canada, as other than a sojourner, and establishes residential ties with Canada,²⁵ he will be considered to have become a resident of Canada for tax purposes on the date he entered Canada.²⁶

Thus, if the athlete is considered either a full-time resident, ordinarily resident, deemed resident, or part-time resident, he or she will be considered a resident of Canada for tax purposes and is therefore subject to tax on his world income. The athlete's world-wide income is only subject to tax for the actual time in which he was a resident.²⁷

B. *Canadian Taxation*

Once an individual has been determined to be a resident of Canada by the Canadian taxing jurisdiction, it is important to determine the tax which will be applied. Generally, Canada taxes the world-wide income of everyone who is a resident of Canada at any time during the year including income that is earned in Canada by nonresidents.²⁸ The Canadian taxing jurisdiction covers world-wide income from sources both within and without Canada.²⁹ Nonresidents of Canada are liable for ordinary income tax payable in respect of employment or business income.³⁰ Professional athletes are considered

25. For purposes of this Note, an individual who is a citizen of another country but plays for a Canadian-based team would qualify as an individual who enters Canada as someone other than a sojourner. See generally Salmas, *supra* note 11, at 260 (discussing the situation of Roberto Alomar and the fact that he would be deemed as a part-time resident therefore not a sojourner).

26. See IT-221R2, *supra* note 10.

27. See Salmas, *supra* note 11, at 260.

28. See 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VI. Principal Taxes para. A. Income Tax, A-22, Oct. 13, 1997. See also DELOITTE AND TOUCHE 14.01, *supra* note 11 (stating that individual residents of Canada are liable for income tax on their worldwide income).

29. See 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. Income taxation para. B. The Canadian tax net 2. The tax base for Canadian residents, A-30, Oct. 13, 1997.

30. See *id.* sec. VII. Income taxation para. B. The Canadian tax net 3. The tax base for nonresidents of Canada, A-30. See also DELOITTE AND TOUCHE 14.01, *supra* note 11 (stating that nonresidents are liable on Canadian-source income including income from employment in Canada as well as income from carrying on a business in Canada). In general, business profits earned in Canada by nonresidents are not subject to Canadian income tax unless they were engaged in business in Canada under paragraph 2(3)(b) of the Income Tax Act. See Richard G. Tremblay, *Permanent Establishments in Canada*, 2 J. INT'L TAX'N 305, 305 (1992).

engaged in a trade or business.³¹ However, if a nonresident is carrying on a business in Canada, he may be exempt from Canadian tax based on the operation of a Canadian bilateral tax treaty.³² An athlete who is protected by a treaty "is subject to Canadian tax on his business profits only to the extent that these are attributable to a permanent establishment in Canada."³³ Article 16 of the United States-Canada Income Tax Treaty, Artists and athletes, states that earnings are subject to tax in the country of residence and in the country where the services are performed if gross receipts plus expenses reimbursed to the athlete, and borne on the athlete's behalf, exceed fifteen thousand dollars in the currency of the country of non-residence for the taxable year involved.³⁴ However, the provisions of Article Sixteen "shall not apply to the income of an athlete in respect of an employment with a team

31. In Canada, business is broadly defined to include a profession, calling, trade, manufacture, or undertaking of any kind. See 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. para. B. The Canadian tax net 3. The tax base for nonresidents of Canada a. Business Income, A-30, Oct. 13, 1997.

32. See *id.* at A-31.

33. *Id.*; United States-Canada Income Tax Convention, Article VII Business Profits, Aug. 16, 1984; Double Taxation Taxes on Income and Capital Convention Between the United States of America and Canada, Article VII Business Profits, Aug. 16, 1984, U.S.-Ca., 1984 WL 161896 [hereinafter Double Taxation Convention]. Both the United States-Canada Income Tax Convention and the Double Taxation Convention state:

business profits of a resident of a Contracting State shall be taxable only in that State unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

United States-Canada Income Tax Convention, art. VII; Double Taxation Convention, art VII. A permanent establishment is defined according to each separate treaty. See 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. para. B. The Canadian tax net 3. The tax base for nonresidents of Canada a. Business Income, A-30, Oct. 13, 1997.

34. See United States-Canada Income Tax Convention, Article XVI Artists and athletes, Aug. 16, 1984; Double Taxation Convention *supra* note 33, at Article XVI. The United States-Canada Income Tax Convention and the Double Taxation Convention state:

income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities do not exceed fifteen thousand dollars (\$15,000) in the currency of that other State for the calendar year concerned.

United States-Canada Income Tax Convention, art. XVI; Double Taxation Convention, art. XVI.

Tax treaties exist for two primary reasons. First, they attempt to prevent the problem of double taxation. See *infra* note 74. Second, treaties help to prevent the evasion of tax responsibility. See Debra Dobray & Tim Kreatschman, *Taxation Issues Facing the Foreign Athlete or Entertainer*, 9 N.Y.L. SCH. J. INT'L & COMP. L. 265, 278 (1988).

which participates in a league with regularly scheduled games in both Contracting States.”³⁵

For professional athletes in Canada, income from employment may include income from: (1) salaries;³⁶ (2) bonuses;³⁷ (3) fees;³⁸ (4) living and travelling expenses; (5) honoraria; (6) payment for time lost from other employment; (7) commuting expenses; (8) free use of automobiles; (9) awards;³⁹ (10) payments made by a club on a player's behalf that would otherwise be a non-deductible expense incurred by the player;⁴⁰ and (11) other benefits.⁴¹ The income tax payable is then determined by applying a percentage rate to the taxpayer's taxable income.⁴² The taxable income of the athlete is then subjected to a system of progressive taxation.⁴³

In addition to the Canadian federal tax, all Canadian provinces impose income taxes on individuals. In order to simplify collections, however, all provinces except Quebec charge their provincial tax as a fixed percentage of the federal tax payable and the federal government collects the tax from the provinces.⁴⁴ These tax rates vary from forty-five and a half percent of the federal tax in Alberta to sixty-nine percent of the federal tax in

35. United States-Canada Income Tax Convention, *supra* note 33, art. XVI. *See also* Double Taxation Convention, *supra* note 33, art. XVI (stating the same language as the U.S.-Canada Treaty); Paul Weisman & Ronald Rale, *U.S. Taxation of Athletes in U.S. and Abroad*, 1 J. INT'L TAX'N 218, 221 (1990) (“An exemption negates the Article 16 special provision where the athlete is performing services as an employee of a team that participates in a league with regularly scheduled games in both countries.”).

36. Salaries also include income from personal service contracts. *See* IT168R3 Athletes and Players Employed by Football, Hockey and Similar Clubs, May 13, 1991 (visited Nov. 4, 1998) <<http://www.rc.gc.ca/E/pub/tp/i168r3et/i168r3e.txt.html>>.

37. Bonuses may be given for good performance, for an all-star rating, or for signing bonuses, among others. *See id.*

38. These include fees for promotional activities or other special services performed on behalf of the club. *See id.*

39. These include cash as well as the fair market value of bonds, automobiles, and other merchandise. *See id.*

40. This may include agent's fees, legal fees, income taxes, and fines to name a few. *See id.*

41. *See id.*

42. *See* 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. Income taxation para. E. Computation of Income, A-51, Oct. 13, 1997.

43. *See* 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. Income taxation para. E. Computation of Income 1. Individuals, A-51, Oct. 13, 1997, states:

The federal rates are as follows and are subject to indexing:

<u>Taxable Income</u>	<u>Tax</u>
Up to \$29,590	17%
\$29,590-\$59,180	\$5,030 plus 26% on the next \$29,590
Over \$59,180	\$12,724 plus 29% on the remainder

Id.

44. *See id.* sec. VII. Income taxation para. A. Provincial income tax, A-27.

Newfoundland.⁴⁵ A surtax is also imposed on higher-income individuals in most provinces.⁴⁶ The "standard" provincial rate, however, is fifty-two percent.⁴⁷

C. *Determining United States Residency*

In determining the residency of a U.S. citizen, the Internal Revenue Code (IRC) applies. "[A]n individual who is a lawful permanent resident of the United States at any time during the calendar year is a [United States] resident."⁴⁸ However, a nonresident may be considered a U.S. citizen for tax purposes under IRC section 7701 based on the "green card" and "substantial presence" tests.

1. *The Green Card Test*

Under the IRC, "[a]n individual who holds or applies for an alien registration card—a 'green card'—during the calendar year attains [United States] resident status."⁴⁹ In applying the green card test, IRC section 7701(b)(3)(C)(i)-(ii) applies.⁵⁰ In lieu of obtaining a green card, a foreign athlete may also obtain a temporary work permit which will allow the athlete to work in the United States for up to one year.⁵¹ However, not all nonresident aliens wish to go through the process of obtaining a green card. Therefore, since most foreign athletes typically obtain a temporary work permit as opposed to obtaining a green card, the alternative "substantial presence" test is the more appropriate test for determining whether a foreign athlete will be considered a resident of the United States for income tax purposes.⁵²

45. See *id.*

46. See *id.*

47. See 955-2nd, Tax Management Foreign Income Portfolios, Business Operations in Canada, BNA, sec. VII. Income taxation para. E. Computation of Income 1. Individuals, A-51, Oct. 13, 1997.

48. Stephanie C. Evans, *U.S. Taxation of International Athletes: A Reexamination of the Artiste and Athlete Article in Tax Treaties*, 29 GEO. WASH. J. INT'L L. & ECON. 297, 299 (1995).

49. *Id.* at 299-300.

50. I.R.C. § 7701(b)(3)(C) (1998). I.R.C. § 7701(b)(3)(C) states:

[s]ubparagraph (B) shall not apply to any individual with respect to any current year if at any time during such year: such individual had an application for adjustment of status pending, or such individual took other steps to apply for status as a lawful permanent resident of the United States.

Id.

51. See Evans, *supra* note 48, at 300.

52. See *id.* at 300.

2. Substantial Presence Test

Under IRC section 7701(b)(3), an athlete meets the substantial presence test if he or she is "present in the United States on at least 31 days during the calendar year"⁵³ and "the sum of the number of days on which such individual was present in the United States during the current year and the [two] preceding calendar years . . . equals or exceeds 183 days[.]"⁵⁴ The 183-day requirement is calculated by counting each day of presence in the United States for the current taxable year as one full day.⁵⁵ Each day of presence in the United States for the first preceding calendar year counts as one-third of a day and each day of presence in the United States for the second preceding taxable year counts as one-sixth of a day.⁵⁶ However, an exemption applies for athletes who are temporarily in the United States in order to compete in charitable sporting events which are described in IRC section 274(l)(1)(B).⁵⁷ Therefore, days in which athletes are present in the United States for charitable sporting events will not be included in calculating the 183 days under the substantial presence test. In addition, when an athlete is present in the United States for less than 183 days during the calendar year, has a closer connection to a single foreign country than to the United States, has a tax home for the entire calendar year which is located in the same foreign country for which a closer connection is claimed, and is not currently taking steps to become a lawful permanent resident, that individual will not be considered a resident under the substantial presence test.⁵⁸

D. United States Taxation

Once an individual is determined to be a resident of the United States

53. I.R.C. § 7701(b)(3)(A)(i) (1998).

54. I.R.C. § 7701(b)(3)(A)(ii) (1998).

55. See Evans, *supra* note 48, at 300.

56. See I.R.C. § 7701(b)(3)(A)(ii) (1998); Evans, *supra* note 48, at 300.

57. See I.R.C. § 7701(b)(5)(A)(iv) (1998); Evans, *supra* note 48 at 300. In addition, altruistic, diplomatic, and educational desires have led Congress to allow foreigners to enter the United States and not have to worry about paying taxes. Examples of these situations include:

1) where an individual stays in [the United States] for an excessive period of time due to medical reasons; 2) where an individual is employed in a job related to a foreign government; and 3) where an individual is a visiting teacher, trainee, or student. Another exemption is [given] to those individuals who: 1) stays [sic] in the United States for under six months; 2) maintain a foreign tax home; and 3) can show a greater relationship to a foreign nation than to the United States.

Bennet Susser, *Achieving Parity in the Taxation of Nonresident Alien Entertainers*, 5 CARDOZO ARTS & ENT. L.J. 613, 622-23 (1986). The third exemption usually applies to foreign athletes and entertainers. See *id.* at 623.

58. See Ernest R. Larkins, *Individual Tax Planning: Resident vs. Nonresident May Be Critical*, 7 J. INT'L TAX'N 410, 414 (1996).

for tax purposes, the IRC again applies in order to determine the individual's tax liability. If an athlete is considered a U.S. citizen or resident alien of the United States for tax purposes, the athlete is: (1) subject to income tax on his United States income;⁵⁹ (2) subject to U.S. income tax on all of his foreign-source income;⁶⁰ (3) may be subject to tax on shares he owns in a foreign corporation on his pro rata share of the corporation's earnings if the corporation is either a foreign personal holding company or a controlled foreign corporation; (4) subject to U.S. income tax on all of his capital gains derived from both U.S. and foreign sources; (5) subject to U.S. gift tax on all gifts he makes of either U.S. or foreign property; (6) subject to U.S. tax on transfers by the individual of appreciated securities or property to a foreign company; and (7) subject to tax upon death on his estate based on all property owned by the individual whether it is located in the United States or anywhere else in the world.⁶¹

Under the IRC, "[a] nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxed . . . on his taxable income which is effectively connected with the conduct of a trade or business within the United States."⁶² Non-resident alien athletes performing in the United States are engaged in a trade or business and are subject to tax on their U.S. earnings.⁶³

The IRC provides that United States citizens as well as resident aliens are subject to tax on their world-wide income according to the general graduated tax rate scheme.⁶⁴ Income which is effectively connected with a United States trade or business is taxed, after allowable deductions, at the graduated rates applicable to United States citizens and resident aliens.⁶⁵ An

59. See Marshall J. Langer, *When Does A Nonresident Alien Become A Resident for U.S. Tax Purposes?*, 1976 J. OF TAX'N 220. See also Weisman & Rale, *supra* note 35, at 218 (discussing what is included in world-wide income). The article states:

Items that are generally includable in income of athletes who are U.S. citizens, resident aliens, or nonresident aliens include: wages, bonuses, loans having an interest rate below the applicable Federal rate to the extent of any imputed interest, and the value of meals and lodgings that are not furnished for the convenience of an employer on the employer's premises. Items that are excludable from the income of such athletes are: workers' compensation payments, damages paid for personal injuries, and medical reimbursement payments under an employer's health plan where no deduction was previously taken.

Id. at 222.

60. See Langer, *supra* note 59, at 220. However, an individual may generally take a foreign tax credit for foreign taxes paid. See *id.*

61. See *id.*

62. I.R.C. § 871(b)(1) (1998).

63. *Id.*; Weisman & Rale, *supra* note 35, at 218.

64. See Weisman & Rale, *supra* note 35, at 218. See generally I.R.C. § 1 (illustrating the different methods in which individuals can file their income taxes).

65. See I.R.C. § 871(b)(1) (1998); Dobray & Kreatschman, *supra* note 34, at 266.

athlete's federal taxable income is calculated by taking the athlete's gross income⁶⁶ and subtracting allowable deductions.⁶⁷ "Income from United States sources which is not effectively connected with a trade or business in the United States, is taxed without an allowance for deductions at a flat rate of thirty percent, unless that rate is reduced by a tax treaty."⁶⁸

Today, many athletes playing for professional teams have regular season games in both the United States and Canada. Therefore, they have income both from within and without the United States. IRC section 861(a)(3) provides in part that compensation for labor or personal services performed in the United States shall be treated as income from sources within the United States.⁶⁹ IRC section 862(a)(3) provides that "compensation for labor or personal services performed without the United States" shall be treated as income from sources without the United States.⁷⁰ Income Tax Regulation section 1.861-4(b) allocates the income earned by the athlete within and without the United States.⁷¹ Section 1.861-4(b)(1) provides that, for taxable years beginning after December 31, 1975, if no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when the labor or service is performed partly within the United States and partly without the United States, the amount to be included in gross income of a nonresident alien shall be determined on the time basis. This is the basis that most accurately reflects the proper source of

66. "[G]ross income includes wages, signing bonuses, performance bonuses, prize money, endorsements, royalties, license fees, personal appearance fees, gifts, and imputed interest on interest free loans." Ekmekjian, *supra* note 3, at 231.

67. *See id.*

68. Dobray & Kreatschman, *supra* note 34, at 272. *See also* I.R.C. § 871(a) (1998) (stating that a tax of 30% is imposed on a nonresident alien individual on the amount received from sources within the United States).

69. *See* I.R.C. § 861(a)(3) (1998). I.R.C. § 861(a)(3) also provides that the income of some nonresident athletes or entertainers who perform personal services may be exempt from United States income if they are only in the United States for a brief time and the income earned is minimal. The income from personal services performed in the United States will be exempt if: 1) the services are performed as an employee or under a contract with a nonresident alien individual, foreign partnership or corporation not engaged in a trade or business in the United States; 2) the services are performed while the nonresident alien is temporarily present in the United States for a period not to exceed a total of 90 days during the tax year; and 3) the compensation for the services does not exceed \$3,000. *See* I.R.C. § 861(a)(3).

70. I.R.C. § 862(a)(3) (1998).

71. *See* Treas. Reg. § 1.861-4(b).

income⁷² under the facts and circumstances of the particular case.⁷³ However, income from sources without the United States will generally not be treated as taxable income within the United States and therefore will not be taxed.⁷⁴

E. State Taxation

In addition to taxation at the United States federal level, athletes are also

72. Most often, the income is allocated on a time basis using the duty days method. See *infra* Part III.A.

[T]hat is, the amount to be included in gross income will be that amount which bears the same relation to total compensation as the number of days of performance of labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made.

Richard Gould, *1993 California Tax Policy Conference: Apportionment of Compensation Paid to Nonresident Professional Athletes*, 93 ST. TAX NOTES 232-2, Dec. 3, 1993.

73. See Treas. Reg. § 1.861-4(b); Gould, *supra* note 72.

74. See I.R.C. § 864(c)(4)(A) (1998). This provision helps alleviate the problem of double taxation. Double taxation refers to the problem that would occur if income were to be taxed both by the United States and Canada on the total income which is earned by the athlete. The problem of double taxation also occurs on the state level where athletes could be taxed by multiple states on the same base income received. See *infra* Part III.F.

The United States accomplishes relief from double taxation through a foreign tax credit. See Kimberly J. Tan Majure & Nancy S. Lindholm, *New U.S. Model Treaty Revises Business Profits, Residence Rules*, 7 J. INT'L TAX'N 532, 532 (1996). Under the foreign tax credit, a qualified taxpayer is allowed a tax credit for foreign income taxes paid which will, in turn, reduce the taxpayer's U.S. income tax liability. See Marc Yassinger, *An Updated Consideration of a Taxing Problem: The Harmonization of State and Local Tax Laws Affecting Nonresident Professional Athletes*, 19 HASTINGS COMM. & ENT. L.J. 751, 764 (1997). Section 911(a) of the IRC states that "there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year- (1) the foreign earned income for such individual. . . ." I.R.C. § 911(a)(1) (1998). In addition, § 911(b)(2)(A) states "[t]he foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate of \$70,000." I.R.C. § 911(b)(2)(A) (1998). This applies for taxable years beginning on or before December 31, 1997. See I.R.C. § 911(b)(2)(A). For years beginning after December 31, 1997, the I.R.C. states:

[t]he foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate equal to the exclusion amount for the calendar year in which such taxable year begins.

I.R.C. § 911 (b)(2)(A). Thus, an athlete will get a credit of up to \$70,000 on his U.S. income tax for the amount of money earned in Canada or any other foreign country if earned before December 31, 1997. If earned after December 31, 1997, the athlete will get a credit not to exceed the amount of foreign earned credit equal to the exclusion amount for the calendar year in which the taxable year begins. However, the foreign tax credit is subject to a limitation in that "the credit cannot exceed the same proportion of [the athlete's] U.S. tax, which the taxable income earned in the foreign country bears to [the athlete's] entire taxable income for the year." William H. Baker, *The Tax Significance of Place of Residence for Professional Athletes*, 1 MARQ. SPORTS L.J. 1, 31-32 (1990).

taxed on income at the state and local levels based on the state and local graduated rates.

In professional team sports, athletes compete for their teams in several different states within the United States.⁷⁵ Thus, athletes perform services in both their home state⁷⁶ as well as the states in which they play their away games. Since these athletes are engaging in a trade or business in each state, they are subject to income tax on the income they earn in every state.

Athletes are taxed by their home state based on their total income earned.⁷⁷ In addition, because athletes travel extensively to other states to compete in their respective team's games, the nonresident athlete may be subject to the income tax of the state in which he plays those games.⁷⁸

75. For a list of states which have professional teams for football, baseball, basketball, and hockey see K.P.M.G. PEAT MARWICK, *TAX PLANNING FOR PROFESSIONAL ATHLETES*, exhibit I.

76. Home state refers to the state in which the athlete's team is located. See Baker, *supra* note 74, at 14.

77. See Krasney, *supra* note 12, at 133.

78. See *id.* at 129. California and New York were at the forefront in taxing nonresident athletes. See Richard E. Green, *The Taxing Profession of Major League Baseball: A Comparative Analysis of Nonresident Taxation*, 5 SPORTS LAW J. 273, 281 (1998). In response to these states taking an aggressive stance on collection of athletes' income taxes, other states have enforced retaliatory taxes in order to recover the money in taxes that would otherwise have been paid to the resident state. An example of this is Illinois which proposed a state tax on nonresident athletes when they performed in Illinois. The tax was titled "Michael Jordan's Revenge" and was adopted July 29, 1992. See Ekmekjian, *supra* note 3, at 235. The tax was imposed because states were taking a big cut of Michael Jordan's salary. The Illinois tax only applies to athletes from states which have laws that impose a nonresident income tax on athletes who play for Illinois teams. See *id.* See also Novak, *supra* note 4, at 21 (discussing "Michael Jordan's Revenge" and stating that this retaliatory tax was levied against athletes who play for teams which impose a tax against Illinois athletes after the Chicago Bulls had to pay income taxes to California. The tax was imposed after the Bulls beat the Los Angeles Lakers to win the Bulls' first NBA championship).

Although states have begun imposing retaliatory taxes, there are some states which refuse to tax athletes or entertainers who come to their state to perform. An example is the state of Georgia. Georgia's governor, Zen Miller, vetoed a bill which "would have required nonresident professional athletes and performers to pay state income taxes" to Georgia. Ekmekjian, *supra* note 3, at 237. Miller's reason for not imposing a tax was he feared that the tax would make Georgia "less appealing for athletes and entertainers." *Id.* See also Elliot Almond, *Pro Athletes Find Rules Taxing: States Concoct Ways to Collect From Visiting Stars*, MILWAUKEE JOURNAL SENTINEL, Apr. 19, 1998, at 9 (discussing Georgia Governor Zen Miller's decision to veto an entertainer tax in 1992 and stating that it would discourage entertainers from coming to Georgia to perform). In addition, some cities have also refused to impose local income taxes on nonresident athletes and performers. An example is Pittsburgh which refused to impose an income tax on nonresident athletes, citing that imposing an income tax on visiting athletes and entertainers "would cause musicians and artists to avoid performing in Pittsburgh." Ekmekjian, *supra* note 3, at 237.

Generally, however, athletes are taxed on a "source basis"⁷⁹ and are only taxed on the portion of their income which is earned in the taxing state.⁸⁰ Presently, forty-three states and the District of Columbia impose a tax on personal income.⁸¹

Since athletes compete in regularly scheduled games in several different states,⁸² they earn income in several states and subsequently must file income tax returns in each jurisdiction. This has led to a serious problem because professional athletes are required to file returns in as many as twenty-four different states as well as the District of Columbia and several Canadian provinces.⁸³

In order to solve the problem of multiple filing, the Federation of Tax Administrators (FTA) set up a Task Force to determine possible solutions.⁸⁴ The task force has recommended "four options for resolving the uniformity

79. Taxation on a source basis is defined as income that "is taxable where it is earned or where the services giving rise to the income were performed." Federation of Tax Administrators, *FTA Report, State Income Taxation of Nonresident Professional Team Athletes*, March 1994, 94 ST. TAX NOTES 72-43, April 14, 1994 [hereinafter *FTA Report*]. The justification for taxing on a source basis is "that the state provides services to nonresidents who earn income in the state, and that sourcing is necessary to prevent low-tax states from becoming tax havens . . . for high-income [athletes] with income from several states." Andrew J. Hoerner, *A Nation of Migrants: When a Taxpayer Has Income from Several States*, 92 ST. TAX NOTES 71-13, Apr. 13, 1992.

80. See *FTA Report*, *supra* note 79.

81. States with no income tax include: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming. See Almond, *supra* note 78, at 9; Baker, *supra* note 74, at 3; Yassinger, *supra* note 74, at 763.

82. Athletes also have regularly scheduled games in Canada. An example can be illustrated using Chicago's professional teams and their team schedules for baseball, basketball, and hockey. In baseball, for the 1998 season, the Chicago Cubs had 162 total games with three games played in Canada. See *Chicago Cubs Team Schedule: Baseball news, scores, standings, stats and more from ESPN SportsZone* (visited Jan. 23, 1999) <<http://www.espn.go.com>>. In basketball, for the 1996-1997 season, the Chicago Bulls had a total of 90 games, three of which were played in Canada. See *Chicago season schedule* (visited Jan. 23, 1999) <<http://www.espn.go.com>>. In hockey, for the 1996-1997 season, the Chicago Blackhawks had a total of 82 regular season games of which 10 games were played in Canada. *Chicago season schedule* (visited Jan. 23, 1999) <<http://www.espn.go.com>>.

83. See Plattner, *supra* note 4, at 37 n.3. In Major League Baseball, teams reside in 17 different states as well as in two Canadian provinces. The National Basketball Association has teams which reside in 20 different states as well as the District of Columbia and two Canadian Provinces. The National Football League has teams in 21 different states and the District of Columbia. The National Hockey League has teams in 13 different states as well as the District of Columbia and six franchises in Canada. This, in turn, has led many athletes to complain about the difficulty of filing their tax returns. See generally Novak, *supra* note 4, at 21 (discussing the difficulties posed by having to file multiple tax returns).

84. See *FTA report*, *supra* note 79.

and compliance issues involved in the taxation of nonresident team members."⁸⁵

1. *Uniform Apportionment Model*

"The essence of a uniform [apportionment model] is an agreement among states hosting professional sports teams to treat all nonresident professional athletes playing in their respective states in the same manner."⁸⁶ This would provide for a consistent approach to the division of income by all states taxing nonresident team members.⁸⁷ "Athletes would allocate their income for tax purposes in the same way for each state in which they play."⁸⁸ This model would help address several problems facing athletes and tax authorities including "compliance, uniformity,⁸⁹ discrimination, and interstate tax warfare."⁹⁰

85. *Id.* The task force also made two recommendations to the states in regard to why there needs to be uniformity in filing. The first was that "[s]tates should adopt a uniform formula for apportioning the income of team members." *Id.* The task force stated that "[u]niformity is the key to insuring complete taxation of the income and appropriate treatment of the taxpayer as well as effectively forestalling any potential federal government intervention. In addition, the compliance burden facing taxpayers, teams and states can be addressed effectively only through a consistent method of taxation." *Id.*

The second recommendation was that "[s]tates should take affirmative steps to reduce the return filing and compliance burden facing team members and sports teams." *Id.* The task force stated:

[t]he practical difficulties and costs associated with the filing of tax returns in each of the states in which team members and teams perform are substantial and real and should be addressed by the states. State tax agencies also face compliance burdens in attempting to enforce their tax laws on an individual team member basis and in processing multiple returns with relatively small liabilities. The adoption of simplified filing approaches will help promote voluntary compliance among team members and teams and is thus in the best long-term interests of the states. The Task Force specifically recommends that states adopt either a simplified withholding system or a composite tax return alternative to allow the team members' return filing responsibilities to be met with a single, annual filing in each state on behalf of all eligible members of the team.

Id.

86. Krasney, *supra* note 12, at 159. See also Plattner, *supra* note 4, at 38 (stating that uniformity is a way of taking "affirmative steps to reduce filing and compliance burdens imposed on the athletes and their teams").

87. See *FTA Report*, *supra* note 79.

88. Krasney, *supra* note 12, at 159. See also Ekmekjian, *supra* note 3, at 247-48 (stating that a uniform apportionment model would have the states adopt similar allocation and enforcement regulations).

89. The lack of a uniform system for filing places an unreasonable burden on professional athletes and may lead to incomplete compliance. The result of this may lead to haphazard compliance efforts by athletes, and arbitrary and unfair enforcement efforts on behalf of state tax administrators. See Krasney, *supra* note 12, at 159; Yassinger, *supra* note 74, at 762.

90. Krasney, *supra* note 12, at 159.

2. Home State Apportionment

A second approach recommended by the FTA is the home state apportionment method. Under this approach, "all compensation received by an athlete would be deemed to have been earned in the state where the athlete plays his home games[,]""⁹¹ or otherwise maintained the team's primary facilities.⁹² Therefore, the athlete would only have to file returns in his team's home state and in his or her state of residency.⁹³ In addition, "states would continue to collect the same amount of tax revenues without the current compliance burdens."⁹⁴ Other advantages to this formula are that "it is simple to comply with and easy to enforce."⁹⁵ This would also help to avoid the problem of double taxation.⁹⁶

Although home state apportionment is the favored model of the various players' associations, there are some disadvantages. The major disadvantage with this method of apportionment is the potential conflict with the United States Constitution. Home state apportionment would obligate the home state to require a nonresident to include in their tax base income which is derived from services performed outside of the state.⁹⁷ Another disadvantage is that the home state apportionment method "tends to merge together the two taxing concepts of source and residence."⁹⁸ A final disadvantage is that athletes will

91. *Id.* at 162. This method of apportionment is also the system which is most favored by the various players associations. See *id.*; Leslie A. Ringle, *State and Local Taxation of Nonresident Professional Athletes*, 2 SPORTS LAW J. 169, 181-82 (1995).

Because half of the games an athlete plays are in the state of the home team and half of the games are away games, home state apportionment would result in a state receiving about the same amount of revenue it would if it apportioned the income of all visiting teams. See *id.* at 182; *FTA Report*, *supra* note 79, n.6.

[A] team member would face roughly the same total liability as if all teams apportioned income for games played away from home, dependent on several variables including the parity of total salary levels among teams, the parity in the amount of time spent in-state and out-of-state by a team member, and parity in income tax rates among states.

Id.

92. See Yassinger, *supra* note 74, at 761; Plattner, *supra* note 4, at 38; Ringle, *supra* note 91, at 181.

93. See Krasney, *supra* note 12, at 162; Ringle, *supra* note 91, at 182; Green, *supra* note 78, at 300.

94. Ringle, *supra* note 91, at 182.

95. Krasney, *supra* note 12, at 163.

96. See *id.* See also *supra* note 74 (discussing the problem of double taxation).

97. See Ringle, *supra* note 91, at 182. This is not a problem if the athlete is a resident of the home state. However, if the athlete is a nonresident, the home state may be in violation of the due process clause. See *id.*; *FTA Report*, *supra* note 79, n.9; Yassinger, *supra* note 74, at 761.

98. Krasney, *supra* note 12, at 163. Source refers to the place where the income is earned as opposed to residence which refers to where the athlete is domiciled. *Id.*

The concept of source and residence are merged because the home state, in the context

avoid double taxation "only if their state of residence provides a credit for taxes paid to their home state."⁹⁹ In addition, if this method is used, "municipalities would lose the ability to tax nonresident professional athletes."¹⁰⁰

3. *Base State Model*

The third recommendation by the FTA task force is the base state model. Under this approach, the tax return filing responsibilities are "satisfied by a single filing with the state in which the team was domiciled, which state would, in turn, be responsible for providing the relevant information and funds to all other states involved[.]"¹⁰¹ However, a problem with this approach is that states are often ill-equipped with the resources and funds necessary to perform such a task.¹⁰²

4. *Partnership Model*

The final recommendation by the FTA task force is the partnership model. Under this approach, the tax return filing responsibilities are satisfied through a composite or consolidated return filed on behalf of all eligible team

of home state apportionment, refers to the state in which the athlete plays his home games. However, the state where the athlete plays his home games may not be the state of residency of the athlete. The problem with this is that the concepts of source and residence are competing theories under which the states have established their taxing jurisdictions. *See id.*

99. *Id.* For a list of states that provide tax credits, see *infra* note 106.

100. Krasney, *supra* note 12, at 163. The reason municipalities would lose their ability to tax is because the taxes would be issued and collected by the state as opposed to the municipality. Thus, it is the state which is taxing and collecting and not the municipality. If the municipality wants to collect taxes, they would have to collect from the state. *See id.*

101. *FTA report, supra* note 79. *See also* Plattner, *supra* note 4, at 38 (stating that an athlete could file a single return with the state in which the athlete is domiciled); Ringle, *supra* note 91, at 180 (addressing that the athlete need only file a return in the state where the athlete is domiciled); Yassinger, *supra* note 74, at 762 (discussing that an athlete would be responsible for filing a single return in the state in which the athlete is domiciled). *See generally* Ekmekjian, *supra* note 3, at 248 (describing the base state model as the composite return system and a centralized filing system where the athlete is required "to file one state return and have that state allocate the tax payments to the other states based on a predetermined formula"). This approach is similar to the International Fuel Tax Agreement (IFTA) which apportions tax liability on interstate motor carrier fuel use. Under IFTA, an interstate carrier is liable for fuel tax on the basis of the proportion of miles traveled in each state. A carrier files a single tax return in the "base state" or state of domicile rather than filing with each state in which he traveled. The base state then provides payments and information to any other state in which the carrier operated. *See FTA report, supra* note 79, at n.7.

102. *See* Ekmekjian, *supra* note 3, at 248.

members.¹⁰³ This may be a good solution because the teams themselves are in the best position to have all of the pertinent tax information required. This model has been endorsed by some teams.¹⁰⁴

F. Tax Credits

Once the filing requirements have been determined, the next focus for the athlete is to determine the amount taxable to each taxing jurisdiction in which they participate and how the tax is to be calculated. To avoid double taxation,¹⁰⁵ the home states and states of residency provide tax credits for income that is allocable to nonresident states.¹⁰⁶ However, "[b]ecause the state issues a credit, the athlete's overall tax bill remains unchanged."¹⁰⁷ The "purpose of a tax credit is to avoid double taxation of nonresident income."¹⁰⁸ The states have varying policies in regard to tax credits. A number of states only provide a tax credit if the nonresident state allows a similar credit. As of

103. See Yassinger, *supra* note 74, at 762; Green, *supra* note 78, at 300; Plattner, *supra* note 4, at 38. This model may be analogized "to a scheme in which many states permit large multi-state partnerships to file a composite return on behalf of nonresident partners." Yassinger, *supra* note 74, at 762. See generally *FTA report*, *supra* note 79, at n.18 (stating that this option is similar to current provisions in other states which allow composite return filings by partnerships on behalf of nonresident partners).

104. See Yassinger, *supra* note 74, at 762.

105. See *supra* note 74. But see Plattner, *supra* note 4, at 36 (stating that there is fear of potential double taxation notwithstanding the income tax credit which is generally offered by states to their residents).

106. See Krasney, *supra* note 12, at 134 n.28. States that allow tax credits include: Alabama, Arizona, Arkansas, California, Colorado, Delaware, the District of Columbia, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont, Virginia, West Virginia, and Wisconsin. See *id.* at 134 n.30. See also Green, *supra* note 78, at 296 (addressing some of the states that have allowed tax credits); Overstreet, *supra* note 4, at A1 (noting that states allow tax credits); Ringle, *supra* note 91, at 171 (mentioning that athletes' states of residence generally offer tax credits); Williams & Horgan, *supra* note 2, at A1 (stating that states allow tax credits).

107. Ekmekjian, *supra* note 3, at 241. See also Gottschalk, *supra* note 4, at A1 (stating that it ends up becoming a "zero sum game" because an athlete will get a tax credit for paying taxes in another state in which he plays); Yassinger, *supra* note 74, at 763 (stating that since states grant credits for income taxes paid in other states, an athlete theoretically should not be paying any additional state tax).

108. Krasney, *supra* note 12, at 134. Each state grants a tax credit for the taxes paid to other states. See Yassinger, *supra* note 74, at 762-63. "In order to compensate for the reciprocal loss of this potential tax revenue due to the granting of the credit, states have been virtually forced to take a more active stance in collecting taxes from nonresident professional athletes." *Id.* However, athletes who reside in states which do not assess any state income tax are now responsible for paying nonresident taxes to the states which aggressively tax nonresident athletes. Thus, the athletes end up having to pay state income taxes to the states in which they compete. See Green, *supra* note 78, at 292.

1995, only eighteen states granted residents tax credits for any income taxes paid to other states.¹⁰⁹ However, three states grant no tax credit for taxes paid to other states.¹¹⁰ States will often place restrictions on tax credits they allow. The most common restriction is to allow a credit only for taxes paid to a nonresident state on income derived from sources within the nonresident state.¹¹¹ A second restriction is to grant a credit if the other state's income tax is levied regardless of where the athlete is a resident or is domiciled.¹¹² The third restriction is that a credit will only be allowed for tax paid on earned or business income.¹¹³

In addition to tax credits, some states also have reciprocal tax agreements with other states.¹¹⁴ Reciprocal agreements "allow the taxation of

109. See Krasney, *supra* note 12, at 134-35. The states that allow credits only if the credits allowed are reciprocal are: Alabama, Colorado, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New Mexico, North Dakota, Ohio, Pennsylvania and Wisconsin. See *id.* at 135 n.31.

110. See *id.* at 135. Those states are Connecticut, New Hampshire, and Tennessee. See *id.* at 135 n.32.

111. See *id.* at 135. States that use this restriction include: Arizona, Arkansas, California, Delaware, Maine, Missouri, Montana, Nebraska, New York, Oklahoma, Oregon, Utah, Vermont, and West Virginia as well as the District of Columbia. See *id.* at 135 n.33; Ringle, *supra* note 91, at 181. But see Green, *supra* note 78, at 279 n.48 ("Colorado Department of Revenue extends a courtesy and does not require athletes associated with non-Colorado sports to file a Colorado income tax return.").

112. See Krasney, *supra* note 12, at 135. States that use this restriction include Arizona, California, Hawaii, Idaho, Louisiana, and Montana. See *id.* at 135 n.34. But see Baker, *supra* note 74, at 27 (discussing the situation where an athlete is a resident of one state but resides during the sports season in the state of his home team. This athlete would be a resident of his home state for income tax purposes and may or may not receive a credit for income taxes paid to the home state depending on the laws of the home state.).

113. See Krasney, *supra* note 12, at 135. The only state which allows a credit for tax paid on earned or business income is Virginia. See *id.* at 135 n.35.

114. Currently, 15 states have reciprocal agreements with other states. The states in the left hand column each have reciprocal agreements with the states listed to the right of that state.

Illinois: Iowa, Indiana, Kentucky, Michigan, and Wisconsin

Indiana: Illinois, Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin

Iowa: Illinois

Kentucky: Illinois, Indiana, Michigan, Virginia, West Virginia, and Wisconsin

Maryland: District of Columbia, Pennsylvania, Virginia, West Virginia, and Wisconsin

Michigan: Indiana, Iowa, Kentucky, Minnesota, Ohio, and Wisconsin

Minnesota: Michigan, North Dakota, and Wisconsin

Montana: North Dakota

New Jersey: Pennsylvania

North Dakota: Minnesota and Montana

Ohio: Indiana, Kentucky, Michigan, Pennsylvania, and West Virginia

Pennsylvania: Indiana, Maryland, New Jersey, Ohio, Virginia, and West Virginia

Virginia: District of Columbia, Maryland, and West Virginia

Wisconsin: Illinois, Indiana, Kentucky, Maryland, Michigan, and Minnesota

West Virginia: Kentucky, Maryland, Ohio, Pennsylvania, and Virginia.

all income of a resident of one of the states that is [a] party to the agreement and earned in either of the states to be taxed in the taxpayer's state of residence."¹¹⁵

However, one problem with the credit system is the variation in tax rates between the states.¹¹⁶ Thus, the state of residency will only give a tax credit for the income tax which the state of residency applies. Anything over that percentage will still be owed to the nonresident state.¹¹⁷ Conversely, if the athlete's state of residency taxes at a higher rate on income earned than the nonresident state, the athlete will get a full credit from his state for the tax allocable to the nonresident state. In addition, states vary on the amount of income they will tax. For example, California taxes athletes' total income as opposed to New York which only taxes the income earned in New York.¹¹⁸

Besides the problem associated with the application of different tax rates from state to state, the difference in tax rates also affects the athlete's choice of where to perform. For example, if an athlete performs as a member of a team that plays in Missouri, where the tax rate is only 6%, and is traded to California where the tax rate is 9.3%, and the athlete is earning the same salary, the athlete's contract will be worth at least 3.3% less than it was before the athlete was traded to the California team.¹¹⁹ In addition, many athletes

See Hoerner, *supra* note 79.

115. *Id.*

116. For example, California taxes at a rate of 9.3% on income in excess of \$23,950, Cal. Rev. & Tax Code § 17041 (West 1983 & Supp. 1989), and New York imposes a rate of 8% on income exceeding \$12,400, N.Y. Tax Law § 601 (McKinney 1984 & Supp. 1988). See Baker, *supra* note 74, at 3. North Dakota taxes at a rate of 12% on income over \$50,000, Montana imposes a rate of 11% minus \$1,897 for income in excess of \$66,400, Hawaii taxes at a rate of 10% for income over \$41,000, Iowa taxes at a rate of 9.98% for income over \$48,645, the District of Columbia taxes at a rate of 9.5% on income over \$20,000, Oregon taxes at a rate of 9% for income over \$5,400, Maine taxes at a rate of 8.5% on income over \$16,500, Minnesota taxes at a rate of 8.5% for income over \$93,340, and New Mexico taxes at a rate of 8.5% for income in excess of \$100,000. See Mark Nowlin, *The Tug for Taxes*, THE SAN DIEGO UNION & TRIB., May 25, 1997, at C15.

117. An example of this can be demonstrated by using the tax rates of Missouri and California. Missouri taxes individuals at a rate of 6% for all income in excess of \$9,000. This rate applies to all nonresident athletes. Missouri also offers a credit to athletes for the percentage of their income that the nonresident state has taxed. However, since Missouri only has a 6% rate of tax, if the athlete performs in California where they apply a 9.3% tax rate, the athlete will still owe 3.3% in taxes to California. Thus if California taxes an athlete on \$100,000 of his income, the athlete still owes \$3,300 to California. See Green, *supra* note 78, at 287-88.

118. See Overstreet, *supra* note 4, at 1. Compare Cal. Rev. & Tax Code § 17041 (West 1998) and N.Y. Tax Law § 1304 (West 1998) (showing the difference in how the tax rates are applied).

119. An example of this is illustrated by looking at the situation of Juwan Howard, a basketball player for the Miami Heat. Howard had a \$100 million contract with the Miami Heat. When Howard was traded to the Washington (D.C.) Bullets, now the Washington (D.C.) Wizards, Howard lost \$4.2 million on the trade in taxes. See Chris Jenkins, *The Tug for Taxes*:

prefer to play in the states which have no income tax¹²⁰ or even decide to change residency to states that have no income tax.¹²¹ Despite having to pay taxes to nonresident states, athletes are able to maximize their income by minimizing their tax liability by choosing to live in a state that does not impose state income taxes.¹²² Thus, when free agents go shopping for a team, those states with no state income tax will likely be higher on the list. In addition, this would deter athletes who may be thinking of playing for a Canadian based team where the tax rates are even more exorbitant.¹²³

III. ALLOCATION METHODS

Athletes owe taxes to Canada as well as the United States at the federal, state, and local levels. In order to determine how the taxes will be allocated, different allocation methods have been used. These allocation methods include the duty days method, the games played method, and the de minimus rule.

These Days, Uncle Sam Isn't the Only One Reaching for a Piece of Those Big Paychecks, SAN DIEGO UNION & TRIB., May 25, 1997, at C1.

Due to situations such as this, if a player is negotiating a contract with a team in a state with a higher income tax, the athlete may demand a more lucrative salary. See Green, *supra* note 78, at 299. "[A] player might even decide to accept a lower salary with a team in a state that has no income tax instead of a higher salary from a team in a state with a significant state income tax." Baker, *supra* note 74, at 4. An example of this may be demonstrated by looking at the decision of free agent Alex Fernandez, a former member of the Chicago White Sox. Fernandez reportedly considered a five year offer from the Cleveland Indians for \$38 million but instead accepted a reported five year, \$36 million contract with the Florida Marlins. Fernandez was cited as commenting that one of his reasons for accepting a lower offer was that Florida did not have a state income tax so the offers were virtually the same. See Sheldon I. Banoff and Richard M. Lipton, *Want to Sign Free Agents? Lower Your State Taxes!*, J. TAX'N 127, 127 (1997).

120. For a list of the states which do not impose an income tax, see *supra* note 81.

121. An example of this can be illustrated by the advice agents give to their clients. As stated by the vice president of IMG, a Cleveland-based management firm that handles some of the world's richest athletes, "[t]he first move for a golfer is definitely to move to Florida, especially if you're a California resident[.]" Jenkins, *supra* note 119, at C1.

Another reason to move to a state with no personal income tax is if the athlete will be receiving a signing bonus. See Tom Weir, *Facing a Wealth of Decisions Taxation: Saving Key Issues Athletes Need to Understand*, USA TODAY, Aug. 26, 1998, at 03C.

122. See Green, *supra* note 78, at 292; Jenkins, *supra* note 119, at C1; Nowlin, *supra* note 116, at C15.

123. See Elliot Almond, *Athletes Playing in Canada Face a Ferocious Tax Bite*, SEATTLE TIMES, Apr. 19, 1998, at 9; Jenkins, *supra* note 119, at C1. In addition to the high tax rates in Canada, athletes are forced to put clauses in their contracts that they want to be paid in American as opposed to Canadian dollars because the Canadian dollar is worth less than the American dollar. *Id.*

A. Duty Days

Once jurisdictions began taxing athletes on their income earned within that taxing jurisdiction, it was important to find some uniform method in which to allocate the athlete's income throughout the different taxing jurisdictions. In order to help solve this problem, a Task Force was created by the Federation of Tax Administrators (FTA).¹²⁴ Based on the Task Force recommendations, the most widely used apportionment formula that allocates income between taxing jurisdictions is the duty days method.¹²⁵

Under this formula, duty days include "all days from the beginning of pre-season training through the last day in which the team competes."¹²⁶ Duty days also include days in which the individual is required to perform services that fall outside of the above mentioned period such as instructional leagues, "all-star" games, or other promotional events.¹²⁷ Duty days also include "days during the off-season when a team member undertakes training activities as part of a team-imposed program, but ONLY IF CONDUCTED AT THE FACILITIES OF THE TEAM."¹²⁸

Each duty day will be assigned to the state in which the service is performed. Days in which a team member is on the disabled list AND performing no services for the team will not be apportioned to any particular state, but will be included in the total number of duty days for apportionment purposes.¹²⁹

124. See Plattner, *supra* note 4, at 36. See generally Hoerner, *supra* note 79 (discussing that the purpose of the FTA task force was to help determine the appropriate and uniform methods for apportionment of income, and to improve compliance through improved withholding systems).

125. See Dan Weissman, *Professionals Face Hodgepodge of State Rules: Taxing Athletes Confuses the Goal*, STAR-LEDGER, Oct. 29, 1995, available in 1995 WL 11792033.

126. Gould, *supra* note 72. See also Ekmekjian, *supra* note 3, at 238 (stating that duty days include all days from the beginning of the team's official pre-season training through the last game in which the team competes including post-season games); Ringle, *supra* note 91, at 174 (mentioning that duty days include all days from the beginning of official preseason training through the last game in which the team competes).

127. See *FTA Report*, *supra* note 79; Paul R. Comeau & Mark S. Klein, *New York's Revised Audit Guidelines for Nonresident Allocations Raise Questions*, 5 J. MULTISTATE TAX'N 263, 267 (1996); Gould, *supra* note 72; Yassinger, *supra* note 74, at 758.

128. *FTA Report*, *supra* note 79.

129. *Id.* See also Gould, *supra* note 72 (stating that days in which the athlete is injured are considered duty days and are assigned to the home state); Salmas, *supra* note 11, at 270 (discussing that duty days include days in which the athlete is disabled). See generally Jenkins, *supra* note 119, at C1 (mentioning that in Missouri, an athlete will be required to pay taxes for days that the athlete was on the disabled list and did not make the trip, as well as in situations where a pitcher for a baseball team does not pitch that day).

Travel days are also included in the apportionment formula. Travel days which include a game, a required practice, or a meeting or other service, are apportioned to the state in which the game, practice, or service is conducted.¹³⁰ "Travel days involving no game, practice or required service will not be apportioned to any particular state, but will be included in the total number of duty days."¹³¹

The income which is to be apportioned by the duty days formula includes all compensation paid to a team member for the performance of team service including regular and pre-season games, as well as performing required training or otherwise performing required services.¹³² Income which is not included in this formula consists of "strike benefits, severance pay, termination pay, contract buy-out payments, relocation payments and other payments not related to the performance of services."¹³³

This formula applies to active team members, team members on the disabled list, and other persons required to travel with and perform services on behalf of a professional team including coaches, managers, and trainers.¹³⁴ The formula is designed to apply to any professional sports team.¹³⁵ However,

[i]f it is determined that the [duty days] formula does not fairly apportion a team member's income, the state tax agency may require the team member to use an alternative formula prescribed by the agency. In addition, the team member may request approval of the state tax agency to use an alternative apportionment formula if it is considered that the [duty days] formula produces an unfair result.¹³⁶

130. See *FTA Report*, *supra* note 79; Comeau & Klein, *supra* note 127, at 267; Yassinger, *supra* note 74, at 758-59.

131. *FTA Report*, *supra* note 79. See also Ringle, *supra* note 91, at 183-84 (stating that travel days not involving a game, practice, or team meeting are included in the total number of duty days but not apportioned to any particular state); Green, *supra* note 78, at 285 (discussing the example of a New York resident athlete and stating that travel days not involving a game, practice, team meeting, or other team event are not considered duty days spent in New York State but are considered in the total duty days spent both within and without New York State).

132. See *FTA Report*, *supra* note 79; Comeau & Klein, *supra* note 127, at 267.

133. *FTA Report*, *supra* note 79. See also Comeau & Klein, *supra* note 127, at 267 (stating that strike benefits, severance or termination pay, and certain other benefits are not included); Weissman, *supra* note 125 (stating that players will not be taxed for days on the disabled list, severance pay, termination pay, or contract buy-out payments).

134. See Comeau & Klein, *supra* note 127, at 267; Gould, *supra* note 72.

135. See *FTA Report*, *supra* note 79.

136. *Id.* See also Yassinger, *supra* note 74, at 759 (stating that if the state tax agency determines that the duty days formula does not apportion an athlete's income fairly, the state tax agency may require the athlete to use an alternative formula which is approved by the state tax agency). But see *In the Matter of the Appeal of Joseph Barry Carroll*, 1987 Cal. Tax LEXIS 75, at *1 (1987) (State Board of Equalization of the State of California) (per curiam) (holding that where Carroll, a professional basketball player, wanted to apportion his income based on

Thus, the amount of tax allocated to the taxing agency is determined by taking the total number of duty days allocated to the taxing agency and dividing them by the total number of duty days. That ratio is then multiplied by the athletes total taxable income in order to determine the amount that is allocated to each taxing agency.¹³⁷

The duty days formula is the most widely used formula because it most accurately allocates income between the different taxing jurisdictions.¹³⁸ Since its inception, several states who had not previously used this method, have adopted a formula similar to that which the FTA has proposed.¹³⁹ Today, almost all states use the duty days formula to allocate income between taxing jurisdictions, as does Canada.¹⁴⁰ The duty days method is also used to allocate income under the income tax treaty between the United States and Canada¹⁴¹ and is used by the IRS for allocation purposes.¹⁴² Although the FTA report only addresses the applicability of the duty days apportionment method for athletes who play basketball, baseball, football, and hockey, other leagues which are likely to take advantage of this method include: the Continental Basketball Association, the Arena Football League, Major League Soccer, and minor league baseball.¹⁴³

B. Games Played

A second method of allocation that has been used by athletes to apportion their income between the different taxing jurisdictions is the "games played" method. Under this method, "compensation to the athlete is apportioned based on the ratio of games played in a particular jurisdiction to

the games played formula, Carroll had to use the duty days apportionment formula).

137.

$$\frac{\text{Number of duty days performed in the taxing jurisdiction}}{\text{Total number of duty days allocable}} \times \text{taxable income} = \text{amount of income}$$

138. See Weissman, *supra* note 125.

139. See Iowa Department of Revenue and Finance, *Iowa Department of Revenue and Finance Proposes to Change Rules for Taxing Compensation of Nonresident Athletes*, 95 ST. TAX NOTES 116-H, June 16, 1995; New Jersey Division of Taxation, *New Jersey Division of Taxation to Establish Apportionment Method to be Used by Nonresident Athletes*, 95 ST. TAX NOTES 194-22, Oct. 6, 1995; Department of Revenue, *Wisconsin Department of Revenue Proposes Allocation Rule for Professional Athletes*, 96 ST. TAX NOTES 1-47, Jan. 2, 1996.

140. See generally Green, *supra* note 78, at 285-92 (noting that some taxing jurisdictions that use the duty days formula include: California, New York, Ohio, Missouri, Minnesota, Wisconsin, Illinois, New Jersey, and Canada).

141. See Krasney, *supra* note 12, at 137. See generally Salmas, *supra* note 11, at 272-75 (discussing the application of the Canada-United States Income Tax Convention).

142. See Ringle, *supra* note 91, at 175.

143. See Yassinger, *supra* note 74, at 767-68.

the total [number of] games played."¹⁴⁴ Pre-season and post-season games are also included as total games in determining the applicable ratio.¹⁴⁵ This ratio is then multiplied by the athlete's taxable income in order to determine the taxable income allocable to the particular taxing jurisdiction.¹⁴⁶

The benefit of using this allocation method is that, unlike the duty days method, it is easy to determine what the numbers in the ratio are since they are simply the number of games in which the athlete performed.¹⁴⁷ However, the games played formula does have its shortcomings. Unlike the duty days formula, the games played formula fails to reflect that athletes are paid for services in addition to game performances such as practice days,¹⁴⁸ team meetings,¹⁴⁹ and public relations activities.¹⁵⁰ A second problem regarding the games played method is that this method of taxing leads to an inequality in the apportionment of income taxed in the nonresident jurisdictions in which they perform.¹⁵¹ In addition, using a games played formula generally means higher revenues for the taxing body since the denominator of the fraction is reduced, as compared to the duty days formula.¹⁵²

Due to these problems, states have abandoned the games played formula in favor of the duty days formula. The last major state to use the games

144. Krasney, *supra* note 12, at 137. For a discussion of the games played method, see Pierog, *supra* note 4, at 5; Ekmekjian, *supra* note 3, at 240; Green, *supra* note 78, at 284-85; Ringle, *supra* note 91, at 178; Yassinger, *supra* note 74, at 760-61.

145. See Comeau & Klein, *supra* note 127, at 267; Ekmekjian, *supra* note 3, at 240. Krasney, *supra* note 12, at 138.

146. An illustration for the calculation of tax using the games played method is:

$$\frac{\text{Total number of games played in the taxing jurisdiction}}{\text{Total number of games played}} \times \text{total income} = \text{total income allocable}$$

147. See Plattner, *supra* note 4, at 37.

148. See Krasney, *supra* note 12, at 138; Ekmekjian, *supra* note 3, at 240; Green, *supra* note 78, at 285; Overstreet, *supra* note 4, at 1.

149. See Yassinger, *supra* note 74, at 761; Ekmekjian, *supra* note 3, at 240.

150. See Plattner, *supra* note 4, at 37; Ekmekjian, *supra* note 3, at 240.

151. See Overstreet, *supra* note 4, at 1. For example, when a football player plays a game on Sunday, he is only in that taxing jurisdiction for a few days. However, one-sixteenth of his income will be taxed in that nonresident jurisdiction (this is excluding pre-season and post-season games and assumes that the regular season is sixteen games long). This can be compared to the duty days method where the ratio would be 2/180. This amount of the athlete's income will be taxed in that nonresident jurisdiction. The difference in ratios between the duty days and games played formulas most likely differs the least for baseball players, since they have more games and less practices as compared to athletes performing in football, basketball, and hockey. See Green, *supra* note 78, at 285.

152. See Ringle, *supra* note 91, at 179; Plattner, *supra* note 4, at 37. See generally Susser, *supra* note 57, at 640-41 (illustrating the problem of higher revenue for the taxing state with the example of a rock star).

played formula was New York.¹⁵³ However, effective January 1, 1995, New York switched to the duty days method of apportionment.¹⁵⁴

C. *De Minimus Visits Exception*

A final method in which an athlete's income may be allocated is based on the de minimus exception. This is not so much a method of allocation as it is a reprieve that certain states give to visiting athletes to ease their tax burdens. States that use the de minimus visits exemption, "exempt certain individuals who are deemed to have had only minimal contacts with the taxing state from nonresident taxation."¹⁵⁵

IV. CONTRACT PLANNING

An athlete's career is never certain due to fierce competition in the various professional sports leagues, as well as the possibility of injury. Therefore, it is important for the athlete to save money during what may be a short career to provide for a long retirement.¹⁵⁶ One way an athlete may be able to keep more of his earnings is by using the duty days method to structure his employment contract in such a way as to include off-season conditioning in his contract, thereby increasing the denominator of the duty days fraction. By increasing the denominator of the fraction, the duty days ratio will decrease and thus, when the ratio is multiplied by the athlete's income, the athlete will have less taxable income, thereby decreasing the athlete's tax liability.¹⁵⁷

153. See Green, *supra* note 78, at 284-85. Other states which have utilized the games played formula include Oregon and Pennsylvania. See Ekmekjian, *supra* note 3, at 240.

154. See Comeau & Klein, *supra* note 127, at 267; Green, *supra* note 78, at 285; New York State Department of Taxation and Finance Adopts Personal Income Tax Amendments Concerning Professional Athletes, 94 ST. TAX NOTES 208-29, Oct. 27, 1994.

155. Krasney, *supra* note 12, at 138. New Jersey will exempt those who maintain a permanent place of residence elsewhere and spend no more than thirty days of the taxable year in New Jersey. See *id.* Massachusetts has a de minimus exception where athletes are exempt from tax if they spend less than ten days in Massachusetts. See *id.* at 139; Almond, *supra* note 78, at 9. Still other states such as Minnesota, Missouri, and Wisconsin exempt nonresident athletes from tax when their income is below a certain dollar amount. See Krasney, *supra* note 12, at 139; Ekmekjian, *supra* note 3, at 246.

156. See GREGORY J. REED, TAX PLANNING AND CONTRACT NEGOTIATION TECHNIQUES FOR CREATIVE PERSONS, PROFESSIONAL ATHLETES, AND ENTERTAINERS 6 (1978) (stating that creative persons, professional athletes, and entertainers have become increasingly aware of the need to conserve capital in order that they may continue to live according to the manner in which they are accustomed).

157. This is especially true when the athlete is a resident of a state that does not have a state income tax. If the athlete is a resident of a state that does not have a state income tax, the only state income tax the athlete will pay is when the athlete must travel to away games. Thus, by including mandatory training programs in the off-season, the athlete will decrease his ratio for

A. Case History

This section will discuss two cases in which courts have been called on to decide whether off-season conditioning may be included in the application of duty days.¹⁵⁸ Under the facts of both cases the courts held that off-season conditioning will not be included in duty days.¹⁵⁹ However, the cases do suggest that it is possible that off-season conditioning may be included under certain circumstances.¹⁶⁰

The first of these cases is *Stemkowski v. Commissioner*.¹⁶¹ Peter Stemkowski was a professional hockey player and a Canadian resident during the off-season. One of the issues in *Stemkowski* was:

[w]hether the Tax Court correctly held that the stated salary in the NHL Standard Player's Contract covered only the services of [the] taxpayer during the regular hockey season and not during the off-season, training camp, or the play-offs, so that only the time a player spent in Canada during the regular season could be used to calculate the portion of his salary excludable from his United States income.¹⁶²

The court held that the contract did not cover off-season services, but that the contract did compensate for training camp and the play-offs as well as the regular season.¹⁶³ The court reasoned that "[f]itness is not a service performed in fulfillment of the contract but a condition of employment."¹⁶⁴ The court also reasoned that there was no evidence that Stemkowski was required to follow any mandatory conditioning program nor was Stemkowski under any club supervision during the off-season.¹⁶⁵ However, one interpretation of the court's decision may be that if Stemkowski had proven that he was required by his contract to follow a mandatory conditioning

out-of-state tax purposes and therefore lower his total income tax liability.

158. See, e.g., *Stemkowski v. Commissioner*, 690 F.2d 40 (2nd Cir. 1982); *Favell v. United States*, 16 Cl. Ct. 700 (1989).

159. *Stemkowski*, 690 F.2d at 45; *Favell*, 16 Cl. Ct. at 722.

160. Both of these cases were decided before the FTA's task force report on the unification of taxation issue. See Gould, *supra* note 72.

161. *Id.* at 40.

162. *Id.* at 42.

163. See *id.* at 45. The court stated: "We agree with the Commissioner and the Tax Court that the contract does not cover off-season services, but we hold that the Tax Court's finding that the contract does not compensate for training camp and the play-offs as well as the regular season is clearly erroneous." *Id.*

164. *Id.* at 46.

165. See *id.* at 46. The court stated that "[t]here was no evidence that Stemkowski was required to follow any mandatory conditioning program or was under any club supervision during the off-season." *Id.*

program in the off-season and did this training under club supervision, he would have been able to include these days in the duty days formula, thus decreasing his tax liability.

The second of these cases is *Favell v. United States*.¹⁶⁶ The issue in *Favell* was "whether . . . the Standard Player's Contracts at issue compensate[d] the hockey player for off-season activities, which would in turn allow the off-season period to be included in the time basis or income allocation formula and thereby reduce the hockey player's gross taxable United States income."¹⁶⁷ The court held that the provision in the Standard Player's Contract created a condition of employment rather than a promise to perform these conditioning activities in the off-season.¹⁶⁸ The court reasoned that the language in the contract "to report to the Club training camp at the time and place fixed by the Club in good physical condition" would be read by a reasonable person to mean that off-season training was an employment condition and not a promise.¹⁶⁹ Therefore, the court concluded that since off-season conditioning is a condition of employment and not a promise, off-season conditioning could not be included as duty days.¹⁷⁰ The court also stated that since there were no mandatory off-season conditioning programs required by the contract, the off-season conditioning could not be included in the duty days time allocation formula.¹⁷¹ Thus, as in *Stemkowski*, the language used by the *Favell* court may be interpreted to mean that if Favell had been

166. *Favell*, 16 Cl. Ct. at 700.

167. *Id.* at 719. The plaintiff argued that he was paid for compensation for services performed throughout the entire year so the denominator of the fraction should be 365 days. The government argued that the contract could only be read as a condition of employment and not as a promise, thus the denominator of the fraction should not be 365 days. *See id.* at 721.

168. *See id.* The court stated:

a condition creates no right or duty in and of itself, but merely acts as a limiting or modifying contract provision. "A condition is an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due." If a condition does not occur, whether through breach or other cause, the party fails to meet the condition, and acquires no right to enforce the promise. A contractual promise or obligation, on the other hand, raises a duty to perform a service and its breach subjects the promisor to liability and damages, but does not necessarily excuse performance by the other contracting party.

Id.

169. *See id.* at 722. The court stated:

[a] plain reading of this contract clause and specifically focusing on the punctuation of the clause, could only lead a reasonable person to conclude that the words "in good physical condition" modify the remainder of the clause, "to report to the Club training camp at the time and place fixed by the Club," and describe the condition placed upon the hockey player upon arrival at the training camp.

Id.

170. *See id.*

171. *Favell*, 16 Cl. Ct. at 725.

required by his contract to participate in a mandatory conditioning program, those conditioning days would have been included in the duty days time allocation formula.

B. *Standard Player's Contract*

The clauses of the Standard Player's Contract¹⁷² which pertain to the conditioning of a professional athlete in a team sport are as follows:

7. Physical condition of player.

(a) Standard.

The player represents and warrants that he is and shall continue to be sufficiently highly skilled in all types of [insert the sport] team play, to play professional [insert sport] of the caliber required by the League and by the Club, *and that he is and shall continue to be in excellent physical condition, and shall perform his services hereunder to the complete satisfaction of the Club and its Head Coach.*¹⁷³

(b) Failure to maintain standard.

The Club shall have the right to terminate this Agreement should any of the following events occur: (i) *if the Player fails to establish his excellent physical condition to the satisfaction of the Club physician at the physical examination;* (ii) *if (after having so established his excellent physical condition), in the opinion of the Head Coach, the Player does not maintain himself in such excellent physical condition*¹⁷⁴

The following provisions are excerpts from a Standard Player's Contract which is used for the National Football League (NFL).

8. PHYSICAL CONDITION

Player represents to Club that he is and will maintain himself in excellent physical condition. . . . If Player fails to establish

172. The Standard Player's Contract is a contract provided for by the various professional leagues in order to set minimum uniform provisions in which players and their agents may follow. The Standard Player's Contract is applicable to all athletes of the respective leagues to the extent that the athletes decide to use the Standard Player's Contract as their employment. Thus, the Standard Player's Contract will apply to both U.S. as well as Canadian athletes.

173. 13 RABKIN & JOHNSON, CURRENT LEGAL FORMS WITH TAX ANALYSIS § 12.74 (1988) (emphasis added).

174. *Id.* (emphasis added).

or maintain his excellent physical condition to the satisfaction of the Club physician, or make the required full and complete disclosure and good faith responses to the Club physician, then Club may terminate this contract.¹⁷⁵

FILING

This contract will be valid and binding upon Player and Club immediately upon execution. . . . The Commissioner will have the right to disapprove this contract on reasonable grounds, including but not limited to an attempt by the parties to abridge or impair the rights of any other club, uncertainty or incompleteness in expression of the parties' respective rights and obligations, or conflict between the terms of this contract and any collective bargaining agreement then in existence. . . . On the receipt of notice of disapproval and termination, both parties will be relieved of their respective rights and obligations under this contract.¹⁷⁶

SPECIAL PROVISIONS

This paragraph of the Standard Player's Contract is the section where the parties may insert additional provisions including signing bonuses or incentive or performance bonuses.¹⁷⁷ This may also be the section of the Standard Player's Contract where an athlete, wishing to include off-season conditioning programs, may state this desire in a manner such that it will be interpreted as a promise as opposed to a condition of employment. This may also be the section of the Standard Player's Contract where the athlete describes what the conditioning program consists of and where the conditioning is to be performed.

However, any additional provisions that are included in the special provisions section of paragraph twenty-four are still subject to paragraph nineteen and the commissioner may disapprove.¹⁷⁸ Most often, it is the provisions in paragraph twenty-four which trigger disapproval if the terms added are so vague or incomplete that a dispute is likely to arise, or if the added terms will impair the rights of some other club in the same league as the athlete under contract.¹⁷⁹

175. Gary R. Roberts, *The First Annual Sports Dollars & Sense Conference: A Symposium on Sports Industry Contracts and Negotiations—INTERPRETING THE NFL PLAYER CONTRACT*, 3 MARQ. SPORTS L.J. 29, 40 (1992).

176. *Id.* at 42-43.

177. *See id.* at 37.

178. *See id.*

179. *See id.* at 37-38.

C. Application of Duty Days to Player's Contract

By applying the language from the FTA report regarding duty days¹⁸⁰ to *Stemkowski* and *Favell*, it is clear that an athlete will be able to include days in which he participates in training and conditioning during the off-season, as long as the conditioning program is specified in his contract and is performed at the facilities of the team with which he is under contract.¹⁸¹ If the contract is framed so that the off-season conditioning is a promise as opposed to a condition of employment, the athlete will be able to decrease the denominator in his duty days fraction which, in turn, will make the ratio smaller and thus decrease his tax liability outside the state or locality of residence.

In both *Stemkowski* and *Favell*, the courts held the provisions in the standard players contracts in regard to off-season conditioning were conditions of employment and not promises of employment; therefore, those days could not be included as duty days in calculating the allocation of income owed to taxing agencies.¹⁸² However, both of these cases were decided before the recommendations given by the FTA.¹⁸³ By applying the recommendations offered by the FTA regarding what days may be considered duty days, it is clear that an athlete would be able to include off-season conditioning as duty days, thereby decreasing the denominator in the ratio of calculating their duty days, and thus decreasing the athlete's nonresident tax liability.

The pertinent provisions of the FTA report state that "duty days includes [sic] days during the off-season when a team member undertakes training activities as part of a team-imposed program, but ONLY IF CONDUCTED AT THE FACILITIES OF THE TEAM."¹⁸⁴ From this language it is clear that if the contract is set up so as to make it a requirement that the athlete must perform off-season conditioning, and the conditioning consists of a "team-imposed program" which is "conducted at the facilities of the team," the athlete may be able to include these days as duty days and thus decrease his

180. See *supra* Part III.A.

181. See generally Lloyd E. Shefsky & Daniel G. Pappano, *Recent Tax Issues Affecting Foreign Athletes—Playing Hockey in the United States*, 8 U. MIAMI ENT. & SPORTS L. REV. 71, 82 (1991) (discussing that if off-season training is to be considered compensation under the player's contract, the contract must be drafted to create an obligation on the athlete to engage in training activities). The article states: "The lesson of *Favell* [and] *Stemkowski* . . . is clear: if off-season training programs are going to be considered compensated contractual obligations, the hockey player's contract must be drafted to create an obligation upon the players to engage in specific training activities." *Id.*

182. See, e.g., *Stemkowski*, 690 F.2d at 45; *Favell*, 16 Cl. Ct. 721.

183. See Gould, *supra* note 72. This is important because the FTA report suggests that duty days may include days during the off-season when a team member participates in training activities as part of a team-imposed program, if conducted at the facilities of the team. See FTA report, *supra* note 79.

184. FTA Report, *supra* note 79.

nonresident tax liability.¹⁸⁵

An example of this application can be illustrated by applying the FTA report's recommendations to the case of *Wilson v. Franchise Tax Board of California*.¹⁸⁶ If Wilson had trained in the off-season in a program structured by the Raiders and on the Raiders' facilities, Wilson would have been able to include those days in which he trained during the off-season in the denominator of his duty days fraction, thereby decreasing his nonresident tax liability. This method could also be applied to the Standard Players Contracts in both the *Stemkowski* and *Favell* cases and would increase the denominator in the duty days ratio in order to decrease the athlete's nonresident tax liability.

In addition to the athlete decreasing his tax liability by including the off-season conditioning program in calculating his duty days ratio, an athlete will also be able to receive a deduction as a business expense for those expenses incurred while conditioning.¹⁸⁷ The conditioning expenses can be deducted as long as the physical activity engaged in is work-related as opposed to recreational.¹⁸⁸

D. Recommendation of New Contract

Based on the idea that, by using the FTA report, athletes will be able to

185. See Gould, *supra* note 72.

186. *Wilson v. Franchise Tax Board*, 25 Cal. Rptr. 2d 282 (Cal. Ct. App. 1993). In that case, Mark Wilson, a quarterback for the Los Angeles Raiders, sued the California Franchise Tax Board for a refund on taxes which he was charged while playing for the Raiders. See *id.* at 282. Wilson argued that the denominator of his duty days fraction should be every day of the year, because under his contract, he either worked or had to be available for work every day of the year. See *id.* at 286. The issues were whether Wilson's off-season conditioning counted as duty days and whether Wilson was to be available for work every day of the year. See *id.* at 287. The court held that "Wilson's contracts did not require year round availability or participation in off-season football activity." *Id.* at 288. The court reasoned that the contract did not require any participation in off-season activity and that the provisions in his Standard Player's Contract covered one season which did not include the off-season. See *id.* Although the coaches stated that they thought off-season football activity was mandatory, they conceded that it was not part of the contract and that Wilson engaged in off-season football activity because of Wilson's obligation as an athlete coupled with the fear of being cut. See *id.*

The court also looked at *Newman v. Franchise Tax Board* to reason that not every day of the year should be included in Wilson's contract. In that case, Paul Newman, an actor, was under an exclusive contract which required him to be available on an "on-call" basis for an eleven week period during filming. See *Newman v. Franchise Tax Board*, 256 Cal. Rptr. 503, 504 (Cal. Ct. App. 1989). The court held that Newman's duty days included all the days in which he was on the set or "on-call." *Id.* at 507. The court distinguished Wilson's situation from *Newman* in that Wilson was not "on-call" and therefore could not include every day of the year in determining the total number of duty days in the denominator of his duty days ratio. See *Wilson*, 25 Cal. Rptr. 2d at 289.

187. See Dobray & Kreatschman, *supra* note 34, at 275.

188. See *id.* at 275 n.65.

include off-season conditioning programs in their allocation of duty days, it is important to determine what provisions are necessary to include in the Standard Player's Contract¹⁸⁹ or any contract for a professional athlete in order to accomplish this end.

The relevant portions of the Standard Player's Contract in *Favell* state:

The Player . . . agrees,

(a) to report to the Club training camp at the time and place fixed by the Club, in good physical condition,

(b) to keep himself in good physical condition at all times during the season,

(c) to give his best services and loyalty to the Club and to play hockey only for the Club unless his contract is released, assigned, exchanged or loaned by the Club,

(d) to co-operate with the Club and participate in any and all promotional activities of the Club and the League which will in the opinion of the Club promote the welfare of the Club or professional hockey generally,

(e) to conduct himself on and off the rink according to the highest standards of honesty, morality, fair play and sportsmanship, and to refrain from conduct detrimental to the best interests of the Club, the League or professional hockey generally.¹⁹⁰

Paragraph (a) can be rewritten to state that the athlete *agrees to or promises to* report to training camp in good physical condition at the time and place fixed by the club. By stating the language such that the athlete agrees to or promises to report to training camp in good physical condition, the language could only be interpreted as a promise to report in good physical condition. Thus, reporting to training camp will be a promise in the contract as opposed to a condition. Therefore, the athlete would be able to include those days in the off-season in which he trained in order to decrease his tax liability.

In addition, the contract must state the regimen in which the athlete is to perform his off-season conditioning, as well as state that the training must take place at the facilities of the team of which the athlete is a member. Thus, the contract must state something to the effect that the athlete promises to train in a team-supervised conditioning program for three hours per day and five

189. For purposes of this analysis, the Note will refer to the Standard Player's Contract which was used in *Favell v. United States*, 16 Cl. Ct. 700 (1989).

190. *Id.* at 705-06. See also Shefsky & Pappano, *supra* note 181, at 78-79 n.40 (citing the language from the Standard Player's Contract in *Favell*).

days a week. The program should include strength training¹⁹¹ and conditioning.¹⁹² These contract provisions should be included either in the portion of the contract where it states that the athlete must report to training camp in good physical condition or, if using a standard player's contract, the language may be inserted in paragraph twenty-four in the section regarding special provisions. Once the contract is drafted, the last step is to present it to the commissioner of the league for his approval based upon paragraph nineteen.

If the commissioner affirms the contract and states that it does not violate any of the league's policies, it is clear that the athlete will be able to include these off-season conditioning days in his calculation of duty days and thereby decrease his nonresident tax liability. Based on the FTA report and recommendations, the athlete will be engaged in conditioning activities which are specified in his contract and will be performing the activities at the facilities of his team.

V. CONCLUSION

Professional athletics have long been a part of our North American culture. Often, professional athletes are considered to be above the common individual because of their unique talents and abilities. However, professional athletes are very similar to the average individual in the fact that they cannot escape the two certainties of life: death and taxes.¹⁹³

With the expansion of professional sports and the inclusion of more teams in professional football, hockey, baseball, and basketball, there are more venues in which athletes must participate, and consequently more venues in which to pay taxes. These expansion franchises are moving north of the United States into Canada where an additional taxing agency comes into play. Thus, athletes may be liable for tax on their income at the Canadian federal and provincial rates, as well as for income tax to the United States on the federal, state, and local levels. Due to this multiple taxation, it is imperative that an athlete have a tax plan in order to comply with these filing requirements. In addition and perhaps more importantly, an athlete should have a tax plan to save money for retirement based upon the shorter average career of professional athletes as compared to other careers.¹⁹⁴

Since the inception of the FTA report¹⁹⁵ regarding duty day apportionment of taxation for professional athletes, it is clear that the athlete

191. For example, strength training would likely include weight training.

192. For example, conditioning could include anything from running or jogging to riding a stationary bike or swimming.

193. See Salmas, *supra* note 11, at 256.

194. See *id.*

195. See *FTA Report*, *supra* note 79.

may be able to structure his or her contract in such a way as to minimize nonresident tax liability. By including off-season conditioning in the employment contract, as well as stating the conditioning regimen and that the conditioning will take place at the team's facilities, these off-season days become duty days.

Based on case law¹⁹⁶ which has addressed the issue of whether professional athletes may include off-season conditioning as duty days in determining the applicable ratio of duty days, it is clear that if athletes structure their contracts in such a way as to make off-season conditioning a promise as opposed to a condition of employment, these days may be included in the duty days formula.

In future cases, issues which may arise in regard to this interpretation of case law may revolve around whether the conditioning program was fully specified in the contract, as well as whether it was sufficiently stated in the contract that the athlete is to perform this off-season conditioning at the facilities of the team. Thus, it is important for agents and attorneys of professional athletes to take special care in drafting the athlete's employment contracts.

This Note urges inclusion of the following contract terms in professional athlete's employment contracts: (1) the training regimen; (2) the location of the facility at which the athlete will be performing his or her conditioning; and (3) that the conditioning will be supervised and mandated either by a coach of the athlete's team or the team's trainer. If the professional athlete's contract includes these promises, the case law as well as FTA recommendations demonstrate that athletes will be able to decrease their nonresident tax liability while remaining in shape during the off-season.

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196. See, e.g., *Stemkowski v. Commissioner*, 690 F.2d 40 (2nd Cir. 1982); *Favell v. United States*, 16 Cl. Ct. 700 (1989). See also *supra* Part IV.A. and accompanying text for a discussion of the analysis of both *Stemkowski* and *Favell*.

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