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Robert W. Wood

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Ohtani’s $700 Million LA Dodgers Contract Avoids 14.4% California Tax

The news that baseball star Shohei Ohtani got a record $700 million contract is still mind boggling. So too is the clever slider that he appears to have lobbed at California’s tax man. He reportedly *deferred* most of his salary under his

10-year contract with the Dodgers. Some sources say it cleverly avoids California's 13.3% state income tax as long as he moves out before the big money starts rolling in. Sound fishy?

You might think $700 million means $70 million a year for 10 years. But, he's taking just $2 million per year, with a back-loaded deal that pays $680 million over 10 years starting in 2034. There is evidently no interest on the later pay, so one could say a chunk of that is really interest. But the $64,000 question is whether the state tax gambit works under California law.

I'm sure the star player has big-time tax lawyers, so I am speculating here. But it looks to me like Ohtani's tax play has a good chance of working, shorting the Golden State. Well, for now at least. California taxes just about everything, including athletes who just dip into the state for a game now and then. And as any former California resident is likely to know, 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. But with some issues, the federal law trumps California. 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, as many do before big payments start arriving, he might skip California’s 13.3% rate. Indeed, the Golden State’s top rate climbs to 14.4% in 2024. That’s a lot of tax at stake. It is true that 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 at only $2 million a year, with the back end huge, could the state’s tax man say the contract does not fairly reflect his pay for services in the state? It is not hard to imagine.

For one thing, it is common knowledge that California audits people who leave and who collect a big payday shortly after. 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.

Finally, California litigates cases regularly, and is known to push the envelope, a kind of “show me the money.” California sometimes changes the rules too. Earlier this year, California—retroactively—said that certain trusts to avoid California tax are outlawed. That has caused quite a bit of scrambling, so could California consider Ohtani’s slider and say, “not so fast?” It is too early to say, but California’s FTB is not shy and California tax disputes are difficult.

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