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Cleveland's 'jock tax' a mistake by the lake

On April 30, the Ohio Supreme Court held that Cleveland's specific method of imposing a "jock tax" violated due process. It also held that there was no violation of the U.S. Constitution's equal protection clause in taxing visiting professional athletes but not taxing other visiting professionals.

The ruling was a result of former NFL offensive lineman Jeff Saturday and ex-Bears linebacker Hunter Hillenmeyer challenging Cleveland's jock tax in court.

Hillenmeyer, a nonresident, sued Cleveland arguing that the city used an unlawful method in computing the amount of his compensation subject to a city municipal tax obligation, or a "jock tax."

Jock taxes are income taxes levied against nonresident athletes to states or cities where the athletes perform. Since states cannot realistically track the countless nonresidents doing business within their borders, more wealthy, high-profile people, such as professional athletes, are often targeted.

Jock taxes came into play back in 1991 when the Chicago Bulls beat the Los Angeles Lakers for the NBA championship (you can now take a second to reminisce about the Bulls dynasty of the 1990s).

To nobody's surprise, even from winning the 1991 title alone, Michael Jordan was to receive a significant amount of income. In a clever move, California decided to tax Jordan's earnings that were actually earned while playing in California for the title.

When Jordan received his tax bill from California for a portion of his income, Illinois wasn't too pleased as Illinois believed it deserved all of the taxable revenue from Jordan's income.

To retaliate, the Illinois Department of Revenue began

sending tax bills to California athletes who played in Illinois. This jock tax was coined "Michael Jordan's Revenge."

To date, 22 of the 26 states that are home to professional sports teams have some type of jock tax. Eight cities have their own jock taxes, including Cleveland.

To calculate a jock tax on visiting professional athletes, a majority of jurisdictions use the "duty-days" method. Under this method, a tax is imposed on the number of days an athlete spends in a city performing various duties such as practicing, playing, training and promoting.

Then, the athlete's total income is divided by the total number of days which he performs these services for his team during the year. Each jurisdiction that uses the duty-days method then taxes the athlete only on those duty days spent in their respective jurisdiction.

However, Cleveland has been historically practicing the "games-played" method of taxing professional athletes. Cleveland imposes a 2 percent tax on the income Cleveland finds allocable under the games-played method. This process determines apportionment of income based upon game days alone. Only the number of games an athlete's team played in a season is considered instead of the total number of days actually worked.

In 2004, 2005 and 2006, Hillenmeyer spent two days per year playing football games in Cleveland. He played 20 games per season including preseason games. Hillenmeyer was "on duty" for 160 days total, taking into consideration the days including his practice, training, strategy sessions, promotional activities and other job-related services he engaged in outside of Cleveland.

Under Cleveland's method-ology, 5 percent of Hillenmeyer's

TIME-OUT

AMY N. SCHILLER



Amy N. Schiller is an attorney at Schiller, DuCanto & Fleck LLP where she practices family law with a strong focus on property issues and the complex financial and custody matters facing professional athletes and entertainers. She can be reached at aschiller@sdflaw.com.

income was taxed by the city of Cleveland. This resulted in Cleveland capturing a larger portion of Hillenmeyer's income because there are far fewer actual game days than duty days.

The Ohio Supreme Court found that Cleveland's games-played method imposed an extra-territorial tax in violation of the due process clause of the Constitution. It was found that Cleveland's power to tax should only reach that portion of a nonresident's compensation earned for work performed inside of Cleveland. The games-played method extended to income earned outside of Cleveland, thus violating due process as applied to NFL players such as Hillenmeyer.

In many scenarios, if an athlete pays income tax for work performed in another jurisdiction outside of his home jurisdiction, he will be afforded a full tax credit in his home jurisdiction, but only up to the amount his home state would have collected. But tax rates vary among jurisdictions. If the out-of-state tax is higher, the player will not receive a credit for the incremental out-of-state taxes paid. If the out-of-state tax is lower, then the home state will likely levy a tax for the difference.

If an athlete is taxed under the

games-played method in one jurisdiction and taxed under the duty-days method in his home state, he may ultimately pay income tax twice on a portion of his income.

Worth noting is the U.S. Supreme Court ruling from May 18 that rejected Maryland's income-tax system that allowed double taxation of some residents in certain circumstances who received out-of-state income. The justices held unconstitutional Maryland's refusal to give its residents full credits against income taxes paid to other states. In the majority opinion, Justice Samuel A. Alito Jr. emphasized the unconstitutionality of tax schemes that result in people being taxed twice on the same income.

In the Ohio Supreme Court case, Hillenmeyer sought a refund of approximately \$6,000, which represented the difference between the games-played method computation and the duty-days method computation.

The court ordered that Cleveland recalculate Hillenmeyer's jock tax using the duty-days method, under which Cleveland should have only taxed 1.25 percent of his income.

Professional athletes who were overtaxed in Cleveland may also be able to recoup some money previously paid to the city.

Cleveland will now likely join the other seven cities that impose a jock tax using the duty-days method if it wants to keep the jock tax around at all. The city stands to lose significant revenue — an estimated \$1 million — in the future under the duty-days method. As illustrated by Hillenmeyer's case, each athlete will save a few thousand bucks.

It can be assumed that this lawsuit was based more on principle than money, but it is a small victory for traveling professional athletes.