Tax Issues for Athletes and Entertainers

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I. General – There are two broad categories in which to place clients: employees whose income is predominantly w-2 based (they play team sports) or self employed/loaned out individuals in the entertainment business or athletes that play individual sports (ie, golf, tennis, boxing, etc).

II. Importance of Good Tax Planning – Athletes and Entertainers often have a limited opportunity for making large sums of money which magnifies the effects of both good and bad tax planning.

III. Team Sport Clients – Federal Tax Considerations

   A. Schedule A Deductions – Agent Fees, Workout Expenses, Management Fees, Clubhouse Dues, T and E
   B. Limitations on Deductions – Pease limits and unreimbursed business expense limits place great importance on timing of payments
   C. Other deductions – expenses attributable to earnings from self employment (contribution to qualified plan, marketing fees, royalty expenses, union dues). Get that year end pay stub.
   D. Precautionary Measures – These clients are not corporate clients. Our job is partly to make it as easy as possible for them to be tax compliant.

IV. Team Sports Clients – State and Local Tax Considerations

   A. Overview – The Jordan Rules doesn't just apply to Chuck Daly's defensive strategy to contain Michael Jordan. During the 1980s, Illinois retaliated against other states taxing Michael Jordan road games and so legislatures across the country began to adopt rules to tax nonresident professional athletes. Those rules have a lot of important consequences that the planner must take into account.
   B. What is taxable to a state? The general rule is that earnings attributable to performance of services in a particular jurisdiction creates a tax obligation to that jurisdiction. Some jurisdictions will

not tax a player that does not travel with the team due to injury, but this practice varies from state to state.

C. Mechanics of apportionment – Each team's payroll department maintains close contact with the various revenue departments that such team's employees perform services in. The teams generally do a good job of apportioning and reporting income to states in which employees perform services (including coaches, trainers and front office personnel). The primary formula used to apportion is the duty days method.

D. Special Situations –
    1. New York – No mandatory withholding and reporting; requires vigilance
    2. California – Four year Statute of limitations
    3. Idiosyncratic Payroll Practices
    4. Bonuses – tax treatment varies by type and sport; Barry Sanders and Clayton Kershaw; general rule is to apportion into low/no tax states and away from high tax states
    5. Cleveland apportionment –Hunter Hillenmeyer and Jeff Saturday
        a. "Games played" method (basing the taxable portion of income on the number of games played in Cleveland in relation to the total number of games a player played that year) violates due process rights. (Hillenmeyer v. Cleveland Board of Review, 144 Ohio St.3d 165 (2015)) The state's power to tax reaches only the portion of the non-resident's income earned by work performed in the state. The "games played" method includes in income that which was earned through work outside the State. The state does not have the power to tax income earned through work outside that state.
            i. "Duty days" method (taxable portion of income is based on the number of days the athlete spends in the taxing city in relation to the athlete's total

number of work days for the year) provides due process and satisfies city income tax ordinances. Other methods may also provide as such but were not suggested by the parties.

b. The City does not have the authority to impose tax on a non-resident athlete who does not accompany his team to the City when the team comes to the City to play a game. (Saturday v. Cleveland Board of Review, 142 Ohio St.3d 528 (2015))

V. Individual Sports and Entertainers

A. General – These clients are basically the owners of closely held business interests and have similar federal tax considerations.

B. State Income Tax Issues – There are very complicated apportionment issues for the client that performs services in multiple jurisdictions. Good recordkeeping is essential!

C. Withholding – This is the area of grave danger for the client. If they are not in the habit of setting aside compensation to make quarterly payments, they will be a problem client.

VI. Theft Loss

A. Claiming a deduction for—

1. IRC Section 165(a) allows loss deductions for any loss sustained during a tax year and not compensated for by insurance or otherwise.
2. IRC Sec 165(c)(3) – limit on this deduction for individuals: can deduct when loss arises from theft
3. The Tax Court looks to the law of the state in which the loss occurred to determine whether a loss was a theft loss. (Bellis v. Commissioner, 540 F.2d 448, 449 (9th Cir. 1976), aff'g 61 T.C. 354 (1973) as cited in Leslie T.C. Memo 2016-171)
4. Burden of proof: On the taxpayer to prove by a preponderance of the evidence:
   a. that a theft occurred under the law of the jurisdiction where the loss occurred (*see* Halata v. Commissioner,

T.C. Memo. 2012-351; Monteleone v. Commissioner, 40 T.C. 688, 692 (1960));

b. the amount of the loss (Elliott v. Commissioner, 40 T.C. 304, 311-321 (1963); and

c. the year of the loss

1) deduction is permitted in the year the taxpayer discovers the loss unless there is a claim for recovery. Where there is such a claim, the loss is said to have occurred when it has been determined with "reasonable certainty" that the taxpayer will not receive reimbursement. (Leslie T.C. Memo 2016-171, pg. 23)

B. Safe Harbor provisions for Qualified Ponzi Scheme Victims

1. "Qualified Investors" may deduct losses in the year of the discovery of the fraud regardless of whether they are able to recover any of the investment.

a. "qualified investors" – those who

1) qualify for theft deductions under § 165;

2) "did not have actual knowledge of the fraudulent nature of the investment arrangement prior to it becoming known to the general public" (Rev. Proc. 2009-20, 4.03(2); and

3) Transferred funds to the "lead figure" who promoted a "specified fraudulent arrangement" which caused an investment loss.

2. "Specified Fraudulent Arrangement"

a. i.e., a ponzi scheme – other frauds do not qualify under the safe harbor provision (Rev. Proc. 2009-20, 2009-14 I.R.B. 749)

b. Conviction for fraud is not needed to show fraud if the lead figure is:

1) Indicted for fraud, embezzlement, or other theft loss; or

2) The subject of an ongoing state or federal criminal complaint where that complaint:
    i. Alleged an admission by the lead figure;
    ii. Assets of the arrangement have been frozen; or
    iii. A receiver/trustee appointed with respect to the assets

C. Be Vigilant – Over the last few years, incidents of mismanagement/malfeasance have mushroomed. Be aware of these potential problems when drafting your engagement letter. Advise client to refrain from vesting excessive power, authority or influence in any one advisor that has access to client's funds.
    1. Charles A. Banks, IV
        a. SEC Complaint - Securities fraud (Sept. 9, 2016)
        b. Indictment -(Sept. 8, 2016)
            1) US District Court, Western District of Texas
            2) Wire fraud
    2. Ash Narayan
        a. SEC Complaint - Securities fraud (May 24, 2016)