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# Taxation of Professional Athletes

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THERE IS VERY LITTLE DOUBT that the current income tax laws are not applied with equal fairness to people of all occupations. There are many groups whom Congress has seen fit to give many tax advantages, both directly and indirectly. Others assert, and rightly so, that they must pay too much of the tax burden.

Professional athletes have probably often wondered just which category best fitted them. This article is for the purpose of pointing out some of the unique problems of the "play for pay" boys. I have grouped those problems into three topics, which I call, "Deferred Compensation", "Taxable Income", and "Deductions."

## Deferred Compensation

The average professional sport fosters competition between teams and among individuals, but sometimes the keenest competition of all takes place in the front office where the money men are competing for more and better players. Examples of $100,000.00 bonuses paid to teenage phenoms are not infrequent.

This situation has made even the most naive of these prospects extremely tax conscious; and who can blame them, when all they expect to keep is one third of that $100,000.00. The natural result has been that many schemes for increasing the "bonus baby's" net are now in use. By spreading the bonus over five years, for example, the athlete can count on retaining most of the amount.[1] This becomes even more appealing to the youngster if he marries before the whole bonus is paid, thereby obtaining the tax advantages afforded by being permitted to file a joint return.

Another popular gimmick is to give the boy's father a long term contract as a "part-time scout." This will get money into the family at what is usually a low tax rate. It is also not uncommon for the father to be given some special bonus (such as a new automobile) for his "scouting" efforts in "discovering"

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[1] Rev. Rul. 58-145, C. B. 1958-1,360.

his son. Under those circumstances, the Internal Revenue Service might claim that the transaction actually resulted in an assignment of income by the son without consideration, and therefore taxable to the son.[2]

It is interesting to note that in a recent ruling[3] grouping five situations in which the taxpayers were seeking advice as to the merits of various deferred compensation plans, two of the taxpayers were athletes. It is even more interesting to note that those two plans were the only ones which the Service rejected.

In one case, a football player selected a bank to act as an escrow agent to receive his bonus for signing his contract. Under the escrow agreement, the bank was to pay the bonus plus interest over a five year period. In the other case, a boxer insisted upon dual contracts with a promoter; one calling for a customary percentage of the gate receipts, while the other provided that the sum be paid in installments spread over three years.

Both taxpayers were deemed to have had the beneficial receipt of all the money in the first year. In the escrow situation, the reasoning was that all obligations of the employer had been completed, while the interest inured to the benefit of the taxpayer. The boxer was said to have been engaged in a joint venture, and his share of the receipts belonged to him as soon as they were collected, the promoter merely holding the funds as trustee until paid.

These holdings may seem to be inconsistent with the generally accepted view that payments for services rendered are taxable to cash basis taxpayers when received, regardless of when the obligations were incurred.[4] Otherwise, the spreading of bonuses over many years, which I mentioned earlier, would not be beneficial taxwise. The difference, of course, is made clear when the constructive receipt doctrine is applied.

The Regulations[5] spell out the rule as follows:

> Income, although not actually reduced to a taxpayer's possession, is constructively received by him in the taxable year during which it is credited to his account or set apart for

[2] See Helvering v. Eubank, 311 U. S. 122 (1940); and Chicago Title and Trust Co., 33 B. T. A. 65 (1936).

[3] Rev. Rul. 60-31, I. R. B. 1960-5, 17.

[4] Reg. 1,446-1, c, 1, i (12/24/57). Also, as regards athletes, Rev. Rul. 55-727, C. B. 1955-2, 25.

[5] Reg. 1,451-2 (12/24/57).

him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Usually, there are several factors to consider in determining whether there has been constructive receipt in the hands of a professional athlete. The most important of these is whether the taxpayer exercises effective control over the disbursement of the funds. Other factors would be whether the obligation of the employer was discharged, and for whose benefit the payments were deferred.

As a practical matter, if an athlete desires to have his earnings or bonus spread over a period of years, he may reach an agreement to that effect with his employer. However, he must take special care in the agreement that he retains no right to accelerate his receipt of the funds. It would be somewhat helpful if the money owed was not segregated into a special fund by the employer. This causes the taxpayer to rely on the general credit of the team and helps assure him that no constructive receipt can be claimed.

Two very popular deferred compensation plans, the pension and the stock-option, are not nearly as widespread in professional athletics as in the general business world. Although the two professional baseball major leagues have a very comprehensive pension plan,[6] it is not very much in use among other sports. This is usually because the players have shorter tenures and smaller pay checks, while the teams, leagues, and promoters are not normally as permanent or as substantial.

The restricted stock-option method of deferring compensation[7] is rarely used in professional sports. This is because the employers are usually closely held corporations that do not want outside stockholders. Business people very often give stock options to employees as an incentive to retain their services and their loyalty. Athletes are continually being traded, sold, or released, so that allowing them the opportunity to become shareholders in any one team is not practical.

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[6] The pension plan used by the American and National Leagues is one of the most liberal in use anywhere. Based upon years of employment in these leagues, players and coaches can look forward to a very substantial pension at a comparatively early age.

[7] Sec. 421, IRC of 1954 (As Amended).

## Taxable Income

The typical professional athlete usually has several sources of income directly connected with his particular athletic prominence. Occasionally, therefore, it is necessary to examine the various types of earnings and the tax problems which often arise from them.

A participant in a team sport such as baseball, football, basketball, or hockey is an employee of the team (usually a corporation) and is subject to the same general rules as any other employee. If he is sick or injured, he is entitled to the same sick pay exclusion[8] as an office worker. If he is released by his team, he can apply to the state for unemployment compensation. His deductions in connection with his employment are not governed by any different laws.[9]

The difficulty, when there is one, is usually connected with receipts other than the direct payments of salary which he may receive. Some of these are clearly not taxable, such as per diem expense reimbursements while in training camp or on the road.[10] Another instance of non-taxability is the case of the star who is given a "night" by the fans. Although some of these athletes are given automobiles, appliances, and cash, there appears to be no taxable income, inasmuch as they are considered to be gifts. It also seems that prizes and awards given by organizations other than the athlete's employer would be regarded as gifts.[11]

In some professional sports, athletes are often traded from one team to another, and may be expected to relocate in another city at a moment's notice. The old employer usually gives the departing player a flat, standard amount to cover moving expenses. Generally speaking, reimbursed moving expenses are taken into income except where the employee is transferred from one location to another while in the continuous service of the same employer.[12] It is likely that this rule would not be strictly

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[8] Sec. 105, IRC of 1954 (As Amended).

[9] The application of those laws may create some unique deductions, however, as we shall see later.

[10] The athlete is further benefited by the fact that he need not keep detailed expense records so long as his per diem allowance is $15.00 or less. Rev. Rul. 58-453, C. B. 1958-2, 67.

[11] Rev. Rul. 54-110, C. B. 1954-1, 28. This refers, of course, to prizes and awards given in recognition of past achievements or current abilities. A cash award which is given as the result of being victorious in a direct competition is ordinary income. See Reg. 1.-74-1. Also see Obiter Dictum in Robertson v. U. S., 343 U. S. 711 (1952).

[12] Rev. Rul. 54-429, C. B. 1954-2, 53.

adhered to in the case of professional athletes. Even though they are changing employers, the transfer is created by an assignment of contracts, thereby giving the athlete no choice but to make the move. However, if the amount of the allowance should exceed the amount of the actual moving expense, then the excess is naturally taxable.

Any professional athlete who is fortunate enough to become even moderately well-known, has a tremendously potent, income-producing asset—his name. The possession of this asset usually allows him to receive income from numerous sources, including exhibitions, product endorsements, radio and television appearances, newspaper and magazine articles, and various promotions. Almost all of this must be considered ordinary income, although it is conceivable that under certain circumstances, an athlete might sell an exclusive use of his name in such a manner as to create the possibility of capital gains treatment.

In analyzing some of these side transactions, it sometimes becomes very difficult to distinguish between what is a gift and what constitutes taxable income. An athlete may turn down a speaking engagement that offers $200.00 in cash, while accepting one that pays him nothing. However, he expects to be presented with a handsome gift at the free engagement, a $200.00 television set, for example. It is possible that the athlete and his tax man figure that if they can establish that the set was really a gift, and the star's appearance was merely incidental to receiving it, then they have received more in value than they could have bought with the after-tax dollars from three or four of the cash producing appearances.

Athletes should be very careful to make sure that they are not receiving "gifts" in return for services.[13] The big-name, local hero who works two weeks for an auto dealer without pay, while the dealer publicizes the athlete's availability at the showroom, receives ordinary income for the market value of an automobile given him by the dealer, no matter how gratuitous the transaction appears to be.

Athletes such as professional boxers, bowlers, and golfers are considered to be in business, as opposed to being employees. As businessmen, they have a different tax status than do the employee-athletes. Although they lose some benefits that

[13] See Commissioner v. Duberstein, 363 U. S. 278 (1960).

employees have, they enjoy substantial advantages when attempting to justify expenses. This is discussed below.

Many athletes have some side business going for them, which they look after on a part-time basis and during the off-season. These are not taxed any differently because they are owned by athletes. However, in discussing deductions, I shall point out how important the location of those businesses may be.

## Deductions

As has been stated earlier, the rules for an employee deducting his expenses in connection with employment are the same for athletes and non-athletes alike. A good example of this is wearing apparel used while the employee is performing his duty. There are two requirements that must be met before the deduction for clothing can be allowed. First, the clothing must be necessary for conduct of the particular employment. Secondly, that clothing must not be adaptable for every day use.[14] Therefore, a golfer employed as an instructor by a country club can deduct his shoes, but not his other clothing.[15]

Professional athletes can also deduct such necessary items as special equipment used in training and playing, fees paid to agents for bookings, salaries paid to secretaries answering fan mail, and similar expenses. There are also many expenditures which have to be considered questionable. It is very important for these athletes to keep in the public eye and to maintain good public relations. On this basis, most of these athletes attempt to deduct some entertainment and promotional expenses, and occasionally the Treasury Department questions the propriety of those deductions. Lawyers who represent these taxpayers will probably have that old tort problem, proximate cause, to contend with. Their goal, in other words, should be to show some kind of income directly connected with each type of deduction claimed.

Another close question, to my knowledge still unanswered, is whether an athlete who joins a health club to keep in playing condition can deduct the membership dues of that club. The deduction seems reasonable enough, but to allow it might open the door to many deductions which, when carried to the extreme,

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[14] Mim. 6463, C. B. 1950-1, 29.

[15] The typical professional golfer wears sports clothes which are easily adaptable to everyday use. His shoes, however, are specially cleated for use on the golf course.

would be ridiculous. Several attorneys in my acquaintance would not hesitate to spend a deductible summer in Europe, in order to obtain the correct mental attitude for important litigation in the autumn.

Many professional athletes make their homes in cities other than that in which they are based during their particular season of competition. This brings up the question of "travel expenses while away from home overnight." Can the baseball player who makes his home in North Carolina, but must live in Cleveland six months of the year, deduct his living expenses while in Cleveland? Most tax practitioners know that a taxpayer's home, according to the Internal Revenue Service, is his principal business location, regardless of where his residence is located.[16]

Therefore, our hypothetical North Carolinian cannot deduct expenses while in Cleveland if his only occupation is playing baseball. However, if he happens to be engaged in an off-season business in his home town, he may be the recipient of substantial tax benefits arising from deductible traveling expenses. The Commissioner will undoubtedly allow travel expenses for time spent either in Cleveland or in North Carolina, whichever is not considered his principal business location.[17]

Through this maze of deductions and their problems, one thing seems rather certain: athletes who, by the nature of their activities, are able to file regular business tax returns (Schedule C) will endure fewer disallowances than employed athletes who must necessarily itemize their deductions on page two of their tax return. This advantage is not created by law, but seems to be prevalent only because of the mechanics of reporting and the idiosyncrasies of the examiners of our tax returns.

On a Schedule C, the auditors do not like to spend much follow-up time if the net income seems high enough in relation to the gross receipts. On the other hand, those same items which so effectively reduce gross receipts on Schedule C, stand out like sore thumbs on page two. Very often, the employee's earnings have been subject to enormous withholding taxes, which could result in a sizeable refund. As a matter of policy, returns calling for large refunds are put under closer scrutiny. Here again, the athlete in business has the advantage since he can

[16] G. C. M. 23672, C. B. 1943, 66. Also many cases.

[17] Rev. Rul. 54-147, C. B. 1954-1, 51.

prevent refunds by controlling his quarterly payments on his estimated tax.

## Conclusion

Speaking in general terms, professional athletes are not governed by special rules; they merely have unique problems when trying to apply those rules. Whether the long talked about, much needed tax revisions promised for the 1960's will multiply, alleviate, or ignore the problems of the professional athlete is anybody's guess.