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MLB Jock Tax Index: Quantifying the Monetary Value in After-Tax Dollars

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Abstract

The Jock Tax Index (JTI) is a new proprietary tool and has been featured in "Off the Charts" by Scarlet Fu on Bloomberg Television's Market Crashers. The JTI ranks each of the 30 Major League Baseball (MLB) teams according to the federal, resident and nonresident state and city income tax liability based on their home and away schedule and puts this information into a usable index. It gives a player and agent a practical way to evaluate how the tax burden for each team's players compares to the 29 other teams in MLB. The JTI measures how much a team's location dictates the tax burden on an athlete because of the jurisdiction's income tax policies and allows individuals to compare the net take-home income after tax liabilities and credits of any contract proposal between competing offers from different tax jurisdictions.

Introduction

Last December when former New York Yankee star Robinson Cano chose to sign with the Seattle Mariners, which play their home games in a state with no income tax as opposed to resigning with the Yankees it illustrated how state tax policies can influence professional athletes in their final decision on contract negotiations. While all athletes incur federal tax liability on their earnings, their exposure to state and local taxes will be dictated by a team's home and road schedule. This upcoming season, Major League Baseball (MLB) players will potentially play and be taxes in up to 21 different states and cities.

This paper will outline the history of the jock tax and then shows how the jock tax can be quantified in an index that takes into account each state's unique tax policies. The Jock Tax Index (JTI) takes into consideration not only a state's constitutional power to tax residents on all of their personal income from whatever source derived but also that each state has their own unique tax system featuring different individual tax rates and credit allowed for taxes paid to other states. The JTI also takes into consideration that each team has a unique game schedule that features both home and away games that are played in multiple jurisdictions with each player being subject to those jurisdictions tax policies. The end result is that the JTI allows individuals to take salary proposals from different cities and compare there after tax value.

History of the Jock Tax

How did we get to this complexity of state taxation of professional athletes? Although Article I, Section 8 of the United States Constitution establishes the dual sovereignty of states and the federal government, states in the past rarely taxed nonresidents on personal income. This all changed as increased fiscal pressures faced by many state and local governments at the end of the last century led to increased enforcement against athletes of nonresident tax laws that in most instances have been on the books for many years.[1]

Nonresident taxation on professional athletes gained national attention in the early 1990s. Philadelphia began enforcing its city tax on nonresidents, specifically athletes, while Illinois retaliated against California's nonresident tax on Michael Jordan and his Chicago Bulls teammates following their 1991 National Basketball Association (NBA) Championship against the Los Angeles Lakers. Despite the publicity received from both Philadelphia's and Illinois's implementation of a nonresident tax, state court cases have shown that California had been taxing nonresident athletes as early as 1968, while New York has been doing so since 1971.[2]

Professional athletes make an attractive target for state tax collectors because of their high salaries. The increase in revenue as well as the fact that athletes are easy to identify by the simple use of a box score and schedule has caused the increased enforcement by states against athletes of nonresident tax.[3]

Methods

The JTI measures how much a team's location dictates the tax burden on an athlete because of the jurisdiction's income tax policies. It ranks each of the 30 MLB teams according to the federal, resident and nonresident state, and city income tax liability based on their game schedule.

Using the guidelines outlined in my article "When is a CPA as important as your ERA?," published in the Spring 2009 issue of *Marquette Sports Law Review*, the JTI assumes each individual will earn the 2014 MLB league average ($3,390,000), file as "single," and not miss any games. The only deductions assumed taken on Schedule A of the federal return ("itemized deductions") are state income taxes paid during the year with itemized deductions phased out as the taxpayer's income increases.

The first step in calculating a team's JTI is to breakdown their schedule to include the total number of days in the season and the number of days "duty days" in each tax jurisdiction. From the determination of duty days you can then allocate the income and tax owed. For example, in 2014 a member of the Arizona Diamondbacks would have participated in 14 states and or cities outside Arizona for a total non-resident tax of $40,346.13. The table below list the number of duty days, income earned and tax owed in each jurisdiction.

Diamondbacks Salary Allocation

Jurisdiction	Duty Days	Income Earned	Tax
Cincinnati	3	$47,302.33	$993.35
Cleveland	2	$31,534.88	$630.70
Colorado	10	$157,674.42	$7,284.60
Georgia	3	$47,302.33	$2,643.95
Illinois	6	$94,604.65	$4,727.44
Minnesota	3	$47,302.33	$4,594.60
Missouri	3	$47,302.33	$2,024.00
New York	3	$47,302.33	$4,162.83
Ohio	5	$78,837.21	$4,218.00
Pennsylvania	6	$94,604.65	$2,904.36
Philadelphia	3	$47,302.33	$1,650.61
Pittsburgh	3	$47,302.33	$473.02
St. Louis	3	$47,302.33	$473.00
Wisconsin	3	$47,302.33	$3,565.67
TOTAL			$40,346.13

Along with the income earned outside the state, a player who is a resident of Arizona would also be responsible to file a resident return. As a resident, each member of the Diamondbacks claims their entire income on their resident return. In addition, residents are allowed to claim a limited credit for state taxes paid as a non-resident. The table below shows taxes owed after claiming non-resident credits for a Diamondbacks player to the state of Arizona.

Diamondbacks Resident Tax

Jurisdiction	Duty Days	Income	Tax	Non-Resident Tax	Tax Credit	Total Resident Tax
Arizona	215	$3,390,000.00	$149,687.64	$40,346.13	$27,903.67	$121,783.96

In addition to resident and non-resident taxes paid to cities and states, members of all teams including the Arizona Diamondbacks will also be responsible for Federal, Medicare and Social Security tax. As previously noted in our assumptions, individuals are able to take a limited deduction for state and city taxes. Since state and city tax liability is different for each team, Federal tax will be affected by the amount of tax paid to these jurisdictions. The table below outlines the specific federal tax liability for a member of the Arizona Diamondbacks.

Diamondbacks Federal Tax

Team	Income	Deductions	Taxable Income	Federal Tax	Medicare Tax	Social Security
Arizona Diamondbacks	$3,390,000.00	$67,930.12	$3,322,069.88	$1,273,303.42	$77,864.83	$7,049.00

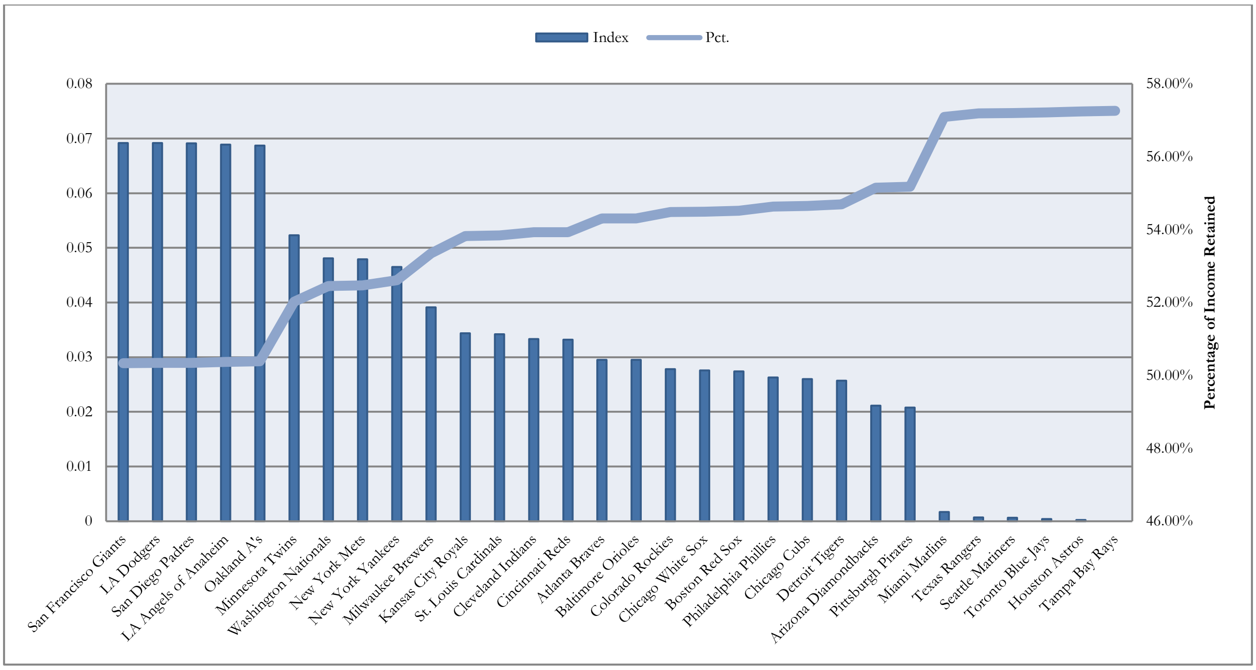
Once Federal, state (resident and non-resident) and city taxes are subtracted from a player's income, the net income is determined. Since net income is the after tax value of a player's income I've referred to this as the net value. For a Diamondbacks player the net value of their income would be $1,869,652.63 or 55.15% of their total salary.

Diamondbacks Net Value

Team	Income	Federal	State and City	Net Income	Pct.
Arizona Diamondbacks	$3,390,000.00	$1,358,217.25	$162,130.12	$1,869,652.63	55.15%

Once every team's net value is calculated a comparative analysis is done to formulate a corresponding index with each team's percentage of income retained. The percentage of income retained in MLB ranges from 50.33% (San Francisco Giants) to 57.26% (Tampa Bay Rays).

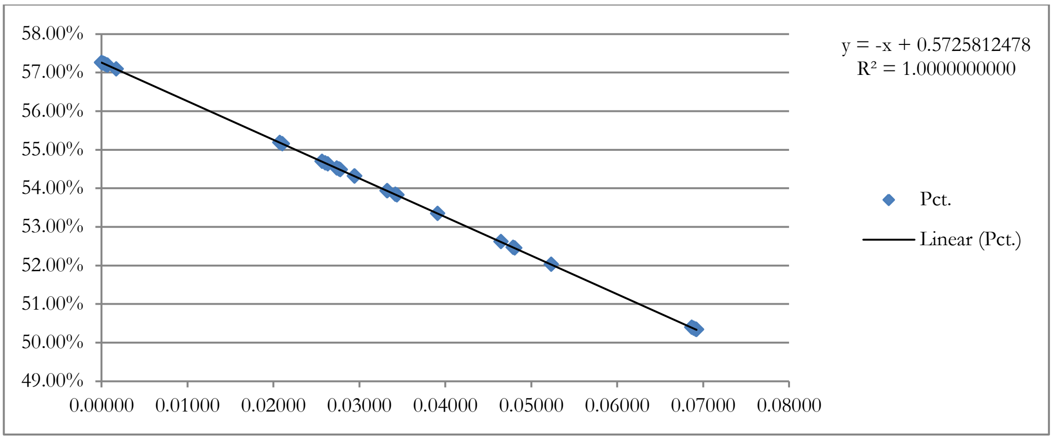
Jock Tax Index in Comparison to Percentage of Net Income Retained



The JTI then measures the difference between each team's percentage of income retained and that of the Tampa Bay Rays (57.26%) which retain the highest percentage of their income.

The JTI provides a direct correlation between any two teams that allows us to calculate a player's net value depending on the team in which they play. The graph below shows the correlation and the formula between the JTI and the percentage of net income.

Correlation between Percentage of Net Income and the JTI



Therefore, to determine the net value of any two salary proposals, all that is required is to apply the JTI for each team into the following formula:

Figure I

$$b = \frac{[a * (-x + .5725812478)]}{(-y + .5725812478)}$$

In this formula (b) solves the contract proposal needed from team #2 in order to produce the same net after tax value as the initial contract proposal from team #1 or (a) with (x) representing the JTI for team #1 or (a) and (y) representing the JTI for team #2 or (b). Therefore, the net take home for an identical salary of $3,390,000 would net an additional $234,745.33 more in Tampa Bay in comparison to San Francisco.

Results

There are two issues to keep in mind: First, the increased tax rates at both the federal and state level, along with the phaseout of itemized deductions, continue to increase the effective rate of an athlete's income tax. Despite the fact that the average salary in MLB increased over the previous year by 5.49%, the overall net income increased by only 1.81%. This is due to the fact that, over the past year, the average federal income tax increased by 10.98% while state and city income tax increased by 5.79%.

Even the Rays' JTI, which remains the best in the league since 2006, when I first compared the effect of state taxes on athletes, means that Rays players take home less than they did in previous years. A member of the 2014 Tampa Bay Rays will take home $181,242.28, or 8.54%, less income than a team member in 2006.

Second, the disparity between the five California teams and the rest of the league continues to grow. Of the 30 MLB teams, the five California teams have the highest JTI, which is a direct reflection of the state's maximum income tax rate of 12.3% and an additional 1% Mental Health Service Tax on income of over $1,000,000. The Giants' JTI increase from 2013 to 2014 means there is an 11.42% increase in the cost to play in San Francisco in comparison to playing for the Tampa Bay Rays.

The JTI disparity should make California teams consider the tax ramifications when pursuing or retaining free agents. An example would be on November 25th when the World Series Champion San Francisco Giants lost their starting third baseman Pablo Sandoval who was an unrestricted free agent and signed with the Boston Red Sox.

The JTI formula can determine the premium that the Giants would have needed to pay Pablo Sandoval in order to match the net value of his accepted salary of $95,000,000 over five years from the Boston Red Sox. As the table below indicates the Giant's would have needed to offer Sandoval $102,897,763.51 or an addition $7,897,763.51 more than the Red Sox contract.

Pablo Sandoval after Tax Comparison

Boston (a) or Team #1 Contract Proposal	Boston (x)	San Francisco (y)	JTI Base	San Francisco (b) or Team #2 [a * (-x + .5725812478)] / (-y +.5725812478)
$95,000,000.00	2.740%	6.92%	0.572581247787611	$102,897,763.51
After Tax [a * (-x + .5725812478)]				After Tax [a * (-x + .5725812478)]
$51,792,029.10				**$51,792,029.10**

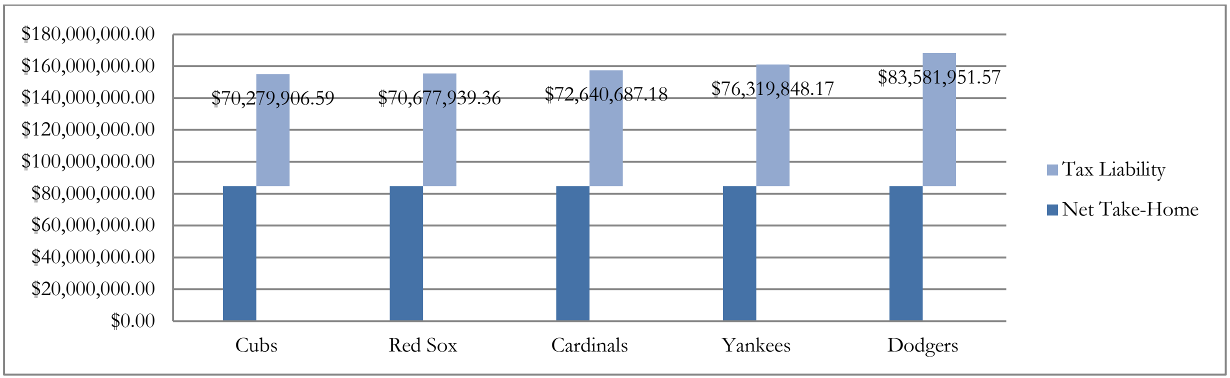
Although the disparity is greatest when comparing the five California teams with the other 25 teams in the league, each team's individual income tax consequences, as indicated by the JTI, indicates some disparity between all the teams in terms of what a player actually takes home after taxes.

The Example of Jon Lester using the JTI

On December 9th Jon Lester signed as an unrestricted free agent with the Chicago Cubs for $155,000,000 over six years for an average annual value of $25,833,333. Take into consideration that the Boston Red Sox, Los Angeles Dodgers, St. Louis Cardinals and the New York Yankees also had varying degrees of interest in signing Lester, the JTI can determined which of these team' salary proposal could be discounted and which ones would need to be at a premium.

The net value of the Cubs contract proposal was $84,720,093.41 for an average annual contract value of $14,120,015.57. The graph below compares the four other team's tax liability based on a comparable net value of the Chicago Cubs proposal.

Net Income Tax Comparison



Based on the 2014 JTI the Cubs salary proposal offered the best tax scenario as every other potential team would need to pay a premium on their contract proposal. As the chart above indicates the Red Sox would have only need to pay a premium of $398,032.77 while the Yankees would have needed to offer $6,039,941.57 million more and the Dodgers premium would have been $13,302,044.98 million.

Conclusion

Last December, Robinson Cano illustrated how state taxes influenced contract decision; the JTI assists in determining the actual value of that decision. By Cano signing with the Mariners the net value of his $240,000,000 million contract over ten years netted him over $11,059,499.47 more in the state of Washington as opposed to playing in New York for the Yankees.

As this article and Cano's situation indicate, the true value of a contract should be measured by the percentage of income retained after-tax or the net value of the contract. Each team is subjected to their own unique tax policies of their jurisdiction and the JTI quantifies this by providing a direct correlation between teams in order to determine a player's net value depending on the team in which they play. The JTI provides teams and players the ability to quantify offers made from multiple teams and determine the true value of each proposal.

References

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

[2] For a more informative breakdown on the history of the taxation of non-resident athletes, 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).

[3] Robert D. Platter, "FTA Recommendations on Taxing Nonresident Athletes Could Have Wider Application," J. MULTISTATE TAX'N & INCENTIVES 36, 36 - 40 (Mar./Apr. 1994).