

# The Jock Tax Contest: Professional Athletes Vs. The States – Background And Current Developments

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## Abstract

*Opening day of the Major League Baseball's 2002 season fell on April 1 of that year. After the National Anthem was sung, the crowd applauded as the New York Mets took the field, and the umpire yelled, "play ball." The State of New York also cheered. Why? New York, like a number of other states and localities, imposes an income tax on athletes that visit its borders. So, when Texas Rangers shortstop, Alex Rodriguez, the highest paid baseball player during the 2002 season with a salary of \$22 million, played 4 regular season games in the Big Apple, he incurred a tax liability of approximately \$34,250. This state income taxation of nonresident professional athletes is commonly referred to as "the jock tax." This paper introduces the reader to the jock tax beginning with a brief explanation of state income taxes, continuing with a discussion of its complexities and historical/current issues faced by athletes, teams and the states through implementation of the tax. The paper concludes with the broader implications of a state or local taxing jurisdiction's powers to tax its nonresident visitors.*

## 1. Introduction

Opening day of the Major League Baseball's 2002 season fell on April 1 of that year. Just two short weeks before the 2001 federal and most state income tax filing deadlines, the National Anthem played in New York, the crowd applauded as the New York Metropolitan took the field, and the umpire yelled, "play ball." The State of New York also cheered the commencement of a new season. Why?

New York imposes an income tax on residents and non-residents working in the state. So, when the Met's and the Yankees take the field with players' payroll for the 2002 season of approximately \$90,000,000 and \$126,000,000 respectively,<sup>1</sup> the State of New York will receive an estimated \$6.725M in tax dollars from its professional baseball players.<sup>2</sup> And that's only from its local teams!

Seventeen out-of-state teams visited Shea Stadium in 2002 to play the Mets in 81 of its regular season home games.<sup>3</sup> Yankee Stadium hosted fifteen visiting non-resident teams during this same time frame.<sup>4</sup> Tax revenue dollars from these out-of-state based teams exceeds \$3M.<sup>5</sup> Simply stated, NY imposes an income tax on nonresident athletes that visit its borders. So, when Texas Rangers shortstop, Alex Rodriguez, the highest paid baseball player during the 2002 season with a salary of \$22 million, played 4 regular season games in the Big Apple, he incurred a tax liability of approximately \$34,250 ( $\$22M \times 5/220 \times 6.85\%$ ). This state income taxation of nonresident professional athletes is commonly referred to as "the jock tax."<sup>6</sup>

This paper introduces the reader to the jock tax in Section II beginning with a brief explanation of state income taxes, continuing with a discussion of issues faced by athletes, teams and the states through implementation of the tax.

Next, in Section III, a time line will be offered commencing with one of the first cases dealing with allocating a nonresident athlete's wages, ending with today's current issues. The time line will highlight: (1) fun facts, such as the increase in average annual salary figures of athletes – a contributing factor to the imposition of the tax; (2) precedential case law; (3) significant articles and journals; (4) reaction to the tax and response by Players' Associations, Teams and the States; and (5) current issues.

Section IV of the paper provides a detailed discussion of a 1994 report issued by the Federation of Tax Administrators (FTA) Task Force on Nonresident Income Tax Issues regarding the taxation of nonresident professional athletes: "State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach." This report suggested a uniform apportionment formula to be used by the various states in an effort to resolve the issue of multiple taxation.

Section V treats current cases coming out of Illinois. The State has chosen to tax a non-resident professional athlete playing for an Illinois based team on 100% of his/her income regardless of where games are played and without allowing for any credits for income taxes exacted by other taxing jurisdictions. Further, the State also denies its resident athletes playing for its home teams a credit for taxes paid to other jurisdictions in which games are played. Illinois tax policy results in double taxation of the athletes' salaries.

In Section VI, the paper will conclude with the broader implications of taxation of other highly paid non-resident professions. For example, in 2002 New Jersey sent out letters to non-resident attorneys that visited the state suggesting that they remit any tax dollars owed before the State's tax amnesty period expired. So, when the authors of this paper travel to a conference to present the paper, will we be next?

## **2. State Income Taxes**

It is a well established constitutional principle that states are empowered with the authority to impose a personal income tax on its residents.<sup>7</sup> Domicile is not the sole basis for individual state income taxation, however. Non-residents may also be taxed as "... states tax personal income on a "source basis," i.e., income is taxable where it is earned or where the services giving rise to the income were performed."<sup>8</sup>

How does this affect professional athletes? As athletes cross state borders to bat, shoot, pass and skate by their opponents, they are subject to that jurisdiction's income tax regulations. For example, during the 2002 regular MLB season, the NY Yankees played its 81 away games in 13 different states and Canada. Of these 13 states, 10 impose a non-resident income tax on visiting athletes. Texas, Florida and Washington have no individual income tax; the State of Tennessee and the District of Columbia complete the list of non-individual income tax jurisdictions in the United States.<sup>9</sup> Accordingly, Yankee players, coaches, trainers and other traveling team members will file a federal individual income tax return and ten or more state tax returns!

### **2.1. Jock Tax Issues**

#### **2.1.1. Arbitrary**

Reactions to the above statement include: "so what, athletes make too much money anyway; why should we feel sorry for them," and "if we have to pay state income taxes, so should they." One may agree or disagree with these statements, however, the issue remains that the tax appears to be arbitrary as the tax is based on the preference or "whim" of the state to focus on athletes and not other non-resident professionals that visit its borders. Top executives, sales personnel, doctors, lawyers, accountants and other professionals travel from coast to coast on a daily basis and, in general, are unconcerned with allocating their wages for the short periods of time that they visit another state.

### 2.1.2. Administrative Nightmare

As stated above, players, coaches, trainers alike are all subject to the above. NBA coaches and trainers, for example, earning far less than a professional athlete, are subject to these multiple state income tax return filings.

The professional sports teams are also faced with administrative burdens with respect to wage allocation and withholding requirements. Teams must comply with each state's income tax rules and regulations including payment and reporting of withholding taxes.

### 2.1.3. Complexity And Double Taxation

Administrative requirements are further complicated as each state has its own tax provisions; there is little uniformity. For example, two general methods have been utilized to allocate wages: "duty days" formula and "games played" methodology. The duty days approach typically apportions income using a ratio of the number of duty days spent in the state taxing jurisdiction to the total number of duty days spent both within and without the State. The term "duty days" has numerous definitions, depending on the taxing jurisdiction, but generally includes "all days during the taxable year from the beginning of the professional athletic team's official preseason training period through the last game in which the team competes."<sup>10</sup> An alternate approach, the games played formula allocates income based on the number of games played in a state to the total number of games played during the year. A comparison of the two approaches is provided below.

*During the 2002/2003 football season, it was reported that New York Jets quarterback, Vinny Testaverde, earned a salary of \$4,922,067. The NFL season provides for 4 pre-season and 16 regular season games (for purposes of this illustration, we will disregard any post-season play). The Jets played 2 of its games in California. While California uses the duty days formula, both alternatives are viewed to illustrate the disparity in results.*

**Tax Calculation – Duty Days Formula:**  $6/200$  (two travel days, two practice days plus two game days divided by the estimated average length of days in a football season)  $\times$  \$4,922,067 = taxable income of \$147,662  $\times$  9.3% (assuming the state's highest marginal tax rate applies) = tax liability of \$13,733.

**Tax calculation – games played formula:**  $2/20$  (number of pre-season plus regular season games)  $\times$  \$4,922,067 = taxable income of \$492,207  $\times$  9.3% = tax liability of \$45,775.

Accordingly, in this example, the games played methodology results in additional taxes of approximately \$32,042. This is a significant difference in tax dollars due based solely on allocation formulas.

In addition, an athlete's wages may be taxed by more than one jurisdiction as allocable days are counted by multiple jurisdictions. So, for instance, if the NY Jets departed from Newark Airport at 12pm on a Friday, does that duty day get counted in New Jersey or California? The answer is found in each taxing jurisdiction's statutes which may reveal that it is counted in BOTH states. This in turn, results in the double taxation of that day's wages by two states.

## 3. Jock Tax Timeline

While 1976 marked the issuance of one of the first appellate decisions concerning state taxation of nonresident professional athletes, it wasn't until the late 1980's and early 1990's that a large number of states and some localities began to require nonresident professional athletes to file tax returns and report an allocated portion of their earnings to the states in which they play games.<sup>11</sup> The answers to "why" and "how" as well as suggested solutions to the numerous issues raised by imposition of the jock tax can be found in the Timeline presented below.

**1976:** One of the first appellate decisions concerning nonresident income taxation of professional athletes – *In re Appeal of Dennis F. and Nancy Partee*, 1976 Ca. Tax LEXIS 35 (State Bd. Equalization Oct. 6, 1976) ruling on an appropriate allocation formula of a professional basketball player's income for 1968.

**1984-1985 Basketball Season:** The salary cap is 3.6 million and the average basketball player's salary is \$330,000.<sup>12</sup>

**1989-1990 Basketball Season:** The salary cap almost triples to 9.8 million dollars and the average basketball player's salary increases to \$717,000.<sup>13</sup>

Early 1990's – Professional athletes salaries are skyrocketing, team members are easily identifiable, team schedules and, therefore, the location of athletic events is relatively easy to access.<sup>14</sup> Each of these factors, along with the fact that states are looking to increase compliance with existing tax laws and fill their coffers, cause the Jock Tax to become more appealing to the states.<sup>15</sup> Nonresident income taxation of professional athletes hits the courts and the news.

### 3.1. Court Decision

#### Issue: How do we determine duty days?

**1991:** Should pre-season training days be included as a duty day? The answer is yes according to: *Hume v. Limbach*, 61 Ohio St. 3d (August 14, 1991) and *Kern et al. v. Wisconsin Dept. of Revenue*, Tax Appeals Commission Nos. 90-I-24, 25 26 35 and 89-I-510-SC (July 26, 1991).

*If an athlete is training during the off-season, these activities are not duty days "unless conducted at the team's facilities as part of a team –imposed program. This is consistent with Wilson v. Franchise Tax Bd., 25 Cal.Rptr.2d 282 (1993), citing Stemkowski v. C.I.R., 690 F.2d 40, (2d Cir.1982) for the proposition that 'Fitness is not a service performed in fulfillment of the contract but a condition of employment.'"*<sup>16</sup>

#### Issue: What compensation is allocated?

**Re. Signing Bonuses:** The IRS determines that signing bonuses do not represent compensation for services. This holding is relevant as several states define compensation by referencing the definition of wages for federal income tax withholding purposes. Accordingly, these and other state courts and administrators agree that an athlete's signing bonus is not allocable compensation for purposes of the jock tax.

- See IRS Rev. Rul. 58-145, 1958-1 C.B. 360 (IRS determined that "a signing bonus paid to a new player solely for signing his first contract, when there was no requirement of subsequent service did not represent remuneration for services performed and therefore, did not constitute wages ...")
- See also, e.g., *Appeal of Testaverde*, No. 9A-0197 (Cal. Bd. Of Appeals Feb. 1, 2000) (Supp. App.6); N.J. Admin. Code sec. 18:35-5.1(b)(4)(iv)(2)(Supp. App. 52).

**Re. Option Year Payments:** In Rev. Rul. 58-301, the IRS held that a payment made for the cancellation of an employment contract does not represent wages subject to federal income tax withholding because it is not a payment for personal services. Accordingly, many states exclude contract or option year buy-out payments received by a non-resident athlete from allocable wages. See, e.g., N.J. Admin. Code sec. 18:35-5.1(b)(4)(iii)(Supp. App. 52); and N.Y. Comp. Codes R. & Reg. Sec. 132.22(b)(4)(I).

#### In The News

**1992:** The City of Brotherly Love mailed tax notices to over twenty thousand non-resident professional athletes that participated in sporting events in Philadelphia, requesting payment of taxes owed dating back to 1986. Mike Board, *Playing in Philadelphia Can Be Terribly Taxing*, CAL. HER., Dec. 14, 1992, at D2. Legal counsel of the four major league players' associations worked out a compromise wherein Philadelphia went back only two years, revoked all interest and penalty charges, and changed its wage allocation methodology from games played to duty days.

**June 1992:** A multi-state task force of the Federation of Tax Administrators (“FTA”) was formed to examine various nonresident income tax issues. The Task Force on Nonresident Income Tax Issues (the “Task Force”) met with representatives of the major league sports and various player associations to discuss the multiple state tax issues that professional athletes face.

**July 29, 1992:** “Michael Jordan’s Revenge was adopted. A retaliatory measure by Illinois to tax athletes from states which tax athletes of Illinois based teams. “The measure was proposed by Chicago lawmakers who were miffed when they found out that California had such a law and was charging Jordan and the rest of the Bulls while they were cashing in their victories in the NBA championship against the Lakers.” Dellios, Hugh, “Legislators OK ‘Jordan’s Revenge,’” July 1, 1991, Chicago Tribune, Sports, pg. 3.

**September 8, 1992:** Representatives of the players’ associations and teams of Major League Baseball, National Football League, National Basketball Association, and National Hockey League prepare and submit a working draft to the FTA analyzing the issues involved in the non-resident taxation of professional athletes: “Working Draft: State Income Taxation of Nonresident Professional Team Athletes.”

**December 1, 1992:** In response to a request by the FTA concerning constitutional issues of the jock tax, Professor Walter Helerstein examined the “Home State Apportionment” approach as a method to tax non-resident athletes. Under this alternative, “states in which a professional sports team is based would require that each athlete employed by that team to allocate 100 percent of his earnings from the playing of (all) games (both in and out-of-state) to that state.” See “Working Draft” above. Illinois utilizes this approach. So, for example, non-resident members of the Chicago Bulls’ Basketball Team are required to report income from all home AND away games to Illinois. Professor Helerstein, an expert in state taxation and constitutional law, opined that the Home State Apportionment method violates the Due Process and Commerce Clauses of the U.S. Constitution. (Please see the discussion in Section V below regarding current case law in Illinois.)

**March 1993:** The “working draft” is finalized and submitted to the FTA: “State Income Taxation of Non-resident Professional Athletes: An Analysis of Options.”

**1994 – Journal Article:** Ekmekjian, Elizabeth C., *The Jock Tax: State and Local Income Taxation of Professional Athletes*, 4 Seton Hall J. Sport L. 229 (1994). (This report also appeared in State Tax Notes, Feb. 28, 1994.) One of the inaugural journal articles published on the topic, this piece introduced the reader to the jock tax, its complexities and issues.

**1994 – Federation Of Tax Administrators:** The FTA Task Force presents its final recommendations in its report: “State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach.”<sup>17</sup> (Uniform Approach). The report raises a number of concerns faced by team members, teams and state administrators and provided two general recommendations to the states: (1) adopt a uniform approach for apportioning taxable income; and (2) take affirmative steps to decrease the burdens faced by athletes and professional sports teams. A detailed discussion of this report appears in Section IV below.

**January 1, 1995:** The State of New York accepted the recommendation of the FTA to adopt a uniform apportionment method, amending its Personal Income Tax Regulations from a games played formula to a duty days formula.

**1995-1999 – Athletes vs. Illinois:** In 1995 and 1996, a number of *non-resident Illinois* based professional athletes received a Notice of Deficiency from the Illinois Department of Revenue adjusting their 1991 and 1992 Illinois State tax returns to allocate to Illinois 100% of the athlete’s team compensation. This allocation is required by Illinois despite the fact that the athletes are taxed by their home or resident state as well as other jurisdictions in which games are played; this causes double taxation of the same income. Approximately 60 athletes protested the allocation; two test cases resulted: Smith and Radinsky.

On or about April 1999, Sammy Sosa (*an Illinois resident*) paid his Illinois personal income tax under protest and filed an action to have the Illinois income tax act declared unconstitutional. Sosa wishes to claim a credit against his Illinois income tax for income taxes paid to other states in which games are played to avoid double taxation.

The background and arguments of the Illinois cases is presented in detail below in Section V of the paper.

**1999 Journal Article:** Chicago attorney expresses the need for congressional intervention: Barger, Paul, *State Taxation of Nonresident Professional Athletes: The Need for Congressional Intervention*, 17 *State Tax Notes* 703 (Sept. 13, 1999).

2002 Baseball Season Salary Information: “Players will earn \$2.023 billion ... . The average salary of \$2,383,235 was up 5.2 percent from last year. The average salary has increased 126-fold from 1967, when it was \$19,000.”<sup>18</sup>

September 2002 - Donovan McNabb, quarterback of the Philadelphia Eagles football team, signed a record 12-year, \$112.92 million deal with his team. McNabb was born in 1976!

#### **4. Federation Of Tax Administrators**

As stated above, in 1994, the FTA Task Force issued its report “State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach” (“A Uniform Approach”). The report raises a number of concerns faced by team members, teams and state administrators including, (1) the compliance burden of filing numerous state and local tax returns; (2) inconsistent rules to govern apportionment of an athletes wages which may lead to multiple taxation of the same earnings; (3) burdens due to withholding and reporting requirements for teams; and (4) administering and enforcing compliance by state administrators and the treatment of athletes as compared to other taxpayers.<sup>19</sup>

In an effort to resolve these issues, the Task Force reviewed the following four alternatives:

“(1) Uniform Apportionment Formula to provide for a consistent approach to the division of income by all states taxing nonresident team members; (2) Home State Apportionment under which team members would allocate income from the playing of all games to the state in which the team played its home games or otherwise maintained its primary facilities; (3) Base State Model under which the tax return filing responsibilities would be 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; and (4) Partnership Model wherein the tax return filing responsibilities would be satisfied through a composite or consolidated return filed on behalf of all eligible team members.”<sup>20</sup>

Attempting to balance the interests of the athletes, teams and state administrators, the Task Force provided two recommendations to the states. First, a proposed uniform regulation, apportioning a nonresident athlete’s taxable income based on a “duty days” approach, was developed. The model regulation incorporated into the report addresses controversial issues including the definition of “duty days” and allocable compensation. Numerous examples are provided to clarify implementation of the provision.

Second, to mitigate administrative and compliance burdens faced by athletes and professional sports teams, the Task Force urged the States to adopt a composite return mechanism or to adopt a simplified withholding requirement.

The Task Force recommendations had an impact on state regulators. For example, effective January 1, 1995, the State of New York changed its non-resident income tax regulations from a games played method to the duty days formula. Massachusetts was also a games played state until January 1, 2002 when new regulation 830 CMR 62.5A.2, which is based on a “duty day” concept, went into effect.

In line with the Task Force's second recommendation, effective January 1, 2002, the Commonwealth of Massachusetts authorizes a professional athletic team to act as an agent for qualified electing non-resident team members by filing a composite return on behalf of its qualified electing non-resident team members. 830 CMR 62.5A.2(6).

## **5. Current Issues: Athletes Vs. Illinois**

The taxing authority of the State of Illinois became interested in the Jock Tax when they noticed the millions of dollars being earned by Michael Jordan of Chicago Bulls fame. In particular, they paid close attention to income taxes he was paying to other jurisdictions. Chicago lawmakers were outraged when they learned that California was taxing Jordan and the rest of the Bulls each time they played the Lakers in Los Angeles in the NBA championships. As a result, Illinois changed its approach to the taxing of professional athletes. On July 29, 1992, "Michael Jordan's Revenge" was enacted. In essence, the State adopted a retaliatory measure to tax visiting athletes from states which tax athletes of Illinois based teams.

Shortly thereafter, the Illinois state taxing authority began to review its laws concerning the taxation of athletes of local based teams such as the Chicago Bulls, the Chicago Cubs and the Chicago White Sox. Under what is referred to as the home state apportionment approach/formula, players on Illinois based professional teams, including non-resident players, are taxed on 100% of their wages with no credit given for taxes paid to other jurisdictions. The effect is to have double taxation of the players' income.

An audit of a number of Illinois based professional athletes resulted in their receipt of a Notice of Deficiency from the Illinois Department of Revenue (the "Department"), adjusting their 1991 and 1992 Illinois State tax returns to allocate to Illinois 100% of the athlete's team compensation. Approximately 60 athletes protested the allocation. In response, the Major League Baseball Players' Association (MLBPA), the baseball players' union, hired legal counsel to represent several athletes. David Smith and Scott Radinsky are two of those athletes.

### **Smith:**

In 1991 and 1992, David Smith (a Texas resident) received compensation as a Chicago Cubs baseball player. He filed his tax returns utilizing a duty days formula in allocating his income among the various taxing jurisdictions in which he played in. A notice of Deficiency was issued by the Department of Revenue (the "Department") for each of the tax years ended December 31, 1991 and 1992. The Notice adjusted his tax returns to allocate to Illinois 100% of Smith's Chicago Cubs compensation.

Smith filed a timely protest claiming, among other issues not addressed by this paper, that the Department's taxing in its entirety the athlete's base salary violates the following provisions of the Illinois and the United States Constitutions: (a) the Uniformity Clause of the Illinois Constitution; (b) The Due Process Clauses of the Illinois and United States Constitutions; (c) The Equal Protection Clauses of the Illinois and United States Constitutions; (d) The Commerce Clause of the United States Constitution; and (e) The Privileges and Immunities Clause of the United States Constitution.

The two provisions of the Illinois statutory scheme of taxing nonresidents that are of particular focus are: section 302 (a) of the Illinois Income Tax Act (IITA) which provides: "Compensation paid to nonresidents. (a) In general. All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment and all items of deduction directly allocable thereto, shall be allocated to this State." 35 ILCS 5/302(a). Section 304(a)(2)(B)(iii), the subsection that best describes the nonresident athlete's employment in this matter, provides that an item of compensation is paid in Illinois if: "(iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, . . . 35 ILCS 5/304(a)(2)(B)(iii). It is the State's contention that since the base of operations of Smith's employer, the Chicago Cubs, is within Illinois, Section 304 as applied through section 302 of the IITA allows a 100% allocation of the athlete's Cubs earnings to Illinois.

On March 23, 2001, an Administrative Decision was issued in the case: “The Department of Revenue of the State of Illinois v. John and Angela Doe” (Smith case). The Decision was adopted by the Illinois Department of Revenue and held that the salary allocation was correct and that Section 304(a)(2)(B)(iii) of the IITA was not unconstitutional. (A complete discussion of the statutes in controversy and constitutional concerns as set forth in the Decision is withheld, but these issues are presented in the section below: see Radinsky.)<sup>21</sup>

Smith then filed a complaint in the Cook County Circuit Court appealing the decision which was then consolidated for the purpose of briefing and argument with Radinsky.

### **Radinsky:**

In 1992, Scott Radinsky was employed by the Chicago White Sox. He was a California resident. The Illinois Dept. of Revenue allocated 100% of the compensation Radinsky received from the White Sox in 1992 to the Illinois income taxes paid for that year. His accountants prepared his 8 state tax returns and 2 city tax returns, allocating income accordingly; taxes were paid in a timely manner. He utilized a duty days formula in preparing his Illinois return.

An audit was performed on the Radinskys’ joint 1992 return and it was determined that all of the athlete’s White Sox compensation was subject to Illinois tax. In 1996, the Department issued a Notice of Deficiency to the Radinskys for the 1992 year, adjusting their 1992 return to allocate to Illinois 100% of Scott Radinsky’s White Sox compensation.

In 1996, lawyers for the MLBPA filed suit against the State of Illinois, et. al., in the Circuit Court of Cook County, Illinois County Department - Law Division, Tax & Miscellaneous Remedies Section on behalf of Radinsky. The test case alleged that the Department of Treasury’s application of the Illinois Income Tax Act was erroneous and challenged Illinois’ right to tax Radinsky and other members of the State’s professional athletic teams, on games played outside the State.

A number of interim proceedings, including amended complaints, dismissal of counts and cross-motions for summary judgment led to the filing of a Motion for Partial Summary Judgment on behalf of Radinsky in October 2002. An order for a refund of the monies paid by the plaintiffs under protest was requested based on Counts V and VII of Plaintiff’s Second Amended Complaint: the Illinois’ taxing scheme as imposed on a nonresident professional athlete under contract to a professional sports team whose domicile is in Illinois violates (1) the Due Process Clause of the United States Constitution and (2) the Commerce Clause of the United States Constitution.

On January 24, 2003, Circuit Judge Thomas R. Chiola struck down that portion of section 304(a)(2)(B)(iii) which defines compensation as is applied through section 302 to non-residents for individual tax purposes as a violation of the Due Process Clause and Commerce Clause of the United States Constitution. *Radinsky v. Zehnder, et. al.* (It should be noted that the Courts holding is consistent with the recommendations made by Prof. Walter Helerstein in his 1992 memo to the FTA. While adoption of the Illinois home state apportionment approach by all taxing jurisdictions would facilitate the administrative burdens imposed on athletes, coaches, trainers, etc. (as each athlete would report his compensation ONLY to the team’s domicile taxing jurisdiction), it fails these constitutional challenges.)

### **5.1. Due Process**

The Court stated that both parties agree that the Due Process Clause imposes three basic limitations on the states’ power to tax. At issue is the following limitation: “the income attributed to the taxing state must be fairly apportioned to the taxpayer’s activities in the taxing state.” The critical issue is whether Illinois may tax all of the compensation that Radinsky earned from the performance of his professional sports services both inside and outside of Illinois?



It is well established that states are empowered to tax nonresidents for income earned from business operations or occupations within the borders of that state. *Shaffer v. Carter*, 252 U.S. 37, 40 S.Ct. 221, 64 L. Ed. 445 (1920). However, Shaffer appeared to restrict the extent of the taxing authority's ability to tax the nonresidents' activities as the Court noted that "the very fact that a citizen of one State has the right to ... carry on an occupation or business in another is a very reasonable ground for subjecting such non-resident, although not personally yet to the extent of ... his occupation or business carried on therein, to a duty to pay taxes ... " (emphasis added). In furtherance of this restriction, the Court also quoted *Container Corporation of America v. Francis Tax Board*, 463 U.S. 159, 103 S.Ct. 2933, 77 L. Ed. 545 (1983), "(u)nder the Due Process Clause and the Commerce Clause of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders'." 462 U.S. at 164.

The Defendants argue that since the base of operations of Radinsky's employer, the Chicago White Sox, is in Illinois, the State's taxing authority is thereby extended to all of the athlete's compensation. This includes activities of the nonresident athlete performed both inside and outside of Illinois. However, no authority was cited to support this position.

Finally, the Court cites to the United States Supreme Court opinion of *Standard Oil v. Peck*, 342 U.S. 382, 72 Sup. Ct. 309, 96 L. Ed. 427 (1952), where the Court struck down an assessment of tax as a Due Process Clause violation:

*The present case is sought to be distinguished on the ground that Ohio is the domiciliary state and therefore may tax the whole value though the boats and barges operate outside Ohio... (M)ost, if not all, of the barges and boats which Ohio has taxed were almost continuously outside Ohio during the taxable year ... and could be taxed by several states on an apportionment basis. The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile... Otherwise, there would be multiple taxation of interstate operations and the tax would have no relation to the opportunities, benefits or protections which the taxing state gives those operations. 342 U.S. at 384-385.*

Based on the above, this Court stated that there is limited support for Defendant's contention that the domicile of the Chicago White Sox is imposed onto the taxpayer-employee's activities occurring outside of Illinois.

## 5.2. Commerce Clause

The test to determine whether a state tax will withstand a Commerce Clause challenge is found in another United States Supreme Court case, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 Sup., Ct. 1076, 51 L. Ed. 326 (1977). Two prongs of this four part test are at issue here: the state tax must be (1) fairly apportioned; and (2) fairly related to services provided by the State.

Plaintiff argues that Illinois attempt to tax all of Radinsky's White Sox compensation, including compensation earned for services performed both inside and outside the State's borders, violates the Commerce Clause. This 100% allocation made by the State, simply because the White Sox are based in Illinois, is not fairly allocated since the taxpayer is a nonresident and a significant percent of his compensation is earned outside of Illinois.

The Defendants argue that because the team has its base of operations in Illinois, more benefits are made available to the taxpayer. And this permits the State to allocate 100% of earnings to Illinois and thereby tax all of his compensation. This argument is made in support of the two tests stated above.

The Court cited *Commonwealth Edison v. Montana*, 453 U.S. 609, 101 S. Ct. 2946, 69 L. Ed. 2d 884 (1981), noting that: "the measure of the tax must be reasonably related to the extent of the contact, since it is the activities ... of the taxpayer in the State that may properly be made to bear a 'just share of state tax burden.' ... When a tax is assessed in proportion to a taxpayer's activities in a State, the taxpayer is shouldering its fair share of supporting the State's provision of 'police and fire protection, the benefit of a trained work force, and the advantages of a civilized society'." 453 U.S. at 626-627.<sup>22</sup>

Based on the above, in striking down the State statute violates the Commerce Clause, the Court stated that the “focus is on the activities of the nonresident taxpayer in the state rather than any purported benefits to be assessed due to the domicile of the taxpayer’s employer in the State.” Defendant’s argument fails.

**5.3. Additional Court Mandates**

The Court permanently enjoined the Illinois Department of Revenue from applying the above referenced provisions of the IITA in a matter that is inconsistent with its findings. Also, the Department was ordered to reassess the Plaintiff’s 1992 tax and allocate to the State only that portion of Radinsky’s White Sox compensation earned from services performed in Illinois.

The Department filed an appeal directly to the Illinois Supreme Court (bypassing the intermediate appellate court), which is required whenever an Illinois State Statute is invalidated. Arguments are expected to be heard late 2003.

**Sosa**

While Smith and Radinsky focused on the allocation of a non-resident professional athlete playing for an Illinois based team, Sosa presents a different issue with respect to an Illinois resident athlete playing for an Illinois based team as discussed below.

In 1998, Sammy Sosa, an Illinois resident, earned compensation as a professional baseball player for the Chicago Cubs. An allocated portion of that income was taxed by other states based upon the amount earned while playing in those other states. Like other Illinois residents, Sosa’s entire income, including compensation from sources within and without Illinois, was also subject to tax by the State. To avoid double taxation of its residents, 35 ILCS 5/601(b)(3) of the Illinois Income Tax Act (the “Act”) provides a credit for amounts paid to other taxing jurisdictions. However, this provision is inapplicable to Sosa and other professional athletes that reside in Illinois and play for an Illinois based team as no credit is offered for taxes on “compensation paid in Illinois” as defined by 35 ILCS 304 (a)(2)(B).

On or about April 1999, Sosa paid his Illinois personal income tax under protest and filed an action to have certain provisions of the Illinois Income Tax Act declared unconstitutional. Sosa’s complaint argued that he was being treated in a different manner than if he, an Illinois resident, played for a team based outside of Illinois. Such a player would be allowed a credit by the State of Illinois for taxes paid to other jurisdictions. The table below compares results of Sosa’s contentions:

	Illinois Resident Playing For...	
	Chicago Cubs	St. Louis Cardinals
<b>Illinois Tax</b>	Based on entire salary	Based on entire salary
<b>Credit for Taxes paid to other jurisdictions</b>	No	Yes
<b>Result</b>	Double taxation on salary taxed by other states in which games are played. Discriminatory provision.	No double taxation

His claim was based on the Commerce Clause of the U.S. Constitution and under the Uniformity Clause of the Illinois Constitution.

On June 26, 2003, the Circuit Court of Cook County, Illinois, the same Judge as in Radinsky, Thomas R. Chiola, dismissed the Motion for Summary Judgment filed by Sosa based on its belief that Sosa failed to show that the foreign tax credit allowed to some by Illinois violated either of the above stated provisions. The court focused on Sosa’s inability to cite any case law in support of his position.

*“Sosa makes a tortured attempt to bring the failure of Illinois to allow a credit for taxes paid to another state under the Commerce Clause. The Court fails to see how the Commerce Clause is implicated by a state’s unwillingness to provide a credit to individuals who are residents for taxes paid to another state.”*

As to Sosa’s arguments under the Uniformity Clause, the Court stated that there was no precedent for requiring a tax credit to be uniform; same only needs to be reasonable.

*“The wisdom of the tax policy presented by a credit which is parsed to some, but not all, is not for this Court to determine; it is a legislative prerogative.”*

If Sosa chooses, his appeal will lie in the Illinois Appellate Court as no statutory provisions were struck down.

## **6. Conclusion**

Will the Illinois taxing authority’s positions be upheld concerning: (1) the allocation of compensation of non-resident athletes; and (2) no tax credits be granted for taxes paid for professional work outside of the State? If so, will other states adopt the Illinois model?

Interestingly enough, in 2002, the State of New Jersey established a tax amnesty program. As part of that program New Jersey sent letters to non-resident attorneys that had come into the state to represent clients. The letter did not assert a claim that taxes were owed. It simply stated that the attorneys contacted might wish to avail themselves of the tax amnesty program.

Why was this letter sent? Was it a harbinger of New Jersey seeking to expand upon its very own “jock tax”?

The implications are clear. New Jersey is contemplating assessing income taxes on non-residents in addition to professional athletes who perform services within the state. Which professionals will be assessed we do not as yet know. By stating that attorneys may wish to avail themselves of this program, it is clear that the taxing authorities of New Jersey clearly believe that failure to pay such taxes is a violation of law for which amnesty is available.

As we write this article, most states are desperately looking for income to fill looming budget deficits. The motivation is strong for these states to seek income from additional sources. The model of the “jock tax” is readily applicable to any number of highly paid professionals whose sojourns to earn income within a state is a matter of public record and whose incomes are large. So while players who earn millions of dollars are often not objects of sympathy when it comes to the payment of additional tax dollars, we cannot help but wonder who will next catch the attention of state taxing authorities with all the ramifications of the above paper applying to them? Could it be you?



## **Endnotes**

1. *MLB - New York Mets Salaries*, CBS SPORTSLINE.COM, <http://cbs.sportsline.com/u/baseball/mlb/teams/NYM/salaries.htm> (visited Jul 8, 2002). *MLB – New York Yankees Salaries*, CBS SPORTSLINE.COM, <http://cbs.sportsline.com/u/baseball/mlb/teams/NYY/salaries.htm> (visited Jul 8, 2002).
2. It should be noted that coaches, trainers, and other traveling team members are also subject to the jock tax. Tax calculation:  $(90,000,000+126,000,000) \times 100/220 \times 6.85\% = \$6,725,455$ . The numerator of 100 represents the approximate number of days that Mets and Yankee players are based in NY. The denominator of 220 days represents an estimate of the number of days in the regular season: generally 220-225 days, Michael LaVerde, CPA, New Jersey. 6.85% represents the highest marginal tax rate in the State of New York.

3. New York Mets Baseball 2002 Schedule.
4. New York Yankees Baseball 2002 Schedule.
5. Estimate calculation: number of players on roster, 25, x player average salary, \$2,383,235, = \$59,580,875 x 1/220 = \$270,822 taxable income per game x 6.85% = \$18,551 per game x 162 games = \$3,005,262 per season. As a general rule, a Major League Baseball team may suit-up 25 of the club's 40 man roster from opening season through August 31. After that, through the end of the season, all players listed on the club's 40 man roster are eligible to play. *Major League Baseball FAQ*, MLB.COM, [http://www.mlb.com/NASApp/mlb/mlb/help/mlb\\_help\\_faq\\_baseball.jsp#top](http://www.mlb.com/NASApp/mlb/mlb/help/mlb_help_faq_baseball.jsp#top) (visited Jul 22, 2002). The average salary for a Major League Baseball player in 2002 is \$2,383,235. *Baseball Players Smash \$2 billion Barrier in Salaries*, CBS SPORTSLINE.COM, April 3, 2002, [http://cbs.sportsline.com/wce/multi/0,1329,5195845\\_52,00.html](http://cbs.sportsline.com/wce/multi/0,1329,5195845_52,00.html) (visited Jul 8, 2002).
6. The focus of this paper is on team athletes such as those participating in the National Football League, Major League Baseball, National Basketball Association and the National Hockey League. Salary income of these athletes is not easily apportioned as compared to a professional tennis player who, for example, can attribute prize money earned in New York at the U.S. Open.
7. See, e.g., *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) (holding that domicile itself affords a basis for state and city taxation).
8. *State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach*, FEDERATION OF TAX ADMINISTRATORS, (March 1994) [hereinafter *A Uniform Approach*]. See e.g. *Shaffer v. Carter*, 252 U.S. 37, 50 (1920), where the United States Supreme Court establishes the right of a state to tax a nonresident performing services within the state.
9. Athletes may also be subject to Canadian income taxes as well. This issue is not addressed in this paper. For additional information, see: Koresky, Kevin, *Tax Considerations for U.S. Athletes Performing in Multinational Team Sport Leagues or "You Mean I Don't Get All of My Contract Money?!"*, 8 Sports Law. J. 101 (2001) and Adams, Jeffrey, *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*, 10 Ind. Int'l & Comp. L. Rev. 79 (1999).
10. A Uniform Approach at 11, supra note 9.
11. The California State Board of Equalization ruled on the appropriate allocation formula to be used in apportioning a professional basketball player's income for the tax year ending December 31, 1968.
12. *Year-by-Year NBA Salary Cap*, CBS SPORTSLINE.COM, July 19, 2001, [http://cbs.sportsline.com/wce/feature/0,1518,4110836\\_54,00.html](http://cbs.sportsline.com/wce/feature/0,1518,4110836_54,00.html) (visited Jul 8, 2002).
13. Id.
14. A Uniform Approach at 1, supra note 8.
15. Id.
16. Id. FN 11 at 9.
17. A Uniform Approach, supra note 8.
18. *Baseball Players Smash \$2 billion Barrier in Salaries*, CBS SPORTSLINE.COM, April 3, 2002, [http://cbs.sportsline.com/wce/multi/0,1329,5195845\\_52,00.html](http://cbs.sportsline.com/wce/multi/0,1329,5195845_52,00.html) (visited Jul 8, 2002).
19. A Uniform Approach at 2-3, supra note 8.
20. Id. at 2.
21. Smith matter represented a "test case" on the issues in controversy and would "bind approximately 60 other protested cases involving various professional athletes that were on hold - as reported in footnote 1 of the Decision.
22. While not a constitutional matter, issues of equity and fairness would further dictate that a more reasonable formula for allocating taxes be made. Illinois enjoys the revenue generated by the presence of professional athletes during sporting events. These amounts are substantial and appear to more than adequately offset the benefits bestowed on these nonresident athletes. An additional issue for consideration is that the nonresident has no voice in Illinois government, the taxing state. Therefore, it appears to be "taxation without representation," with an attendant lack of any participation for which one is required to support monetarily with income tax dollars. See United States Constitution, Article 4, section 2, paragraph 3; See also Williams v. Rhodes, Ohio, 1968, 89 S. Ct. 5, 393 U.S. 23 and U.S. v. Robel, Wash., 1967, 88 S. Ct. 419, 389 U.S. 258.

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<sup>1</sup> *MLB - New York Mets Salaries*, CBS SPORTSLINE.COM, <http://cbs.sportsline.com/u/baseball/mlb/teams/NYM/salaries.htm> (visited Jul 8, 2002). *MLB – New York Yankees Salaries*, CBS SPORTSLINE.COM, <<http://cbs.sportsline.com/u/baseball/mlb/teams/NYY/salaries.htm>> (visited Jul 8, 2002).

<sup>2</sup> It should be noted that coaches, trainers, and other traveling team members are also subject to the jock tax. Tax calculation:  $(90,000,000 + 126,000,000) \times 100/220 \times 6.85\% = \$6,725,455$ . The numerator of 100 represents the approximate number of days that Mets and Yankee players are based in NY. The denominator of 220 days represents an estimate of the number of days in the regular season: generally 220-225 days, Michael LaVerde, CPA, New Jersey. 6.85% represents the highest marginal tax rate in the State of New York.

<sup>3</sup> New York Mets Baseball 2002 Schedule.

<sup>4</sup> New York Yankees Baseball 2002 Schedule.

<sup>5</sup> Estimate calculation: number of players on roster, 25, x player average salary, \$2,383,235, = \$59,580,875 x 1/220 = \$270,822 taxable income per game x 6.85% = \$18,551 per game x 162 games = \$3,005,262 per season. As a general rule, a Major League Baseball team may suit-up 25 of the club's 40 man roster from opening season through August 31. After that, through the end of the season, all players listed on the club's 40 man roster are eligible to play. *Major League Baseball FAQ*, MLB.COM,

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<sup>6</sup> The focus of this paper is on team athletes such as those participating in the National Football League, Major League Baseball, National Basketball Association and the National Hockey League. Salary income of these athletes is not easily apportioned as compared to a professional tennis player who, for example, can attribute prize money earned in New York at the U.S. Open.

<sup>7</sup> See, e.g., *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) (holding that domicile itself affords a basis for state and city taxation).

<sup>8</sup> *State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach*, FEDERATION OF TAX ADMINISTRATORS, (March 1994) [hereinafter *A Uniform Approach*]. See e.g. *Shaffer v. Carter*, 252 U.S. 37, 50 (1920), where the United States Supreme Court establishes the right of a state to tax a nonresident performing services within the state.

<sup>9</sup> Athletes may also be subject to Canadian income taxes as well. This issue is not addressed in this paper. For additional information, see: Koresky, Kevin, *Tax Considerations for U.S. Athletes Performing in Multinational Team Sport Leagues or "You Mean I Don't Get All of My Contract Money?!"*, 8 Sports Law. J. 101 (2001) and Adams, Jeffrey, *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*, 10 Ind. Int'l & Comp. L. Rev. 79 (1999).

<sup>10</sup> A Uniform Approach at 11, supra note 9.

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<sup>13</sup> Id.

<sup>14</sup> A Uniform Approach at 1, supra note 8.

<sup>15</sup> Id.

<sup>16</sup> Id. FN 11 at 9.

<sup>17</sup> A Uniform Approach, supra note 8.

<sup>18</sup> *Baseball Players Smash \$2 billion Barrier in Salaries*, CBS SPORTSLINE.COM, April 3, 2002 <[http://cbs.sportsline.com/u/ce/multi/0,1329,5195845\\_52,00.html](http://cbs.sportsline.com/u/ce/multi/0,1329,5195845_52,00.html)> (visited Jul 8, 2002).

<sup>19</sup> A Uniform Approach at 2-3, supra note 8.

<sup>20</sup> Id. at 2.

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