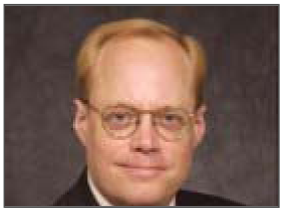

Robert W. Wood

THE TAX LAWYER

Jul. 24 2012 — 11:46 pm

Taxes Explain Jeremy Lin’s Rise And Fall

HOUSTON, TX - JULY 19: Jeremy Lin of the Houston Rockets displays his jersey during a press conference at Toyota Center on July 19, 2012 in Houston, Texas. (Image credit: Getty Images via @daylife)

The spectacular rise of Jeremy Lin from Harvard-bred sports obscurity to Madison Square Garden limelight is inspiring and somehow peculiarly American. As the nation watched, Lin became a household name. He also elevated the New York Knicks from the virtual dustbin of NBA rankings to something respectable.

But then Linsanity waned and Lin headed to Houston to don a Rockets uniform. See Jeremy Lin’s Departure to Houston Already Costing Knicks Money. Was this an American success story, the fleeting glory of a sports legend? Maybe, but it was also a tax story. Freakonomics proves that economics are at the root of just about everything. Taxonomics should prove that taxes are too.

With Lin’s newfound fame, he was a cash cow for New York but Lin knew it. New York offered a bucketful but Houston did too, and that’s where it came down to taxes. According to more than a few sources, When Houston offered one more $5M increment to what would be Lin’s guaranteed salary in his third year, New York couldn’t match it.

Why? Paying only $5M more would cost New York a whopping $20M. How is that possible, you may ask? The NBA has a luxury tax that seems pure punishment, taxing spending beyond prescribed levels.

It's not only Lin's pay that's relevant of course. Given the rest of the Knicks' anticipated payroll in 3 years, taxes metastasize like cancer. NBA luxury tax rules set for 2013-14 impose a 175% minimum tax rate for teams exceeding the tax threshold.

Designed to control team spending, this "luxury tax" in some ways is not a tax at all. The Collective Bargaining Agreement governing NBA players simply calls it a tax or a team payment. It is paid by high spending teams whose payroll exceeds a predetermined level.

The tax level is determined by computing 61% of projected Basketball Related Income–another term defined in the NBA's Collective Bargaining Agreement–subtracting projected player benefits and adjusting for the prior season's variation in actual to projected Basketball Related Income.

For 2011-12 the league and players association agreed on $70.307M for the tax level. Based on a formula for 2012-13, the tax level was guaranteed to be no less than that. The same formula applies for 2013-14 but with no guaranteed minimum.

Do any teams pay it? Yes. In 2011-12, the Lakers ($12.6M), Celtics ($7.4M), Heat ($6.1M), Mavericks ($2.7M), Spurs ($2.5M), Hawks ($0.7M). Who gets it? Sadly, the money doesn't go to reduce the federal deficit, to fund social programs or the defense budget. Up to 50% of the tax money can (but is not required to be) given to non-taxpaying teams. The rest is for "league purposes."

Sportswriters and fans can debate whether Houston, New York or Lin made missteps here. But really, it's all about taxes.

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached 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.