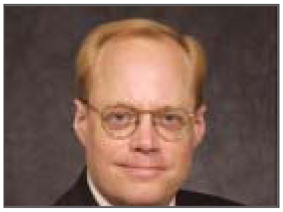
Forbes



Robert W. Wood

THE TAX LAWYER

TAXES | 7/07/2013

Dwight Howard Joins Houston Rockets, Rejects Lakers Higher Offer

Now that seven-time NBA all-star Dwight Howard has chosen to sign with the Houston Rockets, the L.A. Lakers can at least start planning. The Lakers lost out despite offering the star $118 million over five years (7.5% annual hikes). Why did he take Houston's much lower $87.6 million over four years (4.5% annual increases over his existing contract)?

Toney Douglas #15 of the Houston Rockets drives to the basket past Dwight Howard #12 of the Los Angeles Lakers in the second half at Staples Center on Nov. 18, 2012 in Los Angeles, CA. (Image credit: Getty Images via @daylife)

Taxes matter, and tax advisers calculate Howard will collect more after-tax on the smaller deal. The Lakers are in California, with a killer 13.3% top tax rate. In Texas, there's no state income tax. It isn't enough to look at who is highest paid, but rather who the highest paid is after taxes.

A good example is Dallas Cowboys quarterback Tony Romo, the new highest paid NFL player after taxes. Romo signed a 6-year $108 million contract extension to stay in Dallas. It made him the fifth highest paid player but the highest bar none ***after*** taxes. Tax impact leap-frogged Romo from fifth to first in pay.

Now Dwight Howard will join him as a Texan. It is hard to argue with no state income tax. Texas Governor Rick Perry toured California earlier this year to entice business owners to move. Mr. Perry was roundly criticized for trying to lure tax-laden Californians with the promise of Texas' business friendly and tax-savvy lifestyle.

Perry's tax-time tour was panned by California's Governor Jerry Brown. Brown dismissed the interstate recruiting junket as political gimmickry. See Capitol Alert: Rick Perry declares victory in California trip. Still, businesses and consumers are taking note.

There's a silver lining for the Lakers, which should save two ways. First is direct payroll cost. With Howard on Lakers payroll at $20.5 million, the team's total could have climbed to as high as $104.3 million. At that level, the Lakers would face a staggering $97.9 million luxury tax, that the Lakers should now reduce if not avoid.

Professional athletes and entertainers face a dizzying array of tax laws. Most states and countries tax them when they perform or play in their boundaries. Foreign athletes and entertainers must file U.S. income tax returns and face special withholding rules. See IRS Sand Trap For Pro Golfers. But when you are a resident you get taxed on ***everything***.

Increasingly, state taxes matter, as Phil Mickelson and Tiger Woods have shown. Most PGA Tour players live in no-tax states like Florida or Texas. Phil Mickelson may be worth $73 million, but he likely won't talk taxes again. Tiger Woods—worth $600 million—confirmed that he 'understood' why Mickelson might be planning a move from California to Florida or another no tax state. Woods confessed that he left California in the mid-nineties in part over the Golden State's high tax rates. See Tiger Woods admits he left California because of tax rates.

Controversially, California residents voted in November to raise tax rates to 13.3% from 10.3% for those making more than $1 million. That was up from a prior top rate of 10.3%. By comparison, the combined state and local top rate in New York is 12.7%. Combined with federal rates and even sales taxes, the mix is causing some even outside the professional sports stratosphere to think critically about where to live.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.