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Ohtani's $700 Million Contract Sparks California To Seek Tax Law Change

Baseball star Shohei Ohtani's record-breaking $700 million contract with the Los Angeles Dodgers is in the news again, and this time it is all about taxes. The baseball phenom and his advisers appear to have lawfully steered clear of California taxes for most of the outsize pay deal—for now.

Ohtani reportedly *deferred* most of his salary under his 10-year contract with the Dodgers. It may cleverly avoid California's 14.4% state income tax as long as he moves out before the big money starts rolling in. But California's Controller Malia M. Cohen wants Congress to change the tax code to cap deferred payments, a change that could ensure the state gets a hefty cut.

California has been known to change the law to send tax revenues its way, sometimes even retroactively, such as the 2023 law to retroactively tax certain trusts. But a change to get a piece of deferred pay deals like Ohtani's would have to be made to *federal* tax law, not just California. The California Controller asked for Congress to step in over the $700 million Dodgers player contract that awards the start pitcher-slugger just $20 million for ten years of play. The whopping $680 million payout kicks in for 2034 through 2043 to nicely escape California tax, as long as Ohtani moves out by 2034.

Even without a change in the law, it is possible that California could attack the pay deal as unrealistic for Ohtani's services and as artificially back-loaded. But the Controller seems to agree with Ohtani's tax lawyers that the $680 million may slip through California's tax net. The Controller's statement said that "The absence of reasonable caps on deferral for the wealthiest individuals exacerbates income inequality and hinders the fair distribution of taxes. I would urge Congress to take immediate and decisive action to rectify this imbalance."

How much is reasonable retirement pay can certainly be debated, and one idea would be to compare the current and deferred pay. Ohtani's contract is clearly lopsided, just $2 million per year for ten years, with a back-loaded deal that pays $680 million over ten years starting in 2034. There is no interest on the later pay, so a chunk of that is arguably interest too. There were many disputes about retirement pay for decades.

But after Dec. 31, 1995, federal law prohibits any state—even California—from taxing retirement income received by nonresidents. It covers qualified retirement accounts such as pensions and 401(k) plans, and some nonqualified deferred compensation plans if certain conditions are met. Ohtani's contract seems designed to deftly fall into these conditions.

So if he moves out of California before the big payments start arriving, he might skip California's top tax rate, which rose to 14.4% in 2024. Under California law, athletes and performers must report to the FTB their gross pay for performances in the state. Given how little Ohtani is being paid now with the back end huge, the Franchise Tax Board could argue that the contract does not fairly reflect his pay for services in the state. But the Controller's remarks suggest that a federal statute would need to be changed for that to happen.

Residency is a hot tax topic in California. If you leave the state, California tough tax agency, the Franchise Tax Board, is likely to come after you. In fact, sometimes California taxes nonresidents who never even visited. Like the IRS, California taxes its residents on worldwide income earned anywhere. California also taxes nonresidents on California-sourced income. And the Golden State has a tendency to argue about what is sourced here, when you arrived, when you left, and so on.

Moving sounds easy, but if you aren't careful how you do it, you could end up saying goodbye California taxes, and hello to a residency audit. So planning carefully to avoid costly mistakes is key. And no matter how careful you are, in some cases, California can assess taxes no matter where you live. California's tough Franchise Tax Board monitors the line between residents and nonresidents, and can probe how and when you left. Make no mistake, in California, tax disputes are difficult.

California is known to push the envelope, or even to change the rules. Last year, California passed a law stating that certain trusts to avoid California tax are outlawed, with retroactive effect. That caused quite a bit of scrambling. California could still try to argue for a share of Ohtani's deferred pay. But with a call for a change in the law, California's FTB may have its sites set on changing the law once and for all for any people—from athletes to those in Silicon Valley—who might try to emulate Ohtani's example.

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