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Play Ball!

Planning for professional athletes? Here's your rulebook



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Estate planning for professional athletes can be a whole different ballgame.

For most clients, estate planning takes into account wealth that will be, or has been, accumulated over many years. The lawyer's job is to arrange for the orderly disposition of property after these clients die and to ensure that their families' needs will be met as far as those assets can possibly allow.

But, of course, pro athletes create their wealth in an extremely short period of time—they're lucky if it stretches to 10 years. And they

Some professional athletic organizations, like the National Football League, have programs that try to help players quickly get up to speed on their new financial

accomplish this feat while very young. This means an extreme emphasis must be placed on preserving and protecting wealth that athletes accumulate while in their 20s and 30s—and on making their money last for a very long time. Strategies that require irrevocable decisions, such as those using irrevocable trusts, must allow for a much longer time horizon and for the risk that the athletes might consume wealth at a faster rate than anticipated and need access to additional funds.

Not only are these clients young, but also they have been focusing almost exclusively on situations and connect them with financial and estate-planning advisors. But most don't.¹

So, how do estate planners best assist pro athletes to

sports, and odds are they do not come from privileged backgrounds. In other words, they're probably unfamiliar with managing wealth. Yet, suddenly, they're rich, and some are very rich. Many fail to fully comprehend the need to plan to preserve and protect this largesse. Moreover, all too often athletes fall prey to the unscrupulous who take advantage of the pros' tendency to rely on their "posse" rather than professional advisors. And of course, to the young, death seems too far off to consider, let alone plan for, even when the athletes are married with young children.

realize both their lifetime and "at death" goals?

The elements of any estate plan can be as varied as the assets it covers, but the will and revocable trust form the

cornerstone. For athletes in particular, a comprehensive plan pays close attention to the selection of domicile, use of marital agreements, benefits of planning with life insurance held through irrevocable life insurance trusts, disability planning, lifetime gifting and leverage transfer strategies, and asset protection.

So, how do we get started?

Familiarize Yourself

First, it's essential for you as the estate planner to become a true team player with whomever else the athlete picks to manage his finances so that you can coordinate financial, investment and asset protection decisions that fit into a comprehensive plan. This means knowing the other advisors and working with them as seamlessly as possible, consistent of course with attorney-client privilege concerns.

Also, get the big picture: Become familiar with the relevant sport's collective bargaining agreement, which can impose salary caps and "luxury taxes" on teams. These provisions can significantly reduce the athlete's earning potential after his current contract expires.²

You also should consider special issues relating to the taxation of deferred compensation,³ and the use of entities to hold the athlete's licensing rights for the marketing of his right of publicity, including through commercial endorsement deals. Endorsement revenues can potentially be more lucrative than players' salaries, sometimes providing "supplemental" income of tens of millions of dollars per year for the upper echelon superstars.⁴

More and more athletes are coming to understand the importance of a second career after their time in pro sports ends. Some players' associations do a good job providing guidance to help facilitate athletes' transitions to second careers, be it as broadcasters or as real estate brokers.⁵

If the athlete starts a closely held company, that creates opportunities for estate planning, including through leveraged transfers of entity interests to family trusts so asset growth can occur outside of the athlete's taxable estate without triggering any gain on such a transfer.⁶ This could be particularly appropriate for real estate investments, and

investments in private equity start-ups.

In other words, you're going to have to talk to a young athlete about his entire life and all of its possibilities, from the happy to the morbid.

But maybe it's best to start with a simple question, like: "Where do you live?"

Domicile

Given the national (if not international) scope of professional sports, it's not uncommon to find athletes who grow up in one state, play out of one or more other states, then live off-season in yet another state. With the frequency of player movement because of trades and free agency, the web of jurisdictions can actually get much more complicated than even that. Further complicating matters: athletes often can play for several professional teams during their careers; some will even play for two or more professional teams during a single season.

Also, in those states where the athlete is not domiciled and is not otherwise considered a resident for purposes of its income tax, the professional athlete generally is subject to state income tax as a non-resident on a "duty-days" basis

that prorates the athlete's salary based on where he renders services.⁷

Yet, the athlete's domicile, or legal residence, is critical for estate planning. Domicile generally determines the rules governing the disposition of tangible and intangible personal property upon one's death. In addition, domicile can determine the power of a particular state to tax worldwide income and transfers.

Domicile may be defined as an actual residence within a state, combined with the intention of making that state one's permanent home. For the professional athlete to avoid being treated as having more than one domicile, it's important to be clear in establishing the athlete's domicile and relinquishing any prior domicile.

■ **Establishing a new domicile**—Once a location has been selected, the first step in establishing domicile is for the athlete to obtain a place to live in that state. The athlete and his advisors should consider the following steps to make clear that the athlete is establishing a new domicile:

(1) File a formal "Declaration of Domicile" with the local clerk of court.

(2) Transfer all church, synagogue, social club, civic club, country club and other memberships to the new domicile. Many of these organizations allow non-resident members.

(3) File change of address cards with the post office, and notify all persons and organizations (for example, credit card companies, subscriptions, insurance carriers) of this change of address. The athlete should use this new address on all papers calling for information about his residence.

(4) Make sure any businesses he owns, such as restaurants, are operated from the athlete's state of domicile, if feasible.

(5) Register to vote with the local supervisor of elections.

(6) Obtain and keep a driver's license and register all automobiles in the new domicile.

(7) List the new address on his passport.

(8) File federal income tax returns with the Internal Revenue Service for the new domicile. Any state or local tax returns required

by the new domicile also must be filed.

(9) Transfer bank accounts, brokerage accounts and the contents of any safe deposit boxes and other personal property to the new domicile.

(10) Spend as much time as possible at the new domicile. More time should be spent there than anywhere else. Ideally, it would be preferable for the athlete to spend six months or more each year in the new domicile.⁸

■ **Relinquishing the previous domicile**—Relinquishing a domicile is every bit as important as establishing a new one. The athlete can take the following steps to make clear that he is relinquishing a domicile:

(1) Let the taxing authorities in the former domicile know that a new domicile has been acquired.

(2) Stop filing resident income tax returns for the old domicile.

(3) Keep contacts with the old domicile to a minimum.

(4) Limit business activity in the old domicile.

- (5) Give up resident licenses, such as for pets, fishing or hunting, in the old domicile, and obtain such licenses in the new domicile.
- (6) Make a will, health care proxy, living will and durable power of attorney noting the new domicile.

None of these actions are determinative in showing that a new domicile has been established and an old one relinquished, but a court will consider them when evaluating an athlete's intent concerning domicile.⁹

Love and Marriage

Young celebrity athletes with lots of money—no matter how in love they may be—really should have a marital agreement. These agreements can be made before (pre-nuptial) or after (post-nuptial) the wedding ceremony — although odds are it'll be a whole lot easier to get such agreements signed before any "I dos" have been uttered.

Everybody knows that marital agreements are used to define arrangements between spouses if the marriage ends in divorce, including alimony and property settlement. But also marital agreements can be used to determine the rights—

and the duties—of a surviving spouse upon the other spouse's death.

Marital agreements take on a heightened level of significance with professional athletes. In a survey reported by the financial services firm Rothstein Kass in December 2008, more than 80 percent of the 178 athletes polled—each with a minimum net worth of \$5 million and two-thirds under the age of 30—said they were "concerned about being involved in unjust lawsuits and/ or divorce proceedings." The common estimate among athletes and agents puts the divorce rate for pro athletes between 60 percent and 80 percent.¹⁰

Life Insurance

Life insurance is an important part of any estate plan. Given the youth and good health of most professional athletes, policies for them can be obtained at a low cost.¹¹

Should the athlete die prematurely, insurance proceeds are a quick source of cash for his family and can help to replace the income the athlete would have earned. Proceeds can be used to pay debts, taxes and bequests. This can be especially critical for an athlete with a large estate but little liquidity. Life insurance

also provides funds for trusts for members of the athlete's family. These trusts can be used to help raise and educate young children after the loss of the athlete/parent.¹²

Accidental death insurance is important for the professional athlete. Premiums are low, because proceeds are paid only in the event of death by accident. And, given the typical athlete's age and level of health, it's much more likely that, if he dies during his peak earning years, death will occur by accident rather than by natural causes. Such tragedies occur more often or are more notable perhaps than the young pros might like to imagine. (See "Death Be Not Proud," p. 5.)

Disability Planning

While you're talking to a young athlete about the unpleasant subject of his potentially premature demise, you should also point out that he needs to plan just in case he's physically or mentally incapacitated before he dies. You don't have to mention the high rate of early onset Alzheimer's among NFLers or other sports dangers. It's all understood.

What you do have to point out is that certain documents should be in place, just in case. They include:

- (1) revocable living trusts;
- (2) living wills;
- (3) health care proxies; and
- (4) durable powers of attorney, which may confer upon the person designated authority to engage in transactions on behalf of the athlete (such as paying bills, or making gifts within the \$13,000 per recipient annual exclusion amount) even after the athlete has become disabled.

Wills

Athletes unfortunately are notorious for their neglect of various forms of financial foresight, which can affect what happens to their fortunes even after they're gone.

Kansas City Chiefs' Hall of Fame linebacker Derrick Thomas, who died at age 33 following a January 2000 car crash, had ignored the urging of his financial advisor to make a will. Thomas' entire estate was left for the court to divide, touching off a legal battle among the five mothers of his seven children. And there

wasn't much left to fight over: Of the estimated \$30 million Thomas had earned in the NFL, he had only \$1.16 million in valued assets at the time of his death.

His agent Leigh Steinberg was quoted in *Sports Illustrated* as saying, "Derrick didn't care about meeting with his planner, and we tried to set him up to do it 10 times. The sad truth is that there was a certain group of athletes who actually believed that if they ever sat down to write their wills, they were going to die."¹³

Revocable Trusts

Revocable trusts have many of the same advantages as wills and, because they take effect as soon as they're created, have some additional advantages that are particularly helpful for professional athletes.

A trust can set up a program to handle financial matters during the athlete's lifetime, which is especially significant when pro careers are so time-limited and long-term asset management so critical. The athlete can grade his trustee's performance during life. If that performance is unacceptable, the trustee can be replaced.

Use of a professional trustee, such as a bank or trust

company, can take on added importance to the athlete who travels frequently and, for entire seasons, does not have time to administer his wealth personally. Using a professional trustee also can help protect the athlete from tricksters and hangers-on who often see athletes as a source of easy money for dubious private equity investments, outright fraud, systematic overcharging and other financial abuse.¹⁴

If desired, the athlete can serve as co-trustee with a professional trustee. The property in the trust also can provide support if the athlete has a serious career-ending injury.

Another advantage of trusts: Athletes are in the public eye, but property held in a trust is not. The trust is a more private way of distributing his property when he dies.

A revocable trust can be changed or amended by the athlete at any time during the athlete's life. Because a trust puts the system for dealing with property at death in place, costs of administering such property can potentially be reduced.

In addition, placing assets in a revocable trust can simplify estate administration by eliminating the need for an

ancillary probate for real property that is located in a jurisdiction other than the state of the athlete/decedent's domicile.

Leveraged Transfers

All the tools in the estate planner's kit are helpful to pro athletes with substantial wealth. These include gifts (including to charity), grantor retained annuity trusts, and sales to trusts for the benefit of family members whereby appreciation in value (or appreciation in value above a benchmark IRS interest rate) can be shifted outside of one's taxable estate. Also, through grantor trusts, the income taxes attributable to the property transferred to the trust can be charged to the athlete, thereby permitting wealth to accumulate unimpeded by tax outside of his taxable estate¹⁵ (and without triggering any income tax on transactions with the trust).¹⁶ Such a transaction can be particularly beneficial in planning for interests in entities that hold licensing rights related to the athlete's endorsement contracts.

But oftentimes, planning with irrevocable trusts of which the athlete is *not* a beneficiary is undesirable (other than in the case of irrevocable life insurance trusts). That's

because of the athlete's need to ensure he has sufficient wealth to live on for his whole life.

Instead, a better match for the athlete (at least for a "nest-egg" amount of wealth) sometimes is to use an irrevocable trust of which he is one of the beneficiaries (a self-settled trust). Because under the laws of most states, a self-settled trust subjects the assets held by the trustee to the claims of the athlete's creditors, it's generally desirable to use a trust that is held under the laws of a jurisdiction that has enacted asset protection trust legislation. Thus the athlete receives enhanced creditor protection, provided that the basis for a claim against him didn't exist at the time that he transferred assets to the trust.

DEATH BE NOT PROUD

EVEN YOUNG PRO ATHLETES, THE PICTURE OF HEALTH, CAN BE STRUCK DOWN

How do you convince world-class athletes in their 20s or 30s to plan for their deaths so that their families will be financially secure?

Show them this list of sportsmen who, in the past 20 years, died when they were younger than 50 years old.

Year	Athlete	Position Played	Team	Cause of Death	Age at Death
1993	Drazen Petrovic	NBA shooting guard	New Jersey Nets	automobile accident	29
1993	Reggie Lewis	NBA shooting guard	Boston Celtics	heart failure during an off-season practice	27
1999	Walter Payton	NFL running back	Chicago Bears	complications from liver disease	45
1999	Payne Stewart	PGA golfer	two-time U.S. Open winner	airplane crash	42
2000	Derrick Thomas	NFL linebacker	Kansas City Chiefs	automobile accident	33
2000	Bobby Phillips	NBA shooting guard	Charlotte Hornets	automobile accident	30
2001	Dale Earnhardt	NASCAR driver		crash in a last-lap of the 2001 Daytona 500	49
2001	Korey Stringer	NFL lineman	Minnesota Vikings	heat stroke during training camp	27
2003	Dan Snyder	NHL center	Atlanta Thrashers	automobile accident	25
2004	Justin Strzelczyk	NFL lineman	Pittsburgh Steelers	automobile accident	36
2005	Jason Collier	NBA center	Atlanta Hawks	heart condition	28
2005	Thomas Herrion	NFL lineman	San Francisco 49ers	heart condition	23
2006	Cory Lidle	MLB pitcher	New York Yankees	airplane crash	34
2007	Jackson K. Bussell	boxer		collapsing after a fight	28
2007	Eddie Griffin	NBA forward	Minnesota Timberwolves	automobile accident	25
2007	Sean Taylor	NFL defensive back	Washington Redskins	after being shot by an intruder	24
2008	Tom McHale	NFL lineman	Tampa Bay Buccaneers	brain damage	45
2008	Luc Bourdon	NHL defenseman	Vancouver Canucks	motorcycle accident	21
2008	Federico Luzzi	tennis player		leukemia	28
2009	Nick Adenhart	MLB pitcher	Los Angeles Angeles	automobile accident	22
2009	Marquis Cooper	NFL linebacker	Oakland Raiders	lost at sea	27
2009	Corey Smith	NFL defensive lineman	free agent, formerly Detroit Lions	lost at sea	30

— Kevin Matz

The states that have enacted asset protection legislation for self-settled trusts are Alaska, Delaware, Nevada, Rhode Island, Missouri, Utah, Oklahoma and South Dakota. In contrast, offshore asset protection trusts typically involve the transfer of title to cash, securities, personal property and non-U.S. real estate to a trust held under the law of a foreign jurisdiction. The Cook Islands has evolved as the jurisdiction of choice for many foreign asset protection trusts.

Mum's the Word

It's true for every client but more so for athletes: Once the estate plan is in place, it must be monitored frequently—as a rule of thumb, generally every three to five years. These are young men and women whose residences, family circumstances and careers can be in constant flux. Indeed, athletes often have very substantial changes in salaries, bonuses and other compensation (as well as changes in family circumstances), which can create an immediate need for change to their estate plans.

But even while we stay constantly in touch with these famous clients, we have to keep quiet about it.

Many of us estate planners are die-hard sports fans, so having a professional athlete as a client is an honor. It's okay to be star struck. These athletes have earned the right to be admired. But no advisor can relax the need for absolute confidentiality that all clients warrant. This means no war stories to fellow practitioners about famous clients. Indeed, no name-dropping whatsoever.

Endnotes

- 1 See Carolyn A. Chandler and Halah Touryalai, "Advising NFLers," *Wealth Watch*, Dec. 10, 2008, available online at http://trustsandestates.com/wealth_watch/advising_nfl_1203/.
- 2 See, for example, Larry Coon's FAQ on the salary cap, trade rules, and other aspects of the NBA's 2005 Collective Bargaining Agreement, <http://members.cox.net/lmcoon/salarycap.htm>.
- 3 For example, Section 409A of the Internal Revenue Code provides a framework for the taxation of non-qualified deferred compensation and has three consequences to the service provider (including a professional athlete) when it applies: First, it requires the service provider in a non-compliant plan to report a deferral of compensation as current income if the amount deferred is not subject to a substantial risk of forfeiture. Second, it imposes a non-deductible interest charge on the

tax that would have been due had the compensation been includible in income in the year of initial deferral. Third, the amount includible in income attracts an additional 20 percent tax. A non-qualified deferred compensation plan generally includes any plan that provides for deferral of compensation other than a tax qualified retirement plan.

- 4 Depending upon applicable state law, the athlete may also have a descendible right of publicity that is capable of transfer at his death by will or revocable trust. See Joseph D. Wright, "Skyrocketing Dollars and the Tax Reform Act of 1997: Estate Planning for the Professional Athlete in a New Millennium," 6 *Sports Law J.* 27, at pp. 50-54 (Spring 1999).
- 5 *Ibid.*
- 6 See Revenue Ruling 85-13.
- 7 New York State, for example, generally taxes the New York source income of a non-resident professional athlete, that is to say income derived from or attributable to the pro athlete's occupational activities carried on in New York State (New York Tax Law Section 631(b)(1)(B)). New York used to require that the total compensation of the non-resident athlete be allocated based on games played within and without New York State, with the portion allocated to New York being taxed by New York. Since Jan. 1, 1995, however, New York has adopted a "duty-days" method of allocation. Under this allocation method, the New York taxable portion of the non-resident

athlete's total compensation is determined based on the number of duty days spent within New York State rendering services for the team in any manner (excluding travel days) during the taxable year relative to the total number of duty days spent both within and without New York State (including travel days) during a taxable year (New York Tax Law Section 631(a) and 20 NYCRR Section 132.22(a)(1)&(2)). "Duty days" generally include game days, practice days, days spent at team meetings, promotional caravans and pre-season training camps, and days served with the team through all post-season games in which the team competes or is scheduled to compete (20 NYCRR Section 132.22(b)(3)(iii)). However, days for which the player is on the disabled list and does not conduct rehabilitative activities at facilities of the team and is not otherwise rendering services for the team in New York State are not considered duty days spent within New York. (20 NYCRR Section 132.22(b)(3)(vi)).

8 See Patrick J. Lannon, "Domicile Planning—Don't Take it for Granted," *The Florida Bar Journal* (January 2006).

9 *Ibid.*

10 See Pablo S. Torre, "How (and Why) Athletes Go Broke," *Sports Illustrated*, March 23, 2009, available online at <http://vault.sportsillustrated.cnn.com/vault/article/magazine/MAG1153364/index.htm>.

11 The standard forms of life insurance are term, whole life, survivorship, variable life and

universal life.

12 It is axiomatic that the professional athlete's life insurance policies should be held through an irrevocable life insurance trust (ILIT). Using a properly structured ILIT allows the athlete to exclude all life insurance proceeds from estate taxes. If an existing policy is placed in such a trust, the athlete generally must survive at least three years after transferring the policy to the trust to avoid estate tax inclusion. The preferable method is to place cash in an irrevocable trust that allows, but does not require, the trustee to purchase life insurance on the life of the athlete. Once the insurance is purchased, premiums can be funded using cash that the athlete periodically contributes to the trust. Upon death, the insurance proceeds may be used to care for family members, purchase assets from the athlete's estate, or pay estate taxes.

13 *Supra*, note 10.

14 *Ibid.*

15 See Rev. Rul. 2004-64.

16 See Rev. Rul. 85-13.

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