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4-1-1986

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Recommended Citation
J. V. Crum III, *Issues in Income Tax Planning for the Team Sport Player*, 3 U. Miami Ent. & Sports L. Rev. Iss. 1 (1986)
Available at: http://repository.law.miami.edu/umeslr/vol3/iss1/7

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# ISSUES IN INCOME TAX PLANNING FOR THE TEAM SPORT PLAYER

J.V. CRUM, III*

This essay provides an overview of the basic issues of tax planning for team sports players. Because not all of the tax considerations which are relevant for the team player are relevant to the individual sports player, such as the tennis player or golfer, the reader is cautioned against using this discussion in tax planning for non-team sports players. Rather the purpose of this essay is to provide the practitioner with a checklist of tax considerations for use in working with the team sports player-client. A working knowledge of basic income tax law is therefore assumed. Even though this is an overview and not an exhaustive review of case law or statutes, numerous Internal Revenue Code sections, Treasury Regulations, Revenue Rulings and tax cases are referred to in the text and footnotes; they provide both the foundation for this discussion as well as a springboard for the reader's research on specific problems. All law presented in this essay is current as of the date of publication.

The approach taken in this article is to provide a discussion of those tax considerations that either specifically relate to sports aspects of the client or are of paramount concern in tax planning for a team sports player. Other sources provide excellent reviews of the inclusions, exclusions and deductions that apply to all individual taxpayers.[1]

## I. HIGH INCOME/SHORT CAREER

Unlike most wage-earners who generally have a steady or increasing flow of income over a long career-span, the sports player typically has a very short career, frequently marked by a few highly productive years followed by many less productive years.[2] Therefore the tax planner must provide for deferred compensation,[3] receipt of substantially non-vested property,[4] and qualified

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1. *See* M. SAUNDERS, PRINCIPLES OF TAX PLANNING (1978).
2. *See* J. WEISTART & C. LOWELL, THE LAW OF SPORTS (1979).
3. *See, e.g.*, Treas. Reg. 1.451-2(a) (1986); Rev. Rul. 55-727, 1955-2 C.B. 25; Rev. Rul. 72-25, 1972-1 C.B. 128; Rev. Rul. 79-220, 1979-2 C.B. 74.
4. I.R.C. § 83 (1986); Treas. Reg. 1.83-3 (1986).

pension[5] or Keogh plans,[6] together with an Individual Retirement Account,[7] in order to assure adequate economic resources being available to the player in his post-professional athlete career.

## II. Gross Income

### A. The Bonus

Whether bonuses are given to athletes in return for their promise to play for a team[8] or for signing the first contract without any requirement of subsequent service,[9] the bonus is taxable as gross income.[10] In the case, however, of signing a first contract without a requirement of subsequent service, no income tax need be withheld at the time of payment.[11]

Generally, if a specific benefit would be includable in gross income if it were cash, it will also be includable if the benefit is "in kind."[12] Usually a benefit "in kind" which is includable in gross income, is includable at its fair market value[13] (FMV). In the case of *Lawrence W. McCoy*,[14] the court valued a car received by the taxpayer-employee at its value in the hands of the taxpayer and not at its retail value to the employer who bought the car as an award for the taxpayer-employee.[15] Thus the FMV of "in kind" income[16] may be less than the cost to the payor immediately prior to the transaction.

There are three situations in which the team player is subject to receiving "in kind" benefits that are includable in gross income. First, the player may be the recipient of prizes or awards,[17] such as valuable player awards.[18] The prize or award is includable in gross

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5. I.R.C. §§ 401, 403, 404 (1986).
6. I.R.C. § 401(c)-(d) (1986).
7. I.R.C. § 408 (1986).
8. Rev. Rul. 55-727, 1955-2 C.B. 25.
9. Rev. Rul. 58-145, 1958-1 C.B. 360.
10. I.R.C. § 61 (1986); Treas. Reg. 1.61-2(a) (1986) ("bonuses" used).
11. Rev. Rul. 58-145, 1958-1 C.B. 360.
12. Treas. Reg. 1.61-1(a) (1986) ("gross income includes income realized in any form, whether in money, property, or services").
13. Treas. Reg. 1.74-1(a)(2) (1986); I.R.C. § 74(a) (1986).
14. *McCoy*, 38 T.C. 841 (1962).
15. The car had cost the employer $4,452.54 but the court, primarily based on the facts surrounding the value received upon the sale of the car to a dealer ten days after taxpayer received the car, valued it at $3,900.00.
16. Treas. Reg. 1.61-1(a) (1986).
17. I.R.C. § 74(a) (1986); Treas. Reg. 1.74-1(a)(2) (1986).
18. 47 T.C. 428 (1967) (player received car for being outstanding player in National

income unless it is "in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement",[19] and then only if no action was required on the part of the recipient in the past[20] nor will any future services be required.[21] Generally, prizes or awards received by athletes will not fall within the exclusion and therefore, must be included in gross income.

Second, the player may receive meals or lodging that are includable as gross income. Only meals that are received on the business premises for the employer's convenience[22] or on-premises lodging which the player must accept as a condition of employment[23] are excludable. Thus, while pre-season training camp lodging and meals may well meet the tests for exclusion, especially if the player's contract specifies the required lodging and meals, if the player were allowed to stay on the premises at his own choosing and meals were made available for the convenience of the player but not specifically tied into the convenience of the employer, the FMV of the in kind lodging and meals would be included in gross income.[24]

Third, gifts "in-kind" are includable to the extent they do not represent the "detached and disinterested motivation" of the giver.[25] Thus, a gift that represented a commercial interest such as publicity for the giver would be includable—a loan of a car to a player by a car dealer or manufacturer would be an example where commercial interests attach to render the "gift" includable in income at the FMV of renting, insuring, and maintaining a car for the loan period.[26]

### B. *Cash Reimbursements*

Although the general rule is that cash reimbursements of business expenses of the employee are includable in the employee's gross income,[27] if the reimbursements are of the type covered by Internal Revenue Code section 62, they may be deducted from

Football League).

19. I.R.C. § 74(b) (1986).
20. I.R.C. § 74(b)(1) (1986).
21. I.R.C. § 74(b)(2) (1986).
22. I.R.C. § 119(a)(1) (1986).
23. I.R.C. § 119(a)(2) (1986).
24. Treas. Reg. 1.61-1(a) (1986).
25. Commissioner v. Duberstein, 363 U.S. 278, 285 (1960).
26. Treas. Reg. 1.61-1(a) (1986).
27. *Id.*

gross income.[28] If they are not of the type covered by section 62, the player may still be able to deduct the expenses incurred if they fall within those deductions allowed as excess itemized deductions (sections 161-96). Internal Revenue Code section 62(2)(A) allows a deduction for expenses of the employee that are of the type covered by sections 161-96, if incurred in connection with the performance of employee services.

Some cash reimbursements are neither excludable nor deductible from the gross income of the player. Some "fringe benefits" do not meet the tax code specifications for exclusion or deductibility. The Court in *Commissioner v. Kowalski*[29] found that an employee who received a food allowance payment in his check for meals eaten while on the job (a state police trooper on duty) could neither exclude nor deduct the payments from his gross income. The allowance was not excludable because it did not meet the test of section 119(a)(1) and was not deductible because the purchase of meals is a personal, non-deductible expense under section 262.

### C. *Use of Likeness and Endorsements*

For many sports figures, the use of their signature and likeness on consumer oriented equipment, as well as actual endorsements of commercial goods, is a source of income. As with all other income, Internal Revenue Code section 61 requires the inclusion of income received for the use of likeness or endorsements in gross income.

### D. *Interest Free Loans*

The area of interest free loans has provided much uncertainty in the past. With the passage of Internal Revenue Code section 7872 the employee-borrower who is not a shareholder in the corporation-lender must include in his gross income the imputed interest value of the interest free loan, but may then deduct under section 163, as an itemized deduction, the imputed value of interest that would have been paid to the corporation-lender. Note that this is a wash except to the extent the taxpayer has not, prior to the computation for the imputed tax deduction, already itemized deductions in excess of the zero-bracket amount.[30]

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28. I.R.C. § 62(2); Rev. Rul. 77-351, 1971-2 C.B. 23.
29. 434 U.S. 77 (1977).
30. I.R.C. § 63(g) (1986).

### E. *The Assignment of Income Problem*

Income is taxed to the person who beneficially receives it; even if the income is assigned to one who did not earn the income, the beneficial enjoyment remains in the one who earned the income and taxation follows beneficial enjoyment.[31] In the usual case, no assignments of income will avoid inclusion of the income in the gross income of the player-earner.

### F. *Constructive Receipt—The Legal Time Clock*

In general, "gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer."[32]

> 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, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.[33]

Frequently income is deferred by a contractual arrangement between the team and the player. Whether this arrangement will result in constructive receipt of income for a cash basis taxpayer in the year the contract is signed depends on the specific terms of the contract. First, where a mere contract right exists in the player to receive monies in later tax years and no money is set aside for the payment of these debts as they come due, no constructive receipt of monies occurs in the present year.[34] Second, where a mere contract right exists in the player to receive monies in later tax years and money is set aside for the payment of these debts as they come due, no constructive receipt occurs in the present year provided the player is neither the owner nor a beneficiary of any sums set aside (in annuity or other form), the specific money set aside is subject to the general creditors of the employer, *and* the player has no other liens against the employer for the payment of the deferred compensation.[35] The player is not taxed so long as he acquires no interest in the deferred compensation beyond a mere

31. Lucas v. Earl, 281 U.S. 111, 115 (1930).
32. Treas. Reg. 1.451-1(a) (1986).
33. Treas. Reg. 1.451-2(a) (1986).
34. Treas. Reg. 1.451-2(a) (1986); Rev. Rul. 71-419, 1971-2 C.B. 320; Rev. Rul. 55-729, 1955 C.B. 25.
35. Rev. Rul. 72-25, 1972-1 C.B. 128.

contractual expectancy. Third, where the deferred compensation is placed in an escrow account in which the player has a right as owner or as beneficiary, constructive receipt occurs in the year in which the sums are set aside.[36]

## III. Exclusions From Gross Income

Several specific techniques, in addition to reimbursements under I.R.C. section 62 and the deferred receipt of funds due to contractual agreement, are available to reduce gross income either permanently or until an event that triggers recognition occurs. In this section, those methods available to the team sports player for permanently excluding potential income for gross income are discussed.

### A. *Meals, Lodging and Travel Expenses*

As noted above, I.R.C. section 119 allows an exclusion for meals and lodging if both are received for the employer's convenience on the employer's premises and the lodging on the premises is a required term of employment.

In addition to the exclusion for meals and lodging received on the employer's premises allowed under I.R.C. section 119, reimbursements for subsistence such as travel including meals and lodging, when meals are in connection with overnight lodging,[37] are excludable from the gross income of the player provided there is adequate substantiation of the expenses,[38] or in the absence of specific substantiation, per diem and mileage allowances are allowed if they do not exceed those specified by the Internal Revenue Service.[39] Where players are away from the home city of the team, such as during games and pre-season training, these rules will apply. Other subsistence expenses include: "laundry, cleaning and pressing of clothing, and fees and tips for services, such as waiters and baggage handlers. The term 'subsistence' does not include taxicab fares or the costs of telegrams or telephone calls."[40]

36. Sproull v. Commissioner, 16 T.C. 244 (1951); Treas. Reg. 1.451-1(a) (1986); Treas. Reg. 1.145-2(a) (1986); Rev. Rul. 60-31, 1960-1 C.B. 174, 179, 180.
37. I.R.C. § 162(a)(2) (1986); Treas. Reg. 1.162-17(b) (1986).
38. Treas. Reg. 1.274-5(c) (1986).
39. Rev. Rul. 80-62, 1980-1 C.B. 63.
40. Rev. Rul. 80-62, 1980-1 C.B. 63, 64.

Crum: Issues in Income Tax Planning for the Team Sport Player



### *B. Compensation for Injuries or Sickness*

The team athlete, especially in such areas as football, soccer, baseball, hockey, and basketball is often subject to various physical injuries. Therefore, statutory exclusion of various forms of reimbursements are extremely important to these athletes. First, I.R.C. section 104(a)(3) provides for exclusion from gross income the payments received from accident or health insurance for personal injuries or sickness where the player purchased the policy himself. Second, where the employer team purchased the policy, I.R.C. section 105 provides that only amounts received for missed salary are included in income; all else is excluded (with the exception of reimbursements received for costs incurred in a prior year to the extent those costs were deducted on the prior year's income taxes under I.R.C. section 213).[41] Third, where the player receives damages for personal injuries or sickness, whether through suit or agreement (such as a pre-trial settlement), these are also excluded to the extent the compensation is for personal injury.[42]

## IV. Sports Related Deductions

Many deductions provided under the code particularly, but not exclusively, apply to the team sports player.[43] Of particular importance to the athlete are business deductions under I.R.C. section 162, specific trade or business deductions of employees under I.R.C. section 62, depreciation deductions under I.R.C. sections 167-68 (together with investment tax credits under section 46), moving expense deductions under I.R.C. section 217.

### *A. Section 162 Trade or Business Expenses and Section 162 Reimbursements*

Generally, "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business" are deductible.[44] If, however, deductions are taken under I.R.C. section 162 rather than as reimbursed expenses of employees under I.R.C. section 62, the expenses must pass the zero bracket amount[45] before they become deductible, and are deducted from

41. I.R.C. § 105(b) (Supp. I 1986).
42. I.R.C. § 104(a)(2) (1986).
43. I.R.C. §§ 151-248 (1982 and Supp. I 1986).
44. I.R.C. § 162(a) (1986).
45. I.R.C. § 63 (1986).

University of Miami Entertainment & Sports Law Review, Vol. 3, Iss. 1 [1986], Art. 7



adjusted gross income.[46] Therefore, where possible, it is preferable for the player-employee to use I.R.C. section 62(2)(A) reimbursed expenses, I.R.C. section 62(2)(B) expenses for travel away from home, and I.R.C. section 62(2)(C) for transportation expenses when possible.

All "ordinary and necessary expenses"[47] is given a broad enough interpretation to cover many of the expenses of a sports player. Included in the list of expenses which the tax planner should consider are: (a) professional association dues; (b) salaries of the player's accountant, tax planner, attorney, agent and special coaches; (c) uniforms; (d) required non-reimbursed travel expenses; (e) rentals of equipment or gyms; and (f) the capitalized expense of necessary equipment purchases as well as interest paid on amortized purchases of business property.

Salaries of employees or independent service contracts must be reasonable;[48] however, if free bargaining occurs, fees or salaries may be paid on a contingent basis.[49] If payments are made to family members, a clear showing of actual services will be required to avoid assignment of income treatment.[50] Special coaching or training is also deductible.[51] Uniforms and related equipment with a useful life of one year or less are deductible in the year purchased.[52] Rentals of equipment or gyms, if the sports player can substantiate a business purpose, such as required bodybuilding, are also deductible.[53]

In the area of travel expenses, whether deductible under I.R.C. section 62 or I.R.C. section 162, transportation costs[54] are dealt with separately from meals and lodging.[55] Important to both, how-

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46. I.R.C. § 63 (1986).

47. I.R.C. § 162(a) (1986).

48. Treas. Reg. 1.162-7(b)(3) (1986).

49. Treas. Reg. 1.162-7(b)(2) (1986).

50. Allen v. Commissioner, 50 T.C. 466 (1968) (attempted assignment of earnings by athlete/son to mother, where mother performed no services of a business nature, was held to be nondeductible); Hundley v. Commissioner, 48 T.C. 339 (1967) (payment to father/advisor-agent of 50% of future athletic earnings of son was upheld as deductible).

51. Treas. Reg. 1.162-5(a) (1986).

52. Rev. Rul. 70-476, 1970-2 C.B. 35; Rev. Rul. 70-475, 1970-2 C.B. 35; Rev. Rul. 70-474, 1970-2 C.B. 35.

53. Treas. Reg. 1.162-1(a) (1986) ("No such item shall be included in business expenses, however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property").

54. I.R.C. § 162(a)(3) (1986).

55. Treas. Reg. 1.162-2(b) (1986).

ever, is the determination of where is the "home"[56] of the team player. In the case of team sports players, unlike individual athletes, such as tennis players, a majority of the year is spent in one town, the "club's home town," even though the athlete may own a home in another city and perform work there, or elsewhere, during the off-season. Where the player does own a home in a city other than the team's home town, and does work in the two cities, the factors used to determine which place is the home town for the purposes of deciding when the player is traveling under I.R.C. section 162(a)(2) are the "total time ordinarily spent by the taxpayer at each of his business posts, the degree of business activity at each such post, and whether the financial return in respect of each post is significant or insignificant."[57] Note, however, that if the player performs work each year in city A and city B, and city A is determined to be the "home" for the purposes of I.R.C. section 162(a)(2), then the "tax home does not shift during alternate seasons from one business location to the other . . . the employee may . . . deduct the cost of meals and lodging at the minor place of employment while duties there require such employee to remain away from the principal post of duty."[58]

Transportation expenses are deductible, per trip, on an all or nothing basis, if under the facts and circumstances of the case, the majority of time was spent on business related activities.[59] Meals and lodging are, however, deducted proportional to the amount of time spent on business activities.[60] As opposed to travel away from home, local travel expenses exclude meals and lodging[61] and commuting to and from work is generally not deductible.[62]

While interest paid on trade or business related purchases is deductible,[63] disability insurance premiums paid by the sports players are not deductible to the extent they are for reimbursement of lost wages in case a disability occurs.[64]

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56. Rev. Rul. 54-147, 1954-1 C.B. 51; Rev. Rul. 75-432, 1975-2 C.B. 60; Rev. Rul. 63-82, 1963-1 C.B. 33.
57. Rev. Rul. 54-147, 1954-1 C.B. 51, 52.
58. Rev. Rul. 75-432, 1975-2 C.B. 60, 62.
59. Treas. Reg. 1.162-2(b) (1986).
60. *Id.*
61. Rev. Rul. 68-663, 1968-2 C.B. 71 (meals not deductible where not required to stop and rest).
62. Rev. Rul. 76-453, 1976-2 C.B. 86.
63. I.R.C. § 163 (1986).
64. Rev. Rul. 58-480, 1958-2 C.B. 62.

University of Miami Entertainment & Sports Law Review, Vol. 3, Iss. 1 [1986], Art. 7



### *B. Depreciation, Tax Credits, and the Section 179 Election*

Under I.R.C. section 167(a)(1) "property used in the trade or business" can be depreciated. I.R.C. section 168 provides the accelerated cost recovery system percentages for each annual deduction. Of particular importance to the team player who purchases gym equipment with a useful life over one year is I.R.C. section 168(c)(2)(B) which states that it is five year depreciable property. If depreciation is used and the property is I.R.C. section 38 property as defined in I.R.C. section 48, an investment tax credit as provided in I.R.C. section 46 is also allowable. For example, a team player who purchases $7,000 worth of trade or business related equipment (I.R.C. section 48(a)(1)(A) "tangible personal property") during one year can take an investment tax credit under I.R.C. section 46(c)(2) on 66 ⅔ % of $7,000, which equals $4,666.20, thus yielding a direct tax credit of 10% times $4,666.20 or $466.62 (I.R.C. section 46(a)(2)(B) "regular percentage is 10 percent"). After deducting the tax credit of $466.62 from the $7,000, which yields $6,533.38, the applicable depreciation rate under I.R.C. section 168(c)(2)(B) is fifteen percent in year one, a first year depreciation of $980.01 is allowed (year two is $1,437.34; years three through five are $1,372.01). As an alternative to taking a tax credit on the entire basis and then depreciating the adjusted basis, the player can use I.R.C. section 179 and deduct in the first year up to $5,000 of the purchase. If the player elects to use I.R.C. section 179, the calculations are: $7,000 minus a (I.R.C. section 179) $5,000 deduction from adjusted gross income leaving $2,000. I.R.C. section 46 investment tax credit of ten percent on 66⅔% of $2,000 is a $133.32 tax credit. Then depreciation under I.R.C. section 168(c)(2)(B) for year one is fifteen percent times $2,000 minus $133.32 tax credit for a total amount of $280.00 (year two is $410.67 and years three through five are $392.00).

### *C. Moving Expenses*

Although I.R.C. section 217 allows specific deductions for moving expenses, under I.R.C. section 82, the employee must include in his gross income the reimbursement received by an employer for moving expenses. Then under I.R.C. section 217, the deductions allowed are taken; but, these deductions are itemized and must therefore exceed the zero bracket hurdle.[65]

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65. I.R.C. § 63 (1986).

## V. Deferred Compensation—Key to an Economic Future

Because the professional athlete has a short career, during which compensation may be very high, followed by potentially less fruitful economic years, the counselor should make every attempt to impress upon the player the importance of foregoing income now as part of establishing a financial plan for the future. The successful athlete finds himself in a unique position: he receives, for a brief time period, unusually high compensation at a time when he may not yet be prepared to financially handle the "new-found wealth." The counselor can employ the following techniques to reduce the tax consequences now while providing for an economic future.

The purposes of various deferral of income techniques are: (1) to allow income to be postponed to a later date when the player may be in a lower tax bracket; and (2) to allow the income to accumulate interest or gains tax free until the player receives it. Note that even if the future income bracket of the player is uncertain or will be equal to or greater than the present bracket, deferred compensation techniques are still useful provided the value of income, after taxes, if received today would be a greater amount, after taxes, than the player could receive from deferred compensation on a later date in time.

### A. *Deferral of Income by Contract*

This topic is discussed in section *II(G)* above.

### B. *Substantially Non-Vested Property—I.R.C. Section 83*

Property (other than money or an unfunded and unsecured promise[66]) that is received but which is either non-transferable *or* subject to a substantial risk of forfeiture may be excluded from present income. The I.R.S. requires that it be included in income only when one of the two conditions lapses.[67] The advantages of using I.R.C. Section 83 property is twofold. First, the property need not be included in income until one of the two conditions lapses; in the case of non-appreciating property, this gives a time-value dollar advantage. Second, the player has the option of including the FMV of the property transferred subject to an I.R.C. section 83 restriction (less any money paid for the property) in his

66. Treas. Reg. 1.83-3(e).
67. I.R.C. § 83(a) (1986).

University of Miami Entertainment & Sports Law Review, Vol. 3, Iss. 1 [1986], Art. 7



income in the year received.[68] All subsequent appreciation would be taxed at capital gain rates when the restriction lapsed. Note however, if the player elects to include the property in income, a subsequent forfeiture of the property would result in no deduction.[69]

Unlike the situation with deferral of income, where the player is a general unsecured creditor, when I.R.C. section 83 is used, the player actually has possession of the property that will permanently become his property upon the lapse of a condition that qualifies it under I.R.C. section 83. The player can select the type of property he wishes to receive and instead of receiving cash and then purchasing the selected property, the team purchases the same property (car, etc.) and transfers it to the player subject to an I.R.C. section 83 restriction. Careful attention must be given the wording of the restriction:

> If the risk is to be that an athlete perform for a team for a five year period, it will make a considerable difference whether forfeiture occurs if the athlete fails to remain a member of the team for five years or fails to make himself available to the team for five years. In the former situation, the team would control the risk since it could cut the athlete for many reasons which would give the athlete no basis for complaint and preclude the restricted property from vesting. In the latter situation, however, the athlete would control the risk since he would determine whether to be available.[70]

Note that by having the restriction lapse over a period of years, only the value of the property in proportion to the lapse in any year is included in that year's gross income.[71]

Note further that since the team cannot deduct the property which is subject to a substantial risk of forfeiture until the forfeiture risk lapses, one way for both the team and the player to benefit through the use of I.R.C. section 83 is for the team to borrow 100% of the principle needed to purchase the property which is to be transferred along with the restriction, to the player. The counselor should structure the loan so that only interest is due on a balloon note prior to it ballooning, and have the note balloon when the substantial risk of forfeiture is expected to lapse. If the substantial risk of forfeiture lapses upon the player making his ser-

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68. I.R.C. § 83(b) (1986).

69. *Id.*

70. J. WEISTART & C. LOWELL, THE LAW OF SPORTS 871-72 (1979) (footnote omitted).

71. Treas. Reg. 1.83-3(c)(4) (1986).

vices available for five years, the interest on the balloon note should come due at the end of the five year period. The interest paid during the life of the note is deductible under I.R.C. section 163. For the plan to work optimally for both the team and the player, the property used should be a non-depreciating, non-appreciating asset, such as a diesel Mercedes automobile. When the restriction lapses, the team pays off the note and deducts the entire principal payment to the extent of the FMV of the car at that time (if the FMV is greater than the note principal, the excess of FMV over principal is also deductible). The player includes the FMV of the car in his gross income under I.R.C. section 61.

### *C. Pension Plans and Keoghs*

If the team member is covered under corporate pension plans, the team's contributions are excluded from the player's current income taxes.[72] The player has the option of rolling his vested funds[73] into another qualified plan when his position with the team terminates, without inclusion of the amount in his gross income for the year in which the rollover occurs.[74] Although lump-sum treatment is usually not available to the player himself except upon the attainment of age 59 ½,[75] the lump-sum distribution is available if the player becomes disabled.[76] This provides an option of having an extra "insurance" package. If no team plan is available, however, the player can make contributions that are just as high as the team could have made by establishing a Keogh plan.[77] Note that in either case, the income derived from the trust is not subject to income tax.[78] Note further that under I.R.C. section 72, should the player make non-deductible contributions to the employer's plan, those contributions will be exempt from income taxation.

### *D. Individual Retirement Accounts*

Even if covered by a qualified employer deferred compensation plan or a Keogh, the player can also establish an Individual Retirement Account (I.R.A.) and deduct $2,000 from his gross in-

72. I.R.C. § 501(a) (1986) (qualified trust under I.R.C. § 401(a) is made tax exempt by I.R.C. § 501(a)).
73. I.R.C. § 411 (1986).
74. I.R.C. § 403(8) (1986).
75. I.R.C. § 402(e)(4)(A)(ii) (1986).
76. I.R.C. § 402(e)(4)(A)(iv) (1986).
77. I.R.C. § 415 (1986).
78. I.R.C. § 501(a) (1986).

University of Miami Entertainment & Sports Law Review, Vol. 3, Iss. 1 [1986], Art. 7



come for annual contributions ($2,250 if spouse does not work; $4,000 for married couple where each earns at least $2,000 salary during the year).[79] Not only does this provide another deduction, but the distributions can be somewhat regulated by the player to meet his needs upon retirement. Except in the case of disability,[80] payouts that begin prior to age 59 ½ are penalized. Payments need not, however, begin before age 70 ½.[81] Therefore, the player has flexibility to coordinate I.R.A. payouts with other pension benefits both to provide for the best tax treatment and, by delaying I.R.A. benefits to begin at age 70 ½, to provide a hedge against inflation.

## VI. Income Averaging

Because of the 1984 changes in I.R.C. section 1301, many players will no longer qualify for income averaging. Rather than using the previous four years to establish a base average, the new act uses the previous three years and then allows averaging only to the extent that the current year's income exceeds by 140% the average base period income.[82] Note also that the player must have provided more than fifty percent of his income for each of the base period years[83] and must have been a United States citizen during the computation year.[84] For the purposes of determining the percentage of support provided by the player, the value of an athletic scholarship is considered as support provided other than by the taxpayer.[85] Income averaging is therefore probably most useful to the player who has worked professionally for three years and then finds himself having a large increase in gross income.

## VII. Personal Service Corporations

With the advent in 1982 of I.R.C. section 269A, an era of battles between many personal service employees who had incorporated and the Internal Revenue Service may have been brought to a screeching halt. Prior to the change in the law, which became effective January 1, 1983, the athletes who provided services for essentially one entity (the team player who performed exclusively for one team and had little or no other sources of personal service

79. I.R.C. § 408 (1986).
80. I.R.C. § 408(f)(3) (1986).
81. I.R.C. § 408(a)(6) (1986).
82. I.R.C. § 1302(a) (West Supp. 1986).
83. I.R.C. § 1303(c)(1) (West Supp. 1986).
84. I.R.C. § 1303(a) (West Supp. 1986).
85. Heidel v. Commissioner, 56 T.C. 95 (1971).

income), could incorporate, allow the corporation to lease his services out, and provide services to the corporation through an employment contract with the corporation. This arrangement allowed the "team player" to derive many benefits which corporations can provide an employee and which are both deductible to the corporation and excludable from the employee's gross income.[86] The potential risks involved include a personal holding company penalty tax of seventy percent on all "undisturbed personal company income."[87] If, however, all personal holding company income, which includes all income derived from personal services of the athlete,[88] is used up in payments for tax deductible expenses of the business, which includes salary to the athlete employee-owner, or in contributions to qualified pension funds, the penalty risk is alleviated.

While the use of a personal service corporation still has viability for the team athlete who provides services for more than one entity where substantially all of his services are not performed for either of the entities, under I.R.C. section 269A, if "substantially all of the services of a personal service corporation are performed for (or on behalf of) 1 other corporation, partnership, or other entity, and"[89] the principal purpose of the corporation is tax avoidance, the Internal Revenue Service can step in and reallocate "all income, deductions, credits, exclusions, and other allowances."[90]

Note, however, that I.R.C. section 269A does not apply unless the employee-owner owns ten percent or more of the stock on any day of the tax year[91] and the rules of I.R.C. Section 318 on attribution are also changed by lowering fifty percent in I.R.C. section 318(a)(2)(C) to five percent. Therefore, in the case of a team player who derives most of his revenues from one source, the team has only two real possibilities to qualify for having a personal service corporation: either (1) not own directly or indirectly (through attribution) ten percent of stock in the corporation, *or* (2) show that no one entity provides "substantially all" of the personal service compensation. To date, no treasury regulations have been promulgated and therefore, there is no guidance as to what constitutes "substantially all."

One commentator has noted four "unanswered questions"

86. I.R.C. § 105(b) (1986) (medical reimbursement, including all members of household); I.R.C. § 106 (1986); I.R.C. § 62 (1982); I.R.C. § 162 (1986).
87. I.R.C. § 541 (1986).
88. I.R.C. § 543(a)(7) (1986).
89. I.R.C. § 269A(a)(1) (1986).
90. I.R.C. § 269A(a)(2) (1986).
91. I.R.C. § 269A(b)(2) (1986).

raised by I.R.C. section 269A that would affect personal service corporations started after the effective date of I.R.C. section 269A:

1. What constitutes "substantially all" the services of a personal service corporation?
2. When is the "principal activity" of a corporation the performance of personal services?
3. Over what time period does one test whether a corporation's services are performed for one other entity?
4. At what point does the "principal purpose" test apply?[92]

It therefore seems unlikely that the personal service corporation is a useful tax-planning tool for the sports team player. Even for those few team players who may qualify for establishing a personal service corporation, an on-going consideration must be the avoidance of personal holding company tax.[93]

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92. M. Meyer & J. Viera, 1983 Entertainment, Publishing, and the Arts Handbook 270-71 (1983).

93. I.R.C. § 541 (1986).