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NAME, IMAGE & LIKENESS: THREE WORDS THAT ENDED AMATEURISM UNDER THE NCAA -- AND THE UNFORSEEN TAX CONSEQUENCES

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SECTION I: INTRODUCTION

Joe Theismann was a senior at the University of Notre Dame in the fall of 1970 when Roger Valdiserri, the University's Sports Information Director, suggested that he change the pronunciation of his last name.[1] Theismann had

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led the Fighting Irish to an 8-2-1 record and a 5th overall ranking in the final Associated Press poll during his junior year.[2] He was, in Valdiserri's opinion, a candidate for the Heisman Memorial Trophy, which is awarded annually to college football's top player.[3] To promote Theismann, Valdiserri wanted to change the pronunciation of his name from THEES-mann to THIGHS-mann to rhyme with Heisman.[4] Not only was "Theismann for the Heisman" an unsuccessful marketing campaign—Stanford's Jim Plunkett won the award[5]—but Theismann was unable to capture any of monetary value that he provided to the University or himself due to the National Collegiate Athletic Association's (NCAA) strict amateur policy.

Half a century later, quarterback Stetson Bennett was on a path much like Theismann. As a junior, he started eight games and helped the University of Georgia win the NCAA Championship.[6] Then, at the start of his senior year in fall 2022, he changed his nickname from the "Mailman" to the "Milkman" as part of a new name, image, and likeness (NIL) campaign for the Dairy Alliance.[7] Unlike Theismann, however, a change in NCAA policy allowed Bennett to profit from his promotional campaign.[8]

This dynamic shift in NCAA policy reached the pinnacle on June 30, 2021, when the Association announced that it would allow all incoming and current

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[1] Bill Littlefield, *Theisman, As In Heisman…Or Was It?*, WBUR (Dec. 9, 2016), https://www.wbur.org/onlyagame/2016/12/09/joe-theismann-heisman-name-pronunciation.

[2] *1971 Notre Dame Fighting Irish Schedule and Results*, SPORTS REFERENCE: CFB, https://www.sports-reference.com/cfb/schools/notre-dame/1971-schedule.html (last visited Apr. 25, 2024).

[3] *Id.*

[4] Littlefield, *supra* note 1.

[5] Jacob Myers, *Heisman Trophy Winners, Runners-Up Since 1935*, NCAA (Dec. 9, 2023), https://www.ncaa.com/news/football/article/2023-12-06/heisman-trophy-winners-and-runners-each-year-1935.

[6] Jacob Camenker, *Stetson Bennett College Timeline: Sony Michel's Retirement Puts Old Rams Rookie's Age in Perspective*, SPORTING NEWS (Aug. 12, 2023), https://www.sportingnews.com/us/nfl/news/stetson-bennett-college-timeline-age-sony-michel-retirement-rams-rookies/jetw77lrkz2n83sftrmi0mnf.

[7] The Partnership, *The Dairy Alliance Fuels the Power of Milk with NIL Featuring Stetson Bennett as "The Milkman"*, EIN PRESSWIRE (Nov. 18, 2022, 4:03 PM), https://www.einpresswire.com/article/602049691/the-dairy-alliance-fuels-the-power-of-milk-with-nil-featuring-stetson-bennett-as-the-milkman.

[8] According to On3 NIL Valuation, Stetson Bennett's annual valuation of $1.4 million ranked him ninth in college football. *Stetson Bennett IV*, ON3 ELITE, https://www.on3.com/db/stetson-bennett-iv-108660/nil/ (last visited Feb. 27, 2024). On3 NIL Valuation is a proprietary algorithm that calculates an athlete's Brand Value and Roster Value using dynamic data points, which target three primary categories: performance, influence, and exposure. *See* Shannon Terry, *About On3 NIL Valuation, Roster Value and NIL*, ON3 NIL (Jul. 29, 2022), https://www.on3.com/nil/news/about-on3-nil-valuation-per-post-value/.

student athletes to profit from their NIL.[9] This was in direct response to "pay to play" legislation in several states across the U.S.,[10] as well as the Supreme Court's ruling just nine days earlier against the NCAA.[11] The Association argued unsuccessfully that it was afforded special treatment under federal antitrust law and that it could thus enforce the challenged compensation restrictions; it insisted that the rules were necessary to preserve amateurism and offer intercollegiate competition as a unique product, distinct from professional sports.[12]

The NCAA's new policy provides the following guidelines on NIL income:

- Individuals can engage in NIL activities that are consistent with the law of the state where the school is located. Colleges and universities may be a resource for state law questions.
- College athletes who attend a school in a state without an NIL law can engage in this type of activity without violating NCAA rules related to name, image and likeness.
- Individuals can use a professional services provider for NIL activities.
- Student-athletes should report NIL activities consistent with state law or school and conference requirements to their school.[13]

Although the NCAA statement provides some guidance to student athletes, it raises many questions and a lot of uncertainty. There are more than 170,000 Division I athletes in the NCAA, participating in 24 different sports at over 350 member schools.[14] Each one of these students is now eligible to earn NIL compensation, and it is critical that they understand the tax consequences and protect themselves against any unforeseen liabilities.

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[9] Michelle Brutlag Hosick, *NCAA Adopts Interim Name, Image, and Likeness Policy*, NCAA (Jun. 30, 2021, 4:20 PM), https://www.ncaa.org/news/2021/6/30/ncaa-adopts-interim-name-image-and-likeness-policy.aspx.

[10] Matt Norlander, *Fair Pay to Play Act: States Bucking NCAA to Let Athletes Be Paid for Name, Image, Likeness*, CBS SPORTS (Oct. 3, 2019, 5:43 PM) https://www.cbssports.com/college-football/news/fair-pay-to-play-act-states-bucking-ncaa-to-let-athletes-be-paid-for-name-image-likeness/.

[11] *See* NCAA v. Alston, 594 U.S. 69 (2021).

[12] *See id.* at 15-22.

[13] Brutlag Hosick, *supra* note 9.

[14] *Our Division I Students*, NCAA, https://www.ncaa.org/sports/2021/5/11/our-division-i-students.aspx (last visited Feb. 27, 2024).

The first half of this article provides an overview of how NIL funds are typically earned by student athletes and how they are properly characterized, sourced, and taxed. Specifically, Section II reviews key U.S. tax code sections, revenue rulings, and court cases that help inform whether these funds are properly characterized as compensation for services or NIL royalties.[15] Section III then delineates the tax consequences, providing an overview of where these funds are sourced and the differences in tax treatment.[16]

The second half of the article provides practical examples, illustrating the potential tax consequences of these payments. Section IV presents two case studies, each focusing on a different characterization of NIL funds; the first examines NIL royalties, and the second looks at personal service income.[17] For each of these characterizations, the tax liability is computed for two athletes and at four different income levels. The only difference between the athletes is that they reside in separate states where they each play in-state football, one for the University of Texas Longhorns and the other for the University of Southern California (USC) Trojans. The results show that the amount of NIL income, how it is characterized, and where it is sourced are factors that significantly impact a student athlete's tax exposure. These factors can produce inequities among students, based on where they live or where they go to school.

Section V expands on these case studies and demonstrates that, despite the complexities, tax saving opportunities do exist.[18] If the student athlete is proactive in adopting a tax planning strategy—from establishing their state of residency, choosing the school for which they play, structuring the NIL contract, and understanding the deductions that may be available—they can realize a substantial tax savings. Section VI then concludes with a summary of the findings and a brief discussion of the schools within this new landscape that have a clear competitive advantage using NIL compensation to recruit their student athletes.[19]

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[15] For a discussion of key U.S. tax code sections, revenue rulings, and court cases that help inform whether these funds are properly characterized as compensation for services or NIL royalties, see *infra* notes 19-55 and accompanying text.

[16] For a discussion of where NIL royalties and personal service income are each sourced and the differences in their tax treatment, see *infra* notes 51-61 and accompanying text.

[17] For a discussion of the first case study, examining NIL royalties, see *infra* notes 68-75 and accompanying text. For a discussion of the second case study, examining personal service income, see *infra* notes 68-71 and 76-92 and accompanying text.

[18] For a discussion of tax saving strategies, see *infra* notes 93-127 and accompanying text.

[19] For a summary of the findings and a brief discussion of the schools that have a competitive advantage using NIL compensation to recruit student athletes, see *infra* notes 128-29 and accompanying text.

SECTION II: NIL INCOME FROM ENDORSEMENT, SUPPORT, OR PROMOTION: IS IT PERSONAL SERVICE INCOME OR ROYALTIES?

Individuals who are accomplished or have a brand image can transfer this positive feeling to a product through endorsement, support, or promotion ("endorsement"). It makes sense that the more accomplished they are or the greater their brand image, the more compensation they can garner from their endorsement.[20] This is how student athletes stand to profit from their NIL.

Determining the tax consequences of endorsement income begins with a few guiding principles. First, all income is taxable at the federal level unless it is specifically exempted by law.[21] Accordingly, endorsement income must be included in federal taxable income. This is also generally true at the state and local level. Moreover, it must be reported by the individual earning the income and in the tax period in which it is made available, even if it is received by a parent, agent, or some other individual or entity.[22] It is then taxed at the applicable rates.[23]

Next, endorsement income must be properly characterized on the federal tax return. Subsequent sections demonstrate the tax differences based on the characterization.[24] For now, the key consideration is whether endorsement income is properly characterized as personal service income or NIL royalties.

"Personal service income" is just what the term suggests—compensation for the performance of personal services.[25] For tax purposes, the term "royalties" requires a bit more probing; neither the Internal Revenue Code (IRC) nor the Treasury Regulations provide a clear definition. That task has been left to the courts and, in some instances, the dictionary. Perhaps the best definition may be found in Revenue Ruling 81-178:

> To be a royalty, a payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the

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[20] *See* Grant McCracken, *Who is the Celebrity Endorser? Cultural Foundations of the Endorsement Process*, 16 J. OF CONSUMER RSCH. 310 (Dec. 1989), https://www.researchgate.net/publication/24098613_Who_Is_the_Celebrity_Endorser_Cultural_Foundations_of_the_Endorsement_Process ("[T]he celebrity endorser is defined as any individual who enjoys public recognition and who uses this recognition on behalf of a consumer good by appearing with it in an advertisement.").

[21] *See* I.R.C. § 61.

[22] Lucas v. Earl, 281 U.S. 111, 114-15 (1930).

[23] *See* I.R.C. § 1.

[24] For a discussion of the tax differences based on the characterization as either NIL royalties or personal service income, see *infra* notes 55-66 and accompanying text.

[25] 26 C.F.R. § 1.162-7 (2024).

use made of such property, are ordinarily classified as royalties for federal tax purposes.[26]

While personal service income and royalties may seem clearly distinguishable, there are instances in which the Internal Revenue Service (IRS) and taxpayers disagree on the proper characterization of endorsement income. The U.S. Tax Court has provided some practical insight on the issue in at least two cases involving professional golfers. Those cases are discussed in detail in the subsections below.

But, first, an important procedural note: the burden of proof falls initially on the taxpayer to establish the proper allocation between personal service income and NIL royalties.[27] As with any court proceeding relating to income tax, however, the burden of proof on an issue will shift to the Secretary of the Treasury once the taxpayer introduces credible evidence of the relevant facts.[28] For this rule to apply, the taxpayer must have complied with the requirements under the IRC to substantiate any item.[29] They must have also maintained all records that are required and "cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews."[30]

A. Retief Goosen

This first apportionment case involved the 2002 and 2003 U.S. nonresident tax returns for Retief Goosen, a citizen of South Africa who resided in the United Kingdom.[31] As the champion of the U.S. Open in 2001, Goosen entered into endorsement agreements that allowed sponsors to use his NIL for a specified period of time for advertising and promotional purposes.[32] Goosen's NIL had been marketed overseas since the 1990s, but sponsors began

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[26] Rev. Rul. 81-178, 1981-2 C.B. 135. Revenue Ruling 81-178 examined payments received by a tax-exempt organization (members of which were professional athletes) and determined whether they constituted royalties, which were excluded from the organization's unrelated business income under I.R.C. § 512(b)(2), or personal service income. It determined that payments from certain licensing agreements for use of the organization's trademarks, trade names, service marks, and copyrights, as well as its members' names, photographs, likenesses, and facsimile signatures, were royalties within the meaning of I.R.C. § 512(b)(2) (even if the organization retained the right to approve the quality or style of the licensed products and services. Agreements requiring the personal services of the organization's members, on the other hand, were not royalties within the meaning of I.R.C. § 512(b)(2).

[27] Welch v. Helvering, 290 U.S. 111, 115 (1933) (holding that the Commissioner of Internal Revenue's rulings are presumed correct, and the taxpayer bears the burden of providing otherwise).

[28] I.R.C. § 7491 (a)(1).

[29] *Id.*

[30] *Id.* at § 7491 (a)(2)(A)&(B).

[31] Goosen v. Comm'r, 136 T.C. 547, 549 (2011).

[32] *Id.* at 549 and 551-52.

aggressively promoting Goosen in the United States after his U.S. Open victory.[33] He had worked hard to develop and maintain a special image that was clearly marketable apart from his athletic performance.[34]

Goosen's endorsement agreements paid him a base fee for his NIL, and he also agreed to perform some services.[35] In fact, certain agreements prorated Goosen's base endorsement fee if he did not play in a specified number of golf tournaments annually.[36] Still others provided Goosen a bonus for specific achievements in a PGA or European Tour tournament or in the World Golf Rankings.[37] He contended that his on-course endorsement income should be characterized as 50% royalties and 50% personal service income, while his off-course endorsement income should be characterized as 100% royalties.[38] The IRS agreed with Goosen about his off-course endorsement income, but argued that his on-course endorsement income was connected fully to personal services.[39]

The Tax Court issued its decision on June 9, 2011, agreeing with Goosen that it was appropriate to characterize his on-course endorsement income as 50% royalties and 50% personal service income, acknowledging that, "while … precision in making such an allocation is unattainable, we must do the best we can with the evidence presented."[40] The rational was that Goosen's image was as important to his sponsors as his participation and performance in the tournaments.[41]

B. Sergio Garcia

The next apportionment case involved the 2003 and 2004 U.S. nonresident tax returns for professional golfer Sergio Garcia, a resident of Switzerland.[42] Born in Spain and nicknamed "El Nino," his skill and dynamic personality differentiated him from most other professional golfers, making him a "fan

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[33] *Id.* at 552.

[34] *See id.*

[35] *Id.* at 552-53.

[36] *Id.* at 553-54.

[37] Goosen v. Comm'r, 136 T.C. 547, 553-54 (2011).

[38] *Id.* at 557. Goosen also argued that he was entitled to claim treaty benefits for any U.S.-sourced royalties, but the Court disagreed. *Id.* at 548.

[39] *Id.* at 557-58.

[40] *Id.* at 562 (citing Kramer v. Comm'r, 80 T.C. 768, 781-82 (1983); DeMink v. U.S., 448 F.2d 867, 870 (9th Cir. 1971); Comm'r v. Ferrer, 304 F.2d 125, 135 (2d Cir. 1962), *rev'g* 35 T.C. 617 (1961); and Ditmars v. Comm'r, 302 F.2d 481, 488 (2d Cir. 1962), *rev'g* T.C. Memo. 1961-105 [¶61,105 PH Memo TC]).

[41] Goosen v. Comm'r, 136 T.C. 547, 562-63 (2011).

[42] Garcia v. Comm'r, 140 T.C. 141, 142-43 (2013).

favorite" and a "world-famous celebrity."[43] Those characteristics also helped him become one of the most marketable golfers in the world.[44] Sponsors valued Garcia's endorsement because it allowed their products to be associated with his popular personal brand.[45]

Under the endorsement contract at issue, Garcia agreed to exclusively use and/or wear golf products by TaylorMade and its associated brands and to allow them the promotional use of his image, likeness, signature, voice, and other identifying attributes.[46] Besides using their products, he agreed to perform other personal services, including posing and acting for advertisements, making personal appearances, and playing in professional tournaments.[47] The sponsor, in turn, agreed to compensate Garcia, with the caveat that he would incur various penalties for not fulfilling certain obligations under the contract.[48] For example, if he did not play in 20 professional golf events in a given year, his base fee would be reduced proportionately.[49]

Garcia took the position that at least 85% of the compensation he received under the endorsement agreement constituted NIL royalties and the remaining amount was for personal services.[50] Initially, the IRS countered that the full amount was for personal services, but later it argued that the "vast majority" was.[51] The Tax Court disagreed. Based on the circumstances surrounding Garcia's contract and his celebrity, it ruled that 65% of the endorsement fees constituted NIL royalties and the remaining 35% was personal service income.[52]

The Retief Goosen and Sergio Garcia cases[53] demonstrate that, though not an exact science, the facts and circumstances relating to endorsement income will inform the proper allocation between personal service income and NIL royalties. To the extent the proceeds are effectively connected to the taxpayer's performance of services—including their participation, engagement, or ranking

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[43] *Id.* at 143.

[44] *Id.*

[45] *Id.* at 143-44.

[46] *Id.* at 144.

[47] *Id.* at 145-46.

[48] *See* Garcia v. Comm'r, 140 T.C. 141, 146 (2013).

[49] *See id.*

[50] *See id.* at 147.

[51] *See id.* at 151.

[52] *See id.* at 158.

[53] *See generally* Goosen v. Comm'r, 136 T.C. 547 (2011); Garcia v. Comm'r, 140 T.C. 141 (2013). For a discussion of Goosen v. Commissioner, see *supra* notes 31-41. For a discussion of Garcia v. Commissioner, see *supra* notes 42-52.

in a sport—the amounts are properly allocable as personal service income. The remainder are NIL royalties.

Section II explored the framework for properly characterizing endorsement income as either personal service income or NIL royalties.[54] Next, Section III examines the rules for sourcing and taxing such income.[55]

SECTION III: WHERE IS ENDORSEMENT INCOME SOURCED, AND HOW IS IT TAXED?

The proper characterization of NIL payments as either personal service income or NIL royalties is critical because it determines where the income is sourced, *i.e.*, the national, state, and local jurisdictions in which the income may be taxed. It also determines the precise nature of the taxes assessed.

A. Personal Service Income

Under federal tax rules, when income is effectively connected to the performance of services, the geographic area in which the taxpayer performs the services is generally considered the source of the income, regardless of where the contract was made, payment was issued, or the payer resides.[56] Thus, all wages and compensation for services performed in the U.S. are considered sourced within the U.S.[57] Notwithstanding, U.S. citizens and resident aliens are generally taxed in the U.S. on their worldwide income, regardless of the source (although they may be entitled to a foreign tax credit for taxes paid to other nations). U.S. nonresident aliens, on the other hand, are generally taxed in the U.S. only on their U.S.-source income. For residents of foreign countries who may be subject to tax in the U.S., the foregoing rules may be modified by applicable U.S. tax treaties. Within the U.S., state and local governments have generally adopted analogous rules for sourcing and taxing income of their residents and nonresidents.[58]

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[54] *See supra* notes 19-53 and accompanying text.

[55] *See infra* notes 55-66 and accompanying text.

[56] *See Source of Income – Personal Service Income*, IRS, https://www.irs.gov/individuals/international-taxpayers/source-of-income-personal-service-income (last updated May 24, 2023).

[57] *See id.*

[58] For a full discussion of the constitutionality of state and local income taxes assessed on nonresident taxpayers, see Alan Pogroszewski, *When is a CPA as Important as Your ERA? A Comprehensive Evaluation and Examination of State Tax Issues on Professional Athletes*, 19 MARQ. SPORTS L. REV. 395 (2009). *See also* Alan Pogroszewski & Kari Smoker, *Is Tennessee's Version of the Jock Tax Unconstitutional?*, 23 MARQ. SPORTS L. REV. 415 (2013).

Generally, individuals who receive at least $400 in personal service income (net of business-related expenses) as a non-employee ("self-employment income") also owe a 15.3% federal self-employment tax on at least a portion of that income. In addition, taxpayers who earn over $200,000 in wages, compensation, and self-employment income ($250,000 if they are married) are subject to a .9% Medicare Tax on such income.

One advantage for student athletes receiving personal service income as a non-employee is their ability to take certain deductions, thereby lowering their taxable income and the associated tax liability. These deductions include business-related expenses, the deductible portion of self-employment tax, the cost of any self-employment health insurance, and any contributions to a qualified self-employment retirement plan.[59]

B. Royalty Income for the Use of the Student Athlete's NIL

Within the U.S., the sourcing rules for NIL royalties are different than for personal service income. Individuals who receive royalties solely for the use of their NIL or other intangible property must allocate the income, generally, to the place where the property is used or where the privilege for its use is granted.[60] When this use or privilege extends both to the U.S. and overseas, the contracting parties bear the burden of reasonably allocating it between U.S. and foreign sources; if this is not done, the courts have generally allocated all the income to the U.S. unless the taxpayer can demonstrate a sufficient basis for making a reasonable allocation.[61]

There are several key differences between the federal tax treatment of NIL royalties and personal service income. NIL royalties—so characterized because the income is unrelated to the performance of services—are not subject to self-employment tax nor the .9% Medicare Tax. Instead, they are subject to an additional 3.8% federal net investment income tax (NIIT) that is assessed on the lesser of the taxpayer's net investment income or the amount of their modified

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For specific tax rates by state, see Timothy Vermeer, *State Individual Income Tax Rates and Brackets for 2023*, TAX FOUND. (Feb. 21, 2023), https://taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/. Forty-three states levy individual income taxes: forty-one tax wage and salary income, while New Hampshire exclusively taxes dividend and interest income, and Washington taxes the capital gain income of high earners; seven states levy no individual income tax at all. *See id.*

[59] *See* I.R.C. § 162 (2017).

[60] *See* In re Foster, 1984 Cal. Tax LEXIS 18, *6 (Bd of Equal'n 1984); In re Dorsey, 1989 Wis. Tax LEXIS 8, *6-7 (Tax App. Comm'n 1989).

[61] *See* Goosen v. Comm'r, 136 T.C. 547, 564 (2011).

adjusted gross income in excess of $200,000 (if the taxpayer is single).[62] Moreover, those who receive royalty income will *not* be permitted to offset it with any of the deductions allowed for personal service income, including business-related expenses, the deductible portion of self-employment tax, the cost of any self-employment health insurance, and contributions to a qualified self-employment retirement plan.

C. Tax Documentation: 1099-MISC vs. 1099-NEC

Entities and individuals making NIL payments to student athletes must file an information return to report those transactions to the IRS, and they must furnish a copy to the athlete.[63] The specific form required depends on the nature of the payment. Student athletes receiving over $10 in royalties should receive a 1099-MISC indicating the amount paid to them throughout the year.[64] Those who receive over $600 for their performance of services as a non-employee, whether in commissions or other compensation, should receive a 1099-NEC.[65] Notably, even if royalties are reported to the taxpayer on a 1099-MISC, the taxpayer should report the income as self-employment business income if they are a self-employed writer, inventor, or artist—fields in which the taxpayer is producing a work (such as a book, an invention, or art) on which they are earning the royalties.[66]

Sections II and III reviewed the tax rules for characterizing and sourcing NIL income and discussed the potential tax consequences.[67] Next, Section IV presents two different case studies, illustrating the tax consequences for student athletes and the potential inequities that can arise based on the proper application of the rules.

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[62] *See* I.R.C. § 1411. *Topic No. 559, Net Investment Income Tax*, IRS, https://www.irs.gov/taxtopics/tc559#:~:text=The%20NIIT%20applies%20to%20income,income%20from%20a%20nonpassive%20business (Feb. 12, 2024).

[63] *See* I.R.C. § 6041(a).

[64] *See About Form 1099-MISC, Miscellaneous Information*, IRS, https://www.irs.gov/forms-pubs/about-form-1099-misc (Oct. 4, 2023).

[65] *See Reporting Payments to Independent Contractors,* IRS, https://www.irs.gov/businesses/small-businesses-self-employed/reporting-payments-to-independent-contractors (Jan. 30, 2023).

[66] See *What is Taxable and Nontaxable Income?*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/what-is-taxable-and-nontaxable-income (Nov. 2, 2023). Which states, "Royalties… You generally report royalties in Part I of Schedule E (Form 1040 or Form 1040-SR), Supplemental Income and Loss. However, if you hold an operating oil, gas, or mineral interest or are in business as a self-employed writer, inventor, artist, etc., report your income and expenses on Schedule C." *Id.*

[67] For a discussion of the framework for properly characterizing endorsement income as either personal service income or NIL royalties, see *supra* notes 19-55 and accompanying text. For an examination of the rules for sourcing and taxing such income, see *supra* notes 56-66 and accompanying text.

SECTION IV: CASE STUDIES

The first case study presented in this section examines the tax consequences of endorsement income that is properly characterized as NIL royalties. Specifically, it compares four different payment amounts received by two athletes during 2022, each one playing in-state football at a different university. The second case study repeats the exercise but examines instead the tax consequences of personal service income. In each case, the student athlete is assumed to be single and claiming the standard deduction.[68] It is also assumed that no other taxpayer can claim them as a dependent.[69]

These examples demonstrate not only the complexity of NIL taxation but also the potential inequity that arises when two students receive equal payments and yet owe significantly different tax amounts, based solely on how the income is characterized and then sourced. This inequity is amplified when comparing, as in the following examples, a student athlete playing in-state football for the Texas Longhorns (in a state that imposes no income tax) with one playing in-state football for the USC Trojans (in California, which imposes the highest income tax rates in the United States).[70]

A. Case Study: NIL Royalties

Endorsement income that is not effectively connected to the performance of services constitutes NIL royalties and is sourced to the student athlete's place of residence, as opposed to the location of their school. Thus, students who are residents of different jurisdictions may have distinctly different tax consequences, even if they attend the same university and receive the same amount of NIL royalties.

In the first example, the student athlete plays in-state football for the Texas Longhorns. They receive royalty income, which is sourced to their place of residence in Texas and is reported by the University on a 1099-MISC. The athlete then reports it on their federal income tax return and is taxed at the

[68] For tax year 2022, the standard deduction amount for single taxpayers is $12,950. *See IRS provides tax inflation adjustments for tax year 2022*, IRS, https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2022 (Oct. 23, 2023).

[69] If a taxpayer can be claimed as a dependent, then their standard deduction is limited to the greater of $500, or $250 plus the individual's earned income. *See* I.R.C. § 63 (c)(5)(A) & (B).

[70] For a comparison of the income tax rates for various states, see Timothy Vermeer & Katherine Loughead, *State Individual Income Tax Rates and Brackets for 2022*, TAX FOUND. (Feb. 15, 2022), https://taxfoundation.org/data/all/state/state-income-tax-rates-2022/. California's rate starts at 1% tax for taxable income of $9,325 and accelerates to a tax rate of 13.3% for those with taxable income exceeding $1,000,000. *See id.*

applicable rates.[71] However, there is no state income tax in Texas. Table 1A provides a breakdown of the federal and state income tax liabilities for each of four different royalty amounts: $10,000; $100,000; $1,000,000; and $5,000,000. Also shown is the additional 3.8% federal NIIT assessed on the royalty income in excess of $200,000.[72]

Table 1A
Player for the Texas Longhorns (Texas Resident)
Royalties not connected to personal services.

Amount	Federal Tax	NIIT	State Tax	Net Income
$10,000.00	$0.00	$0.00	$0.00	$10,000.00
$100,000.00	$14,774.00	$0.00	$0.00	$85,226.00
$1,000,000.00	$328,164.00	$30,400.00	$0.00	$641,436.00
$5,000,000.00	$1,808,164.00	$182,400.00	$0.00	$3,009,436.00

Next, consider the same facts, except the student athlete plays for the USC Trojans, exposing them to California state income tax. As shown in Table 1B, they still incur no income tax liability on $10,000 of NIL royalty income. However, on $1,000,000, they incur a state income tax liability of $104,891 (Table 1B) compared to $0 for the student from Texas (Table 1A). The additional state income tax liability grows significantly for the student in California who receives $5,000,000 in NIL royalty income: $636,839 (Table 1B) compared, once again, to $0 for the student from Texas (Table 1A). As the tables illustrate, the only difference between the two students is that they are residents of different states.

[71] For the tax rates effective for tax year 2022, *see IRS Provides Tax Inflation Adjustments for Tax Year 2022*, IRS, https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2022 (Oct. 23, 2023).

[72] *See supra* note 62 and accompanying text.

Table 1B
Player for the USC Trojans (California Resident)
Royalties not connected to personal services.

Amount	Federal Tax	NIIT	State Tax	Net Income
$10,000.00	$0.00	$0.00	$0.00	$10,000.00
$100,000.00	$14,774.00	$0.00	$5,430.00	$79,796.00
$1,000,000.00	$328,164.00	$30,400.00	$104,891.00	$536,545.00
$5,000,000.00	$1,808,164.00	$182,400.00	$636,839.00	$2,372,597.00

For the 2022 college football season, the USC Trojans' roster comprised 110 players, 22 of whom hailed from states with no income tax. Another two came from Washington State (with a net investment income tax on certain high earners), and still another two from jurisdictions outside the United States.[73] Because royalty income is allocated to the taxpayer's place of residence, those athletes who are residents of states with no income tax would have tax consequence similar to those presented for the Texas resident in Table 1A. For the two athletes who are not U.S. residents, the royalties would generally be sourced outside the United States (subject to applicable treaty provisions) and, in that case, would not be taxed at either the federal or state level.[74]

B. Case Study: Income Effectively Connected to the Performance of Personal Services

In the second set of examples, the endorsement income is effectively connected to the performance of personal services in the U.S., such as the student's creation of social media content or their actual performance as an athlete. It is thus allocable to the state and local jurisdictions in which the income is earned. In addition, it is considered self-employment income and is subject not only to applicable federal, state, and local income taxes but also federal self-employment tax. In that case, the school should report the income on a Form 1099-NEC, and the student should include the amount on their Form

[73] *See 2022 USC Football Roster*, USC, https://usctrojans.com/sports/football/roster/2022 (last visited Feb. 12, 2024).

[74] *See id.* The U.S. nonresident players are Tyrone Taleni from Western Samoa and Aadyn Sleep-Dalton from Australia.

1040 *U.S. Individual Income Tax Return* (on both Schedule C *Profit or Loss from Business*[75] and Schedule SE *Self-Employment Tax*[76]). To fully evaluate the tax consequences, it is critical to understand and properly apply the apportionment rules for personal service income.

1. Apportionment of Personal Service Income

Our national economy has been ever dependent on interstate commerce. Thus, the U.S. Supreme Court has explored at length the constitutionality of state and local income taxes that are assessed on taxpayers who, although not residents of the jurisdiction, earn income sourced there.[77] If a taxpayer earns income tied to the performance of services in multiple states or localities, the income must be properly apportioned to each.[78] Take, for instance, the student who signs on with the Texas Longhorns. Although they show up regularly for practice and home games on their Austin, Texas, campus, they will travel with the team to other cities and states for away games. How is the endorsement income tied to their performance as an athlete properly apportioned to Texas and each other jurisdiction?

State courts have addressed the merits of both game-day and working-day (or "duty-day") apportionment for professional athletes. For each city and/or state, game-day apportionment considers the percentage of game-days in the season for which the athlete is present in the jurisdiction.[79] That same percentage is then used to apportion their income to that jurisdiction. Duty-day apportionment, on the other hand, considers not only game-days but also practice- and travel-days.[80] Moreover, the courts have addressed the kinds of activities comprising a season for which the professional athlete earns their pay and are thus properly included in the duty-day apportionment factor. Early court rulings concluded that days spent in training camp, exhibition games, and league playoffs—all required in a standard professional player's contract—are

[75] *See About Schedule C (Form 1040), Profit or Loss from Business (Sole Proprietorship)*, IRS, https://www.irs.gov/forms-pubs/about-schedule-c-form-1040 (last visited Feb. 22, 2024).

[76] *See About Schedule SE (Form 1040), Self-Employment Tax*, IRS, https://www.irs.gov/forms-pubs/about-schedule-se-form-1040 (last visited Feb. 22, 2024).

[77] For a full discussion of the constitutionality of state and local income taxes assessed on nonresident taxpayers, see Alan Pogroszewski, *When is a CPA as Important as Your ERA? A Comprehensive Evaluation and Examination of State Tax Issues on Professional Athletes*, 19 MARQ. SPORTS L. REV. 395 (2009). *See also* Alan Pogroszewski & Kari Smoker, *Is Tennessee's Version of the Jock Tax Unconstitutional?*, 23 MARQ. SPORTS L. REV. 415 (2013).

[78] Pogroszewski & Smoker, *supra* note 77, at 420.

[79] *See In re Partee*, 1976 Cal. Tax LEXIS 35 (Bd. of Equal'n 1976).

[80] *See id.*

included.[81] Subsequent rulings determined that off-training days, although beneficial for both the team and the player, are not.[82]

The amount of income apportioned to each state and/or other locality thus depends on whether game-day or duty-day apportionment is used. The apportioned income is then subject to the respective jurisdiction's income tax rates. In the case of the Texas Longhorns player, the team played 10 games in the state of Texas during the fall 2022 season (including the Valero Alamo Bowl in San Antonio), plus two games in Kansas and one game in Oklahoma.[83] As Table 2 illustrates, duty-day apportionment results in a larger income allocation—and thus a larger tax liability—the state in which the player attends school. Arguably, it may also reflect more accurately the degree of service performed by the student in each state.

Table 2
Texas Longhorns Player (Texas Resident)
Game-Day v. Duty-Day Income Allocation

	Game-Days	Allocation	Duty-Days	Allocation
Total	13	100%	120	100%
Texas	10	76.9%	114	95.0%
Kansas	2	15.4%	4	3.3%
Oklahoma	1	7.7%	2	1.7%

This is an important consideration because the appropriate method is highly dependent on the circumstances and nature of the sport in question, and the courts look to the terms of the contract to make the proper determination. For instance, the California State Court determined in *In re Partee* that the "working day" formula was appropriate for professional football because the players' contracts explicitly required them to participate in practices, but that the "games

[81] *See In re White*, 1980 N.Y. Tax LEXIS 535 (Tax Comm'n 1979). The court ruled that since White was obligated to participate in spring training or face consequences (such as breach of contract), his salary and other compensation should account, in part, for exhibition games, even though he was not expressly paid for them. The court reasoned that White had as much of a contractual and professional obligation to participate in exhibition games as he did in regular season games.

[82] *See Wilson v. Franchise Tax Bd.*, 20 Cal. App. 4th 1441, 1452 (Ct. App. 1993). The court follows and expands on the previous ruling from In re Krake, 1976 Cal. Tax LEXIS 32 (Bd. of Equal'n 1976).

[83] *See 2022 Football Schedule*, UNIV. OF TEX. ATHLETICS, https://texassports.com/sports/football/schedule/2022?print=true (last visited Apr. 25, 2024).

played" method may be more appropriate for other sports, including baseball, basketball, and hockey.[84]

2. Federal, State, and Local Tax Treatment of Personal Service Income

The tax treatment of personal service income in the second case study (Tables 2A and 2B) produces several key differences compared to NIL royalties in the first study (Tables 1A and 1B). First, the endorsement income escapes the 3.8% federal NIIT because it is effectively connected to the performance of personal services rather than investment. Instead, it is characterized as non-employee compensation, and a portion is therefore subject to the 15.3% federal self-employment tax. The amount of compensation in excess of $200,000 (if the taxpayer's filing status is single) is also subject to the additional .9% Medicare tax.

Like the NIL royalty income in the first case study, personal service income is subject to federal income tax, except that individuals are allowed certain deductions in determining their taxable income, including half the amount of their self-employment tax. However, unlike the NIL royalty income in the first case study, personal service income is allocable to all states in which the services are performed. This results in nonresident state and local income taxes commonly known as "jock taxes." Notwithstanding, the taxpayer's home state will commonly tax their total income, but then allow a tax credit reducing the amount they owe by the income taxes they paid to other states.

Again, for the hypothetical student who plays in-state football for the Texas Longhorns (Table 2A), there is no income tax in Texas. However, jock taxes are owed in each jurisdiction that imposes an income tax and in which the Texas Longhorns played their away-games (duty-days) during the fall 2022 season—namely, Kansas and Oklahoma. Although federal self-employment taxes and state jock taxes add to the student's financial burden, the impact is eased significantly because a federal income tax deduction is permitted for half the amount of self-employment tax and because personal service income is not subject to the additional 3.8% federal NIIT.

The result? For the in-state Texas Longhorns player who earns personal service income (see Table 2A) in the $10,000-$100,000 range, the average tax rate increases by approximately 13-14 percentage points compared to the same earnings in NIL royalties (see Table 1A).[85] At $100,000 of income, this amounts

[84] *See In re Partee*, 1976 Cal. Tax LEXIS 35 (Bd. Equal'n 1976).

[85] At $10,000, the average tax rate is 14.13% ($1,413) for personal services income vs. 0% ($0) for NIL royalties. At $100,000, the average tax rate is 27.56% ($27,556) for personal services income vs. 14.77% ($14,774) for NIL royalties.

to an additional $12,782 in taxes. For income limits ranging between $1,000,000 and $5,000,000, however, the additional tax burden imposed on personal service income (see Table 2A) compared to NIL royalties (see Table 1A) becomes negligible. At the $1,000,000 income level, the additional tax on personal service income amounts to an increase of 1.54 percentage points in the average tax rate (or an additional $15,392), while at the $5,000,000 income level, there is a *decrease* of .11 percentage points in the average tax rate (or a savings of $5,426).[86]

Table 2A

Texas Longhorns Player (Texas Resident)

Endorsement income is effectively connected to the performance of personal services.

Amount	Federal Tax	Self-Employment Tax	Additional Medicare Tax	Jock Tax	Net Income
$10,000.00	$0.00	$1,413.00	$0.00	$0.00	$8,587.00
$100,000.00	$13,212.00	$14,129.00	$0.00	$215.00	$72,444.00
$1,000,000.00	$319,837.00	$45,010.00	$6,511.50	$2,597.00	$626,044.50
$5,000,000.00	$1,780,018.00	$152,136.00	$39,757.50	$13,226.00	$3,014,862.50

Next, consider the student playing in-state football for the USC Trojans under a similar set of circumstances, except that state income tax is now owed to the student's home state of California. In addition, jock taxes would normally be owed in each jurisdiction that imposes an income tax and in which USC played its away-games (duty-days) during the fall 2022 season—namely Arizona, Oregon, and Utah. However, Arizona, Oregon, and California are "reverse credit" states.[87] Thus, the in-state student at USC would file a California resident income tax return and an Oregon nonresident income tax return, and they would report their Oregon-sourced income to both states.[88] Oregon would then provide a credit to the taxpayer, lowering their nonresident tax liability by the amount

[86] At $1,000,000, the average tax rate is 37.40% ($373,956) for personal services income vs. 35.86% ($358,564) for NIL royalties. At $5,000,000, the average tax rate is 39.70% ($1,985,138) for personal services income vs. 39.81% ($1,990,564) for NIL royalties.

[87] *See* Jared Walczak, *Do Unto Others: The Case for State Income Tax Reciprocity*, TAX FOUND. (Nov. 16, 2022), https://taxfoundation.org/research/all/state/state-reciprocity-agreements/. The author notes that some sources refer to reverse tax credits as a form of income tax reciprocity, although they function very differently.

[88] *See id.*

of taxes they pay to their home state—California.[89] Because California assesses the highest income tax rates in the nation, the Oregon nonresident income tax would be fully offset. In effect, taxes on the Oregon-sourced income will be owed only to California. The same analysis holds true for the in-state USC student's Arizona-sourced income.

The result is that the in-state USC Trojans player will take a larger tax hit, much like the student from Texas, by having $10,000-100,000 endorsement income classified as personal service income (see Table 2B) instead of NIL royalties (See Table 1B); for $100,000 of endorsement income, they will pay an additional $12,047 in taxes if it considered compensation for personal services.[90] However, this same student will realize a total *tax savings* of $28,770 if he receives $5,000,000 of personal service income (see Table 2B) rather than NIL royalties (see Table 1B).[91]

Table 2B
USC Trojans Player (California resident)
Endorsement income connected to the performance of personal services.

Amount	Federal Tax	Self-Employment Tax	Additional Medicare Tax	State Tax	Jock Tax	Net Income
$10,000.00	$0.00	$1,413.00	$0.00	$41.00	$0.00	$8,546.00
$100,000.00	$13,212.00	$14,129.00	$0.00	$4,835.00	$75.00	$67,749.00
$1,000,000.00	$319,837.00	$45,010.00	$6,511.50	$101,331.00	$792.00	$526,518.50
$5,000,000.00	$1,780,018.00	$152,136.00	$39,757.50	$622,733.00	$3,988.00	$2,401,367.50

SECTION V: TAX PLANNING OPPORTUNITIES

As the above cases demonstrate, NIL income taxation is complex, but with this complexity comes the opportunity for tax planning strategies.

[89] *See id.* Because Oregon allows a "reverse credit" to the California resident for the California taxes paid on the Oregon-sourced income, California does not allow a credit. *See* CAL. REV. & TAX CODE §18001(a)(2) (2021).

[90] At $10,000, the average tax rate is 14.54% ($1,454) for personal services income vs. 0% ($0) for NIL royalties. At $100,000, the average tax rate is 32.25% ($32,251) for personal services income vs. 20.20% ($20,204) for NIL royalties.

[91] At $1,000,000, the average tax rate is 47.35% ($473,482) for personal services income vs. 46.35% ($463,455) for NIL royalties. At $5,000,000, the average tax rate is 51.97% ($2,598,633) for personal services income vs. 52.55% ($2,627,403) for NIL royalties.

Residency

Because state tax systems are based largely on residency, it presents one tax savings opportunity. As noted in Section II, endorsement income that is not tied to the performance of personal services is sourced to the student athlete's place of residence. Thus, for those students who are enrolled at a school in a high-tax state and establish residency in a no-tax state, the structuring of the contract and the nature of the compensation—so that it is properly characterized as NIL royalties—can help alleviate the athlete's income tax liability.[92] Over the years, various states have challenged the taxpayer's position that income was not tied to services, seeking to apportion it as personal service income instead.[93] The threshold to withstand such a challenge is difficult but can be achieved. If both the terms of the contract and the nature of the income indicate that there is no connection to the performance of services, then the income does not need to be apportioned as such.[94]

To illustrate the degree to which residency and the proper characterization of income can provide tax savings opportunities, consider the tax implications for the 22 student-athletes who hailed from states with no income tax but played for the USC Trojans during the fall 2022 season.[95] Under these particular circumstances, it is beneficial for student athletes to maintain residency in their home state and to structure their endorsement contract to reflect the fact that the payment is not tied to services. In doing so, their tax situation would be similar to the student athlete who received NIL royalties and was a resident of Texas, where there is no state income tax; that student realized a $0 state tax liability

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[92] The importance of the contract terms is illustrated in cases dealing with the characterization of signing bonuses. *See*, *e.g.*, *In re Foster*, 1984 Cal. Tax LEXIS 18 at 6 (Bd of Equal'n (1984) (holding that the bonus was a true playing bonus rather than compensation for personal service, because it was consideration for the signing of the contract and for the player's promise not to play for another team; therefore, it was fully apportioned to the player's state of residence). *Compare In re Dorsey*, 1989 Wis. Tax LEXIS 8 (Tax App. Comm'n 1989) (characterizing the signing bonus as compensation for services, and fully apportioning it to the state in which the services were performed, because it was refundable if the player failed to report or if he left the team without its consent). For a further discussion on the constitutional right for states to tax non-resident athletes' income, see Alan Pogroszewski, *When is a CPA as Important as Your ERA? A Comprehensive Evaluation and Examination of State Tax Issues on Professional Athletes*, 19 MARQ. SPORTS L. REV. 395 (2009). *See also* Alan Pogroszewski and Kari Smoker, *Is Tennessee's Version of the Jock Tax Unconstitutional?*, 23 MARQ. SPORTS L. REV. 415 (2013).

[93] *See*, *e.g.*, *In re Foster*, 1984 Cal. Tax LEXIS 18 at 6 (Bd of Equal'n (1984) and *In re Dorsey*, 1989 Wis. Tax LEXIS 8 (Tax App. Comm'n 1989), both cases dealing with the appropriate characterization and sourcing of signing bones based on the terms of the player's contract.

[94] *See In re Foster*, 1984 Cal. Tax LEXIS 18 at 6 (Bd of Equal'n (1984) and *In re Dorsey*, 1989 Wis. Tax LEXIS 8 (Tax App. Comm'n 1989).

[95] *See 2022 USC Football Roster*, USC TROJANS, https://usctrojans.com/sports/football/roster/2022 (last visited Apr. 25, 2024).

(Table 1A) and thus considerable savings—as much as $636,839 in state taxes on $5,000,000 of royalties—when compared, as in our example, to the California resident receiving the same amount of royalty income. (Table 1B).[96]

Moreover, maintaining residency in a no-tax state may be beneficial even if the endorsement income is tied to services. In this instance, the student athlete would apportion their income to each state in which they either played or practiced.[97] Thus, the 24 nonresident USC students in the last example would apportion 93.33% of their income to California using duty-day apportionment (assuming 112 duty days in California out of 120 days total). Income would also be apportioned and taxed in Arizona, Oregon, and Utah because of the USC games played there; the reciprocal tax agreements between California, Arizona, and Oregon would not apply because the students are not residents of any of those states. Finally, as California nonresidents, they would receive no tax credit on their California returns for income taxes paid to other states. Notwithstanding, Table 3A illustrates the additional tax savings, however small, that might be realized as residents of no-tax states rather than a high-tax state like California.

Table 3A
USC Trojans Player: California Resident v. Resident of a No-Tax State
After-tax personal service income using duty-day apportionment.

Income	California Resident: Net Income	Resident of No-Tax State: Net Income	Difference in Net Income for Resident of No-Tax State
$10,000.00	$8,546.00	$8,544.00	-$2.00
$100,000.00	$67,749.00	$67,898.00	$149.00
$1,000,000.00	$526,518.50	$530,996.50	$4,478.00
$5,000,000.00	$2,401,367.50	$2,430,820.50	$29,453.00

Why the potential savings? In this case, the athletes who are residents of a no-tax state apportion only 93.33% of their income to California (which is then taxed at the highest state tax-rates in the U.S.), with the remainder apportioned

[96] In either case, the federal income tax ($1,808,164) and federal net investment income tax ($182,400) remain the same; only the state income tax varies based on the student-athlete's state of residency.

[97] *See supra* note 73 and accompanying text.

to Arizona, Oregon, and Utah. For those student-athletes who are residents of California, on the other hand, *all* their income is apportioned to California and taxed at its high rates, resulting in a larger tax liability. This tax liability is then offset with a smaller credit for nonresident taxes paid to lower-tax states—in this case, only Utah, because of the reciprocal tax agreements between California, Arizona, and Oregon. As Table 3A demonstrates, establishing residency in a no-tax state produces little to no advantage when personal service income ranges between $10,000 and $100,000;[98] however, it provides a more substantial tax savings for personal service income ranging, for example, between $1,000,000 and $5,000,000.[99]

Duty-Day v. Calendar-Year Apportionment

In response to the growing number of states assessing nonresident taxes on professional athletes, the Federation of Tax Administrators [FTA] formed a task force chaired by James W. Wetzler in June 1992.[100] After evaluating the issue, the task force recommended that states apply a uniform apportionment formula that can be applied to professional athletes, as well as personnel who travel with the team, for performance of service income.[101] Income would be apportioned using duty-days, which would account for the exhibition season and any days during the offseason on which a team member undertook training activities as part of a team-imposed program, but only if conducted at the team's facility.[102]

In 1993, the California Court of Appeals specifically addressed the issue of off-season training in *Wilson v. Franchise Tax Board.*[103] Mark Wilson, a resident of the state of Washington, was employed by the Los Angeles Raiders. He argued that preparation for a National Football League (NFL) season was a year-round event, and thus an apportionment factor of only 41.8% in California, or 153 working-days out of a full calendar year, was appropriate for purposes of allocating his income to the state.[104] California, on the other hand, arrived at

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[98] For $10,000 of personal service income, being a resident of a no-tax state rather than a California resident *costs* the taxpayer an additional $2 in taxes. However, for $100,000 of personal service income, the taxpayer realizes a comparative savings of $149 by establishing residency in a no-tax state.

[99] For $1,000,000 of personal service income, the resident of a no-tax state realizes a comparative savings of $4,478. For $5,000,000, the savings is $29,453.

[100] *See* James W. Wetzler, Chair, *State Income Taxation of Nonresident Professional Team Athletes: A Uniform Approach*, J. FED'N OF TAX ADMIN. (Mar. 1994).

[101] *See id.*

[102] *See id.*

[103] 20 Cal. App. 4th 1441 (Ct. App. 1993).

[104] *See id.* at 1448.

a much higher apportionment factor of 88.88%—more than double Wilson.[105] It determined that there were 144 duty-days in California out of only 162 days total, and that those 162 days comprised the 144 California days plus the additional duty-days on which Wilson played out-of-state road games for the Raiders.[106] On December 13, 1993, the California Court of Appeals ruled in favor of the state. It held that, although it was in the Wilson's self-interest to train year-round and the team encouraged him to do so, his contract did not require it, and, therefore, Wilson's off-season training days could not be included in the apportionment factor.[107]

Following the rationale used in *Wilson*, many states have accepted and enforced the FTA's recommendation of duty-day apportionment for service income paid to a professional athlete by their team.[108] However, unlike an athlete playing in a professional league, student-athletes are not compensated by their universities to play sports under a service contract. The income in question relates instead to the student athlete's endorsements for which duty day apportionment is not the presumptive rule. Rather, apportionment ties more closely to the terms of the NIL contract and the precise nature of the services performed. In this case, "calendar-year" apportionment may reflect more accurately the portion of income that the student earns in various locations year-round. To reinforce this position, representatives should consider structuring the terms of the NIL contract to reflect the fact that the student athlete's compensation is earned throughout the year.

Assuming that calendar-year apportionment is the appropriate method under the circumstances, it also provides a tax savings opportunity for student athletes who are residents of low- or no-tax states but perform services in high-tax states. Consider again the USC students from our last example who were residents of no-tax states and earned NIL income effectively connected to personal services. Using duty-day apportionment, Table 3A illustrates a marginal tax savings compared to those teammates who were residents of California. For athletes hailing from no-tax states, calendar-year apportionment would lower the portion of income they earned in California, which imposes the highest taxes in the U.S. This, in turn, would lower their total tax liability and increase their net income, as illustrated in Table 3B.

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[105] *See id.*

[106] *See id.*

[107] *See id.* at 1452.

[108] For a discussion, see Alan Pogroszewski, *When is a CPA as Important as Your ERA? A Comprehensive Evaluation and Examination of State Tax Issues on Professional Athletes*, 19 MARQ. SPORTS L. REV. 395, at 404-06 (2009).

Table 3B
USC Trojans player: Resident of a No-Tax State
Net Personal Service Income using duty-day vs. calendar-day apportionment.

Income	Duty-Day Apportionment 120 Days	Calendar-Day Apportionment 365 Days	Difference	Calendar-Day Apportionment Savings
$10,000.00	$8,544.00	$8,572.00	$28.00	0.28%
$100,000.00	$67,898.00	$71,093.00	$3,195.00	3.20%
$1,000,000.00	$530,996.50	$596,633.50	$65,637.00	6.56%
$5,000,000.00	$2,430,820.50	$2,838,688.50	$407,868.00	8.16%

Business-Related Deductions

Student athletes who receive personal service income must report it on Schedule C of their individual income tax return.[109] They are then entitled to deduct the business expenses that they paid or incurred during the taxable year.[110] Expenses are deductible if they are ordinary and necessary (which is interpreted to mean helpful) in carrying out a "trade or business" and reasonable in amount.[111] For student-athletes, their collegiate sport is their business. Thus, if a student athlete can substantiate that i) an expense they paid or incurred during the taxable year was related to the business of playing collegiate sports; ii) it is common, accepted, helpful and appropriate in that business; and iii) the amount is reasonable, they may be entitled to a trade or business deduction under IRC Section 162.[112] Examples of possible deductions include agent and

[109] *See About Schedule C (Form 1040), Profit or Loss from Business (Sole Proprietorship)*, IRS, https://www.irs.gov/forms-pubs/about-schedule-c-form-1040 (last visited Apr. 25, 2024).

[110] *See* I.R.C. § 162 (2017). *See also Publication 535 (2022)*, *Business Expenses*, IRS (Feb. 2, 2023), https://www.irs.gov/pub/irs-prior/p535--2022.pdf.

[111] The meaning of "ordinary" and "necessary" was addressed by the U.S. Supreme Court in Welch vs. Helvering, 290 U.S. 111 (1933). There, the Supreme Court defined "ordinary" as "common and accepted" for the group or community of which the taxpayer is a part, and "necessary" as "appropriate and helpful." *See id*. at 113-14. The IRS thus defines "ordinary" as "common and accepted" in the taxpayer's "field of business" and "necessary" as "helpful and appropriate" in the taxpayer's business. *See* Pub. 334, *Tax Guide for Small Business*, Chapter 8 at p. 30, IRS (Jan. 11, 2023), http://www.irs.gov/pub/irs-pdf/p334.pdf.

[112] *See* Alan Pogroszewski & Kari Smoker, *My Tax Accountant Says I Can Deduct My Hot Tub. He's the Expert - Should I Question Him?*, 25 MARQ. SPORTS L. REV. 435, 441 (2015). The I.R.S. concedes that "an expense does not have to be indispensable to be considered necessary." *Id*. An additional requirement imposed

trainer fees, travel costs, conditioning, and perhaps even nutritional supplements.[113]

In addition to deductions for business-related expenses, many self-employed taxpayers can take a qualified business income (QBI) deduction, based on the amount of their QBI.[114] Unfortunately, there are several phaseout provisions, including one for high income taxpayers engaged in a specified profession, including athletics.[115] For 2022, if a taxpayer's filing status was single and they were engaged in a specified profession, the QBI deduction is reduced if their taxable income exceeded $170,050, and it is completely phased out if their taxable income was $220,050 or more.[116] Thus, student athletes who earn income at the $1,000,000 and $5,000,000 levels clearly do not qualify for the deduction. Assuming, however, a student athlete received personal service income of $100,000 from which they deduct a 20% agent's fee, the QBI deduction would result in an additional $2,695 tax savings.[117]

Although deductible business expenses depend heavily on the taxpayer's circumstances and vary between athletes, agent fees are consistent. Agents who negotiate NIL contracts generally charge a percentage of the overall value of the contract.[118] Therefore, the final example (illustrated in Tables 4A and 4B) assumes a flat 20% charge and incorporates a deduction for the fee. It also incorporates the QBI deduction allowable at the $100,000-income level. Taken together, the overall impact of business-related deductions and calendar-day apportionment becomes evident. At every income level, the in-state student

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by the courts is that the expense be reasonable in amount. *See*, *e.g*., Commissioner of Internal Revenue v. Lincoln Electric Co., 176 F.2d 815, 818 (1949).

[113] For a broader discussion of the potential expenses available to student athletes, see Pogroszewski & Smoker, *supra* note 112.

[114] *See* I.R.C. § 199A(a)(2)(A) (2017).

[115] *See* 26 C.F.R. § 1.199A-5(2).

[116] *See* Phillip J. Korb, *Qualified Business Income Deduction and the Self-Employed*, CPA J. (July 2022). (https://www.cpajournal.com/2022/07/29/qualified-business-income-deduction-and-the-self-employed/).

[117] Student athletes at the $10,000 income level do not have QBI because they have no taxable income after deducting the standard deduction ($12,950 in 2022), and those at the $1,000,000- or $5,000,000-income levels do not qualify for a QBI deduction because they exceed the phaseout limitation. See *id.* and accompanying text. At the $100,000-income level, the student athlete's net business income is $80,000 ($100,000 - $20,000 agent's fee), and self-employment tax is $11,304 (92.35% of the $80,000 net business income, taxed at 15.3%). Thus, the student's adjusted gross income is $74,348 ($80,000 net business income less the deduction for ½ of the $11,304 self-employment tax). Taxable income is then $61,398 ($74,348 adjusted gross income less the $12,950 standard deduction). The QBI deduction is 20% of taxable income, or $12,280, and further reduces taxable income to $49,118 ($61,398 taxable income - $12,280 QBI deduction). In effect, the QBI deduction reduces the tax liability from $9,120 to $6,425, for a net savings of $2,695.

[118] Fees for an agent who negotiate a name image and likeness endorsement contract, from the authors' professional experience, charge between 10% to 20% of the overall value of the contract.

playing for the Texas Longhorns derives a net savings (Table 4A) that, although minimal at the $10,000-income level, falls between 8.18 and 9.76% for income ranging between $100,000 and $5,000,000.[119]

Table 4A
Texas Longhorns Player (Texas Resident)
Tax Savings: calendar-day apportionment with 20% agent's fee and QBI deductions.

Income	Net Income 120 Duty Days without Deductions	Net Income 365 Calendar Days with Deductions	Tax Savings Using Calendar Days with Deductions
$10,000.00	$8,587.00	$8,870.00	$283.00
$100,000.00	$72,444.00	$82,204.00	$9,760.00
$1,000,000.00	$626,044.50	$707,824.00	$81,779.50
$5,000,000.00	$3,014,862.50	$3,423,895.00	$409,032.50

The tax savings in this example are even greater for a California resident playing at USC (Table 4B). Once again, the savings at the lowest income level are minimal, but the three highest income levels realize a savings ranging between 10.43 and 11.34%.[120]

[119] The tax savings at the $100,000-income level is 9.76% ($9,760/100,000). At both the $1,000,000- and $5,000,000-income levels, the savings amount to 8.18% ($81,780/1,000,000 and $409,033/5,000,000, respectively).

[120] The tax savings at the $100,000-income level is 11.34% ($11,340/100,000). At the $1,000,000-income level, it amounts to 10.43% ($104,300/1,000,000), and at the $5,000,000-income level, it amounts to 10.63% ($531,357/5,000,000).

Table 4B
USC Trojans Player (California resident)
Tax Savings: calendar-day apportionment with 20% agent's fee and QBI deductions.

Income	Net Income 120 Duty Days without Deductions	Net income 365 Calendar Days with Deductions	Tax Savings using Calendar Days with Deductions
$10,000.00	$8,546.00	$8,848.00	$302.00
$100,000.00	$67,749.00	$79,089.00	$11,340.00
$1,000,000.00	$526,518.50	$630,818.00	$104,299.50
$5,000,000.00	$2,401,367.50	$2,932,724.00	$531,356.50

As noted, a California resident playing at USC realizes a greater tax savings using calendar-day apportionment and deducting agent fees from their personal service income compared to an in-state student playing for the Texas Longhorns (Table 4B). For instance, at the $5,000,000-income level, the California resident realizes a tax savings of $531,357 compared to only $409,033 for the Texas resident. Yet, the California player's net income is still comparatively less than the Texas player—the Texas player will realize $491,171 more net income than the California player at the $5,000,000-income level.

Table 5
Net Tax Advantage of In-State Texas Longhorns Player Over In-State USC Trojans Player
365 calendar-day apportionment with 20% agent's fee deduction

Income	Texas Longhorns Player Net Income (365 Calendar Days & Deductions)	U.S.C. Trojans Player Net Income (365 Calendar Days & Deductions)	Net Advantage for In-State Texas Longhorns Player
$10,000	$8,870.00	$8,848.00	$22.00
$100,000	$82,204.00	$79,089.00	$3,115.00
$1,000,000	$707,824.00	$630,818.00	$77,006.00
$5,000,000	$3,423,895.00	$2,932,724.00	$491,171.00

Simplified Employee Pension Plan (SEP) Contributions

The final tax planning strategy involves the use of an SEP. Student-athletes who report self-employment compensation can set up an SEP-Individual Retirement Account (IRA).[121] They can then make an annual contribution to the plan of up to 25% of their net income (subject to a maximum of $61,000 in 2022 and $66,000 in 2023).[122]

This savings vehicle provides two distinct tax benefits. First, there is an immediate income tax deduction for contributions that are made during the tax year, which can result in significant tax savings. Second, the retirement savings grow—and the earnings are reinvested—tax-free.[123] The rules are designed to encourage taxpayers to keep their retirement savings invested until they are at least close to what is considered retirement age; distributions are included in taxable income in the year they are received and are subject to an additional 10% penalty if the taxpayer makes a withdrawal before age 59½.[124]

Tax savings thus occur at both the federal and state levels and increase for taxpayers in higher income tax brackets. Table 6 illustrates these savings for an in-state USC Trojans player making the maximum annual SEP-IRA contribution.

Table 6
USC Trojans Player: Net Tax Advantage of SEP Contributions

Income	AGI	SEP Contribution	Tax Savings
$10,000.00	$5,948.00	$1,487.00	$15.00
$100,000.00	$59,478.00	$14,870.00	$3,386.00

[121] *See Simplified Employee Pension Plan (SEP)*, IRS, https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employee-pension-plan-sep#:~:text=SEP%20contributions%20and%20earnings%20are,a%2010%25%20additional%20tax%20applies (last visited Feb. 18, 2024).

[122] *See SEP Contribution Limits, (Including Grandfathered SARSEPS)*, IRS, https://www.irs.gov/retirement-plans/plan-participant-employee/sep-contribution-limits-including-grandfathered-sarseps (last visited Feb. 18, 2024).

[123] For information, see *Simplified Employee Pension Plan (SEP)*, IRS, https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employee-pension-plan-sep#Operate%20and%20Maintain%20A%20Sep%20Plan (last visited Apr. 25, 2024).

[124] *See id.*

$1,000,000.00	$719,173.00	$61,000.00	$30,073.00
$5,000,000.00	$3,937,323.00	$61,000.00	$30,683.00

For the USC athlete whose income in 2022 is $10,000, taxable income is $0 after taking the $12,550 standard deduction. Thus, deducting the SEP contribution provides no immediate federal income tax advantage, although the athlete still benefits because tax-deferred earnings accumulate while the money is invested. (The $15 income tax savings that the athlete does realize occurs at the state level.)

The SEP contribution does provide an immediate federal income tax benefit, however, at the $100,000-, $1,000,000-, and $5,000,000-income levels. Notably, when the taxpayer is self-employed and contributes to an SEP-IRA on their own behalf (rather than that of an employee), determining net income to calculate the 25% contribution limit is surprisingly complex.[125] In short, the 25% contribution limit at the $100,000-income level amounts to $14,870 and results in a tax savings of $3,386; however, once the athlete's adjusted gross income exceeds $305,000, the annual contribution limit reaches the $61,000 ceiling for 2022.[126] Thus, at the $1,000,000-income level, the athlete's maximum SEP contribution is $61,000, and the related deduction results in a tax savings of $30,073; at the $5,000,000-income level, the athlete's maximum SEP contribution is still $61,000, and the related deduction results in a tax savings of only $30,683—just $610 more because of additional marginal tax savings that occur at the state level.

SECTION V: CONCLUSION

This article illustrates the complexity of federal and state income tax laws for student athletes receiving NIL endorsement income. This complexity, however, presents many opportunities—not only for athletes wanting to implement tax saving strategies, but also for universities negotiating NIL deals to their competitive advantage and for skilled tax professionals providing these parties with expert advice.

Student athletes and their representatives need to be mindful of the wording of their NIL contracts, the way in which it may impact both the characterization

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[125] This complexity is due, in part, to having to factor the tax deduction for half of self-employment tax in the calculation of net income.

[126] *See* Internal Revenue Service, *Publication 560 (2023), Retirement Plans for Small Business*, IRS, https://www.irs.gov/publications/p560#en_US_2022_publink10008982 (last visited Apr. 25, 2024). The $66,000 maximum annual contribution limit in 2023 is reached once the taxpayer's adjusted gross income exceeds $330,000. *See id.*

and sourcing of their endorsement income, and ultimately the tax implications. Under some circumstances, it is ideal for endorsement income to be effectively connected to the performance of services, thus allowing the student athlete deductions for QBI, SEP contributions, and business-related expenses. Under other circumstances, it is to the student's advantage to have it characterized as NIL royalties. The complexity lies in the fact that the student's residency, the location of their school, and the amount of the endorsement income are all factors that uniquely determine how the income should ideally be characterized and sourced. It is essential to adopt a tax planning strategy before the contract terms are negotiated, rather than trying to manipulate the circumstances after the fact. Understanding the potential implications and planning accordingly can provide student athletes with significant tax savings. Poor tax planning can cost them, and not just in tax dollars. It can make them more susceptible to stressful audits and, worse, challenges raised by government authorities.

Colleges and universities also need to be aware of the tax advantages or disadvantages that an NIL deal entails for a particular recruit. While USC and the University of Texas are in polar opposite states, at least in terms of taxation—California imposing the highest state income taxes in the U.S., Texas imposing none[127]—the reality is that every athletic program presents a unique set of circumstances for its recruits. Those circumstances depend, in part, on the location of the program, as well as the student's place of residency.

Table 6 offers a final glimpse at the potential tax consequences for an in-state recruit, this time focusing on some of the traditional powerhouses in college football. Using a $5,000,000 NIL deal tied to the performance of services, allowing for no deductions or credits, and apportioning income over 365 calendar days, it provides a baseline comparison of net income to the in-state recruits at the University of Texas and U.S.C. The results? With no income tax in the state of Texas, the Longhorns still come out on top with the biggest competitive advantage (at least for tax purposes). The Trojans, located in California where income taxes are the highest in the nation, still come out on bottom. Everyone else falls somewhere in between.

[127] For specific tax rates by state, see Timothy Vermeer, *State Individual Income Tax Rates and Brackets for 2023*, TAX FOUND. (Feb. 21, 2023), https://taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/.

Table 7
Net Income on a $5,000,000 NIL Deal for an In-State Star Recruit

School	Resident State	Federal Tax	State & City Tax	Jock Tax	Net Income	Net Income as a % of Total Income
U. OF TEXAS	TX	$1,971,911.50	$0.00	$4,332.00	$3,023,756.50	60.48%
CLEMSON	SC	$1,971,911.50	$143,508.00	$6,271.00	$2,878,309.50	57.57%
U. OF ALABAMA	AL	$1,971,911.50	$157,269.00	$4,099.00	$2,866,720.50	57.33%
U. OF MICHIGAN	MI	$1,971,911.50	$201,104.00	$7,582.00	$2,819,402.50	56.39%
NOTRE DAME	IL	$1,971,911.50	$241,664.00	$9,324.00	$2,777,100.50	55.54%
U. OF GEORGIA	GA	$1,971,911.50	$274,916.00	$8,884.00	$2,744,288.50	54.89%
OHIO STATE	OH	$1,971,911.50	$314,679.00	$6,866.00	$2,706,543.50	54.13%
USC	CA	$1,971,911.50	$622,733.00	$3,988.00	$2,401,367.50	48.03%

Like their counterparts in professional sports, universities in low- and no-tax states have a competitive advantage in that their student athletes can potentially see more take-home pay.[128] As this article makes clear, however, there are many factors that must be considered, and every recruit's situation is unique. Implementing a tax planning strategy early in the negotiations process is critical.

[128] Of the top ten schools in the 2022 final college football rankings, four schools—Texas Christian University, Tennessee, Washington, and Florida State— are in states with no income tax, while three—the University of Michigan (4.25%), Ohio State (3.99%) and Alabama (4%)—are based in states with an income tax rate, as of 2023, of less than 4.25%. For the rankings, see *College Football Rankings (2022)*, ESPN (last visited Feb. 18, 2024) (https://www.espn.com/college-football/rankings/_/year/2022/seasontype/2). For 2023 income tax rates by state, see Timothy Vermeer, *State Individual Income Tax Rates and Brackets for 2023*, TAX FOUND. (Feb. 21, 2023), https://taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/.