Folks:

Take-Away: Let's be honest. There is no way to separate sports from money… or taxes.

Background: There has been a flurry of legal activity in recent years with regard to athletics and taxation, surprising as that might sound. Much has to do with the enormous salaries commanded by many professional athletes, 'big-time' college sports (who are probably *professionally paid* in the SEC, but I digress) and over-zealous college boosters. All of which started with a trend commonly known as the *jock tax.*

Jock Tax: The *jock tax* became a national topic going back to 1991 when the Chicago Bulls played the LA Lakers for the NBA Championship. California imposed an income tax on an allocated portion of the income that the Chicago Bulls players earned based on their *presence* and games played in L.A. during that Championship Series, i.e., California imposed an income tax on out-of-state players for games played in California. Illinois shortly thereafter retaliated and levied its own *jock tax* on out-of-stated athletes when the player's other state imposed its *jock tax.* Since then, the *jock tax* has become a nightmare for professional athletes from both the tax-paying standpoint, and from the filing of a state income tax return standpoint, since these professional athletes are required to file multiple annual non-resident state income tax returns each year. It is estimated that most Major League Baseball (MLB) players file between 20 and 25 non-resident state income tax returns each year.

***Jock Tax* Formulae:** Then, of course, each states uses its own formula to calculate what the player owes that state for its *jock tax.* One approach is based on a ratio of the **games-played** in the non-resident state or non-resident city to the total games played. That **games-played** ratio is then multiplied by an athlete's annual income to determine the amount of income that is to be allocated to the non-resident state (or non-resident city.)

Another approach uses the **duty-days** method of allocation. Under this second approach the denominator of the allocation ratio not only includes the games played but also other team activities such as training camps, team practices and team meetings. The numerator of this **duty-days** approach of the allocation ratio consists of games played and other related team activities that occur in the non-resident state or city.

Example #1 Games-Played Formula: New York Yankee Aaron Judge plays a 3-game series in Detroit. Aaron's annual salary in 2023 is $40,000,000. Michigan uses a 'games-played' method to allocate a non-resident's income for Michigan *jock tax* reporting purposes. At the time, Michigan imposed a state income tax rate of 4.25%. With a regular season of 162 games and no playoff games (sorry Yankees!) Judge owed a Michigan *jock tax* of $31,481.48. [3 games in Detroit divided by 162 games in a MLB season times $40 million times 4.25% Michigan income tax = $31,481.48.]

Example #2 Duty-Days Formula: Kansas City Chiefs quarterback Patrick Mahomes plays a Sunday afternoon game in LA against the Rams. The Chiefs fly to LA on Friday. Team meetings are held on

Saturday before Sunday's game. California uses a duty-days allocation to compute its *jock tax.* The top income tax rate in California is 13.3%. Patrick Mahomes' annual income is $35,793,381. Assume that Patrick Mahomes has 200 duty-days with the Chiefs this year. Patrick will owe California $71,407.80 for its *jock tax.* [3 days in California divided by 200 duty-days per year times Patrick's income of $35,793,381 times 13.3% California income tax = $71,407.80.]

Supreme Court , NCAA and NIL: On June 21, 2021, the U.S. Supreme Court held in *NCAA v. Alston,* that student athletes can be compensated for the use of their name, image, and likeness, aka NIL. Examples of NIL include autographs, personal appearances, promotions, and modeling of sports and non-sports apparel.

Within days of this decision the NCAA issued an interim NIL policy, which included: (i) student athletes can use professional service providers such as agents and attorneys for their NIL activities; (ii) the student athletes *should* report NIL activities consistent with state law, school, or conference requirements; and (iii) student athletes may *not* be paid to play, and schools, athletic departments, school boosters, and donors are not allowed to offer improper recruiting inducements including NIL opportunities. [Yes, I'm thinking of Texas A&M and I'm smiling as I type this!] While there is currently no national law on NIL activities, Nick Saban and other coaches were in Washington DC in recent months to lobby for a national law to 'level the playing field' as Nick claimed.

Some 32 states have passed some sort of NIL laws. If there is any common thread to these state NIL laws it is that the student athletes are prohibited from endorsing alcohol, tobacco, marijuana, gambling, adult entertainment, and other ‘morally questionable activities.’ [I wonder if an 18-year old kid even has an inkling what *morally questionable* means.]

NIL Collectives and the U.S. Treasury: In the aftermath of the *Alston* court decision and the NCAA’s NIL policy and the influx state laws to address NIL, many NIL collectives were established. These collectives are supposed to function independent of the universities, with their stated goal to facilitate the funding of NIL arrangements for athletes. Apparently, some of these collectives plan to seek tax-exempt status, or claim that they already are tax-exempt, thus inducing boosters to contribute in the belief that their contribution to the collective will result in an immediate charitable income tax deduction. On May 23, 2023 the Office of Chief Counsel of the IRS issued *Chief Counsel Memorandum AM 2023-004* in which the IRS clearly stated that many organizations that develop paid NIL opportunities for student athletes are **not tax exempt** and are not described in IRC 501(c)(3) because of the private benefits that they provide to student athletes are not incidental both qualitatively and quantitatively to any exempt purpose that is furthered by that activity.

The Future? Much last summer was written about the Texas A&M football team and the amount of NIL money that was made ‘available’ to its 5-star players, leading (some like Nick Saban to believe) Texas A&M to achieve the best college football recruiting class for 2022. A nexus (available money with ‘no strings’ attached to college football recruits coming to College Station, Texas) Alabama coach Nick Saban publicly noted, leading to a ‘war of words’ in newspaper headlines in the summer 2022 with Texas A&M’s coach- ‘The best college football team money can buy.” All that money paid to the Texas A&M football players did not save its coach from losing his job this past fall, however

(with a $77 million buy-out provision.)

> ***Jock Tax* and NIL:** Thus, consider the implications of a state's *jock tax* trend if it is extended to college athletes who receive NIL compensation. Will Texas, Florida, and Tennessee now have even more of a recruiting advantage (more than just warm weather) since those states do not have an income tax? Is the taxation of NIL compensation a reason why there are so many student athletes who transfer to other out-of-state southern universities these days?
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> **Example #3:** Assume that Johnny M. is a Texas A&M athlete who receives $100,000 NIL compensation from a booster collective (an amount that was actually mentioned in the summer of 2022 for each new Texas A&M football recruit who had yet to play a game for the Aggies.) No portion of Johnny's NIL compensation would be taxed by Texas because it does not impose any state income tax. Suppose that Johnny performs so well during the fall season that he is invited with others to the Heisman award ceremony in New York in early December. New York and the City of New York each impose an income tax, 10.90% and 3.876% respectively. Presumably both the state and City of New York could tax an apportioned amount of Johnny's NIL compensation for his 'appearance' at the Heisman Trophy ceremony. Will Johnny take a pass on attending the Heisman award ceremony, or will the Heisman folks pick up his income tax liability tab?

Conclusion: An Alabama football player in 2022 claimed to have received $1.0 million in NIL compensation. Will we begin to see more student athletes changing their residence to states that do not impose an income tax? How badly does Alabama want to win a National

Championship that it will exclude NIL compensation from its income tax? When, and how, will the *jock tax* impact college athletics is the question that will need to be answered, probably in the near future as money changes college athletics.

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