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A Challenge for Athletes

By Joseph Geier, CPA & Melissa Jordan

Typically when people think of professional baseball players, words like *fame* and *fortune* come to mind. Few realize the complex issues these athletes face throughout their careers and in retirement. Two of the biggest offenders are the combination of short career span with unpredictable income and complex tax issues. Both of these topics play a substantial role in the career lifecycle of an athlete:

1. Pre-draft/draft
2. Minor leagues
3. Peak earning years
4. Twilight of career
5. Post-career

Short Career Span/Unpredictable Income

Although most advisors are working with clients that have careers that span 30 or 40 years, advisors for professional athletes are faced with planning based on career spans of 6 years or in many cases less. A 2007 study concluded that the average career of a Major League baseball player lasts 5.6 years. This places the advisor in a unique position of having to implement a retirement income plan for clients who have not yet reached the age of 40.

Though they may be young, they are very similar to a 60-year-old from a planning standpoint, as securing a sufficient income stream is paramount. Since athletes' prime earnings potential only lasts a few years, they need to be conservative in their investing style early on, with a focus on safe, low-cost investments such as bonds and mutual funds for the bulk of their portfolios. Structure and discipline must be a big part of their plans as these portfolios will end up being their primary source of income once they retire.

New clients need audits of their previous returns to see if mistakes may have been made. And all clients need forward-looking projections, to make sure the proper withholdings are communicated to the teams or that money is set aside on a quarterly basis to pay for the anticipated tax bills that will inevitably come in April.

Athletes also need money market accounts, into which their paychecks can be directly deposited. A certain percentage then flows into investment accounts that their advisors have helped establish. That percentage needs to be calculated in conjunction with an annual budget, which takes into account both season and off-season expenses.

Oftentimes, professional athlete clients request that their advisors pay their bills and manage their banking accounts for them. There are pros and cons to this. On one hand, if advisors assume control over writing out the checks and balancing the accounts, the athletes become disconnected from their daily financial situation. On the other hand, it can make a lot of sense from a logistics standpoint. It allows the advisors to categorize athletes' spending and run reports specific to taxes, drilling down to line items such as clubhouse dues, agent fees, meals and housing.

Advisors do have to adapt to the sporting lifestyle: Professional athletes are very nomadic, and many times bills have been sent to a temporary residence they no longer occupy. This type of activity can severely damage their credit reports and cripple their chances of securing good rates on mortgages or even insurance down the road. Running credit reports and proactively cleaning them up is another must for new clients coming in the door.

Avoid Getting Tackled on Taxes

One of the biggest issues for athletes is taxes. Not only are professional athletes in high tax brackets, but they typically are required to file tax returns and pay taxes in the many different states and cities in which they play. This has been called “Jock Tax.” The athlete is taxed for each “duty day” defined as any in which they participate in a game, practice or even workout. So it is crucial that the advisor know the days the athlete traveled with the team, days injured, and each day he or she was in each state. To determine the percentage taxable, the duty days are divided by the total number of days in the season.

View an example of how Geier Financial Group determines “duty days.”

Understanding the Jock Tax and choosing states of residency that fit into athlete clients' life situation while minimizing their tax burden can be a critical component in the financial planning process.

Once a decision has been made in terms of residency, it is imperative that the taxpayer-athlete take the requisite steps to ensure that the residency is clearly documented. These steps include, but are not limited to, obtaining living quarters, getting a driver’s license, registering to vote, establishing a banking relationship and registering and insuring vehicles in the state of residence.

An example of this at work is a case from 1997, where the State of Maryland claimed that Baltimore Oriole Brady Anderson owed $485,133 in back resident income taxes, even though he was a permanent resident of Nevada and not of Maryland. Anderson paid Maryland taxes in full as a non-resident, but the state claimed that he was a resident because he rented an apartment in Baltimore during the baseball season. That November, the courts ruled that Anderson did not have to pay the back taxes because he was not a permanent resident, but rather he stayed there certain days only to work. Anderson's clear records of his life in Nevada were key to establishing his residency.

Advisors also need to be up on the deductions unique to the professional athlete. Some of these deductions include equipment, union dues, clubhouse dues, agent/advisor management fees, travel, meals and incidental travel expenses, and temporary housing, as long as the athlete was not reimbursed by the team for these expenses. The benefits derived from deductions can be substantial, especially when looking at the average cost professional athletes must pay their agents (oftentimes 2 percent of their gross salary).

There are a ton of tax intricacies specific to the professional sports industry that a tax advisor should know. However, having a strong knowledge of the tax industry in general is not enough to serve this specific clientele well: An extensive knowledge of the industry they work in is crucial! Advisors need to understand more than the proper timing of estimated tax payments or the types of alternative investments that provide potential tax breaks. They have to go beyond that to understanding things like salary structure, contract and bonus structures, what the athletes does and does not get reimbursed for by the team, and the financial repercussions when an athlete is injured.

So the next time one of your non-athlete clients complains about having to file a tax return, just hand them an athlete’s three-inch thick tax return with 13 different state returns attached.

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