Pro Athlete Clients: Spring Training for Estate Planners

The high-earning, but relatively brief, career span characteristic of professional athletes—along with their tendency of having a flamboyant lifestyle—produces special estate planning considerations.

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Pro athletes require financial and estate planning similar to most high net worth clients. However the professional athlete is affected by unique circumstances that require planners to reconsider the planning process itself. Common issues athlete clients face, and which practitioners need to address, include:

- A very short duration, but high earning career. The accumulation period is often a short time span, and the consumption period is long. Thus, the typical athlete faces far greater risk from the potential adverse financial impact from inflation.
- A peak earning period generally early in life. This career arch raises a host of unique challenges for retirement, estate planning and asset protection planning.
- A limited financial and legal background. The lack of prior knowledge in estate and financial planning can create a greater need for planner assistance.
- Endorsement deals and other intangible contractual rights. These agreements are major variables and potentially lucrative income streams, and they can create unique planning challenges.
- The involvement of a sports agent, manager, or management team. Other professionals who surround the athlete need to be factored into the planning process.
- An increased (even high) risk of disabling injuries. Injury can occur anytime in the athlete's career and often cannot be insured against with the simple purchase of a disability income replacement policy that protects most clients.
- A greater need for privacy. As the athlete's success grows, maintaining privacy can prove to be a nearly impossible task.
- The risk of a lockout. Being locked out from one's job presents a financial risk few other clients face. A lockout can be a great financial challenge for young athletes, especially those who have not accumulated significant financial reserves.
- Pressure on young athletes to keep up with the lavish spending of their more established, and often wealthier teammates. These teammates have often not taken basic financial planning steps themselves, and the perceived spending standard can be ruinous for a younger athlete.
- An entourage. Although many individuals who surround the athlete may be true well-wish-

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ers, others might attempt to manipulate and leech. For many athletes, these purported "friends" are their most dangerous financial risk.
- Unique family and significant-other relationships. The statistics of divorce and failed relationships for athletes is far worse than for the general population, requiring increased consideration in planning.

Each of these common characteristics affects every aspect of the planning and drafting process. Practitioners need to tailor efforts on behalf of these clients to enable them to achieve the security that the planning process should provide.

Star power does not equate to financial power

In the now-famous "LeBron Rise" Nike commercial, LeBron James asks "What should I do? Should I admit I've made mistakes?" Unfortunately, Mr. James is not the only professional athlete who has a few mistakes to admit. An overwhelming majority of professional athletes are financially broke within ten years of retirement from playing professional sports. Nearly 80% of NFL players are on the verge of bankruptcy within two years of exiting the league.[1] Some 60% of former NBA players have nothing left of their career earnings within five years of retirement.[2]

Financial trouble affects a wide range of athletes. These problems are so endemic that practitioners should assume them to be a risk for every athlete client and counsel the client on how to avoid trouble. Consider the estimated career earnings of the following star athletes:[3]

- Mike Tyson (boxing)—$400 million.
- Antoine Walker (NBA)—$110 million.
- Lawrence Taylor (NFL)—$50 million.
- Sheryl Swoopes (WNBA)—$50 million.
- Rollie Fingers (MLB)—$8 million.
- John Daly (PGA)—$60 million.
- Jack Clark (MLB)—$20 million.
- George Best (soccer)—$100 million.
- Latrell Sprewell (NBA)—$100 million.

To sports fans, these individuals are all-stars, all-pros, hall of famers, and worldwide sports icons. However, all of these sports idols have had their fortunes fade to little or nothing after leaving the sports they loved to play. These athletes and countless others now have to worry about how they will support themselves and their families at a time when their million-dollar salaries have stopped. Basic planning precautions could have prevented their financial ruin. Their failures might be able to motivate current athletes to plan proactively to avoid similar results.

The risks are real

The natural reaction of many athletes to the stories of penniless former pros is the attitude of "that will never happen to me." With their tremendous success in the sports arena, and the notoriety and stardom they receive, it is often difficult for them to accept limitations that they might have in other areas, such as finance and law. Guiding the athlete client must, therefore, include addressing these intangible psychological considerations:

- History has proven repeatedly that financial planning and precautions are necessary, even essential.
- "Retirement" means the reduction of star earning power as a player. This could occur when the athlete is in his or her 20s or 30s—not at the more typically assumed retirement age of 65. Even if the athlete pursues a second career, for purposes of establishing planning goals, those post-stardom earnings should be assumed to be modest.
- No matter how capable and astute the athlete, even if he or she has a business degree, the forces against him or her are overwhelming and are unlikely to be resisted.
- The financial and legal complexities that they face are incomparable to those anyone else has to combat, other than superstars in entertainment. By virtue of being a professional athlete, these players will simply have basic problems that most people will never encounter.
- Divorce is prevalent among professional athletes. Alimony payments may be based on the athlete's current financial situ-

More Than Just Athletes

Musicians and other entertainers often encounter many of the same financial pitfalls as professional athletes, but their problems tend not to be as acute. While this article focuses on the plight of the professional athlete (and possible solutions to the problems), many of the techniques discussed are also applicable to musicians, other entertainers, and any client with "star" power.

[1] Torre, "How (and Why) Athletes Go Broke," Sports Illustrated, 3/23/2009.

[2] *Id.*

[3] "25 Rich Athletes Who Went Broke," available at http://www.businesspundit.com/25-rich-athletes-who-went-broke/ (last visited on 12/20/2011); Dicker, "10 Star Athletes Who Excelled at Losing Millions,"available at www.dailyfinance.com/2011/09/19/10-star-athletes-who-excelled-at-losing-millions/ (last visited on 12/28/11).

ation. Modification down the line is often difficult and typically insufficient. Thus the athlete's ex-spouse could continue to reap the benefit of the athlete's successes at a time when the athlete is effectively punished for that very success.

- In today's modern society, numerous athletes have had children out of wedlock. Like alimony, child support payments are often calculated based on the athlete's earning power during the athlete's career. The child support exposure for these athletes can be tremendous.
- Professional athletes are often targets for tort litigation and blackmailing. Car accidents that might otherwise end with an exchange of insurance information are much more likely to result in lawsuits when an athlete is involved. In an industry where marketability is crucial, athletes are popular targets for blackmailing, creating unique risks for an athlete's estate and financial planning.
- Athletes frequently turn to each other for advice and often act based on what peers claim. But what they hear others may have done is often not true. Human nature suggests that the storyteller will play up (or make up) successes while downplaying (or altogether ignoring) failures. The athlete needs to take the appropriate steps to safeguard his or her financial well-being, and not fall prey to fish tales, rumor, or innuendo.
- Trust must be vested in the planning process, and not in any one individual or company. The stories of well-known managers, accountants, and lawyers who were found to be incompetent or who have absconded with client/athlete funds, are almost as common as those about athletes who have bankrupted themselves. Even former players who hype themselves as experts and can "help" (e.g., Lenny Dykstra[4]) are a potential problem. A team of independent advisors who meet and communicate to create independent checks and balances is critical. Athletes in particular should heed the warning that any advisor who does not want his or her recommendations disseminated to the entire planning team should not be trusted.

Despite the athlete's earning millions of dollars, financial ruin is, in fact, *probable* unless an athlete uses the proper safeguards and preventative measures to protect his or her earnings. The summer 2011 labor stoppages in the NBA and NFL demonstrate the risks of significant, negative financial events to professional athletes. The statistics will get harder to look at, and more names will likely be added to the list of those facing financial ruin despite an enormously successful career. It is not a coincidence that the NBA players' associations, amid the extended NBA lockout, have been reported to be strongly encouraging athletes to save and protect their money. It should not have been a surprise that during the recent NFL lockout, the negotiating position for the NFL players' unions was severely compromised as a result of many of the players' cash-flow problems.

While the ominous tone of the professional athlete's financial picture described above is harsh, perhaps to the point of sounding like fear mongering, the reality is actually *worse*. Most professional athletes, including those who are America's most adored and admired, face financial and legal ruin on retirement from playing. Even those who manage for some period following retirement tend to hit a financial wall in only a modest number of years. Few actually reach the stage of what most Americans view as retirement with much nest egg savings. This epidemic affects almost all athletes, no matter where their earnings fall on the salary totem pole.

Environmental issues plaguing professional athletes

Athletes typically face the risk of financial ruin due to a combination of six factors:

1. Lifestyle.
2. Family/friends.
3. Legal issues.
4. Divorce.
5. Bad investments.
6. Lack of financial planning.

Lifestyle. As NBA star Patrick Ewing once famously said, "Sure NBA players make a lot, but we spend a lot, too." Athletes are often drawn into spending beyond their means because their more-established teammates are overspending on cars, jewelry, homes, boats, etc. Drugs and gambling are also common and expensive vices. Rookies and mid-level athletes often describe the social pressure to maintain a luxurious lifestyle like their mega-rich, all-star caliber teammates; however, they soon learn that keeping up with the Joneses is expensive and difficult, if not impossible. A multi-million dol-

[4] The plight of Lenny Dykstra is well documented. In 2008, the former baseball star launched a magazine aimed at giving financial advice to professional athletes. It was widely distributed in clubhouses and locker rooms. A year later, amidst all sorts of unflattering allegations, Mr. Dykstra filed for bankruptcy protection, claiming $50,000 of assets against $10 million to $50 million in debts.

lar contract will not go far when an athlete spends more money than is coming in. These athletes also fail to consider the long-term effects of impulsive purchases on their future financial well-being. The real solution for an athlete would be a paradigm shift to the understanding that the most luxurious and valuable purchase, the one that should truly draw the admiration and jealousy of his or her peers, with a glimmer brighter than the biggest diamond, is the acquisition of financial security.

Family/friends. Friends and family often expect the athlete to take care of them financially. Because it is easy to spend someone else's money, the standard of care expected by these friends and family can often become exaggerated. The sustained economic support of an entourage can be an insurmountable financial burden. An athlete's budget, in contrast to that of most clients, might include line items for these types of expenditures. Empowering the athlete to know, based on a quantitative analysis, how much he or she can spend on helping family, friends, or others without jeopardizing his or her own future and financial security may enable the athlete to resist a major item of financial quicksand that has sunk so many others.

As is discussed below, consideration should be given to having the athlete engage a buffer between his or her money and potential predators, thus isolating a certain portion of the athlete's wealth permanently from loss. It is often difficult for the athlete to deal with the social pressures. Saying "no" to requests from family and friends can prove to be impossibly difficult. It is far easier for the pressured athlete to say "I'd love to. Ask my trustee."

"Retirement" means the reduction of star earning power as a player. This could occur when the athlete is in his or her 20s or 30s.

Legal issues. Every client should consider some degree of asset protection planning. At the simplest level, a review of liability insurance may suffice. For other clients, especially as the clients move up the wealth and vulnerability spectrums, more significant asset protection should be a standard discussion. For the pro athlete, however, the risks of a lawsuit are exponentially greater than for most clients. Wealth and star power are magnets for legal entanglements. Predatory individuals pursue legal actions against athletes because they believe that the athlete has deep pockets, is a ripe target for litigation, and will have to protect endorsement contract representations. The latter factor may provide the predator significant leverage to force a settlement. Furthermore, it does not take much sleuthing for a predator to identify an athlete target. All they have to do is see the billboards while they drive or turn on a television.

Proactive asset protection planning and involvement of trusted advisors in all meaningful decisions can help keep the athlete aware of the risks and monitor issues. This can facilitate involving litigation counsel earlier in the process than might otherwise occur, which might alone mitigate damages.

Divorce. Perhaps no issue causes financial damage for athletes quite like divorce. Even higher than the statistic for the general public, some 60% to 80% of marriages involving professional athletes end in divorce, and most of those divorces occur after retirement, when the athlete's income stream has stopped.[5] An ex-spouse is typically awarded half of the marital assets. This includes the athlete's salary earned during the marriage. As an example, it has been estimated that golf legend Greg Norman had to pay his ex-wife, former flight attendant Laura Andrassy, $103 million in 2008 after the two were divorced.[6] (As a side note, Norman went on to become the third husband of former tennis star, Chris Evert, in 2008. They divorced in 2009 after 18 months of marriage. Norman has since married his third wife.) While the athlete may be aware of prenuptial agreements, the agreement may be susceptible to challenge due to defects, such as completion too close to the marriage.

Bad investments. Athletes have been known to invest money in "exciting" business ventures, such as restaurants, car dealerships, and entertainment companies. Unfortunately, the "exciting" business ventures are seldom profitable like their more conservative counterparts. Oftentimes, it is the athlete-investor who takes the brunt of the financial losses.

Athletes need to be advised about the pitfalls of wild investment schemes and why more conservative investing, over a longer period, is a better option. Athletes do not need "get rich quick"

5 Bishop, "Taking Vows in a League Blindsided by Divorce," NY Times, 8/8/2009, available at http://www.nytimes.com/2009/08/09/sports/football/09marriage.html?_r=1 (last visited on 12/20/2011).

6 Lambiet, "Price of Norman's Freedom: $103 Million," Palm Beach Post News, 7/11/2008, available at http://www.palmbeachpost.com/localnews/content/local_news/epaper/2008/07/10/a2a_jose_0711.html (last visited on 12/20/2011).

schemes. They need solid investment and portfolio advice.

Lack of financial planning. As many athletes earn their money at an early age, they simply do not have the knowledge or experience to know how to spend prudently, or plan for their financial future. While the paychecks the athletes receive stop at their retirement, the monthly payments to creditors do not. Many athletes neglect to consider the long-term consequences of their debt obligations, as well as the fact that the money that they earn during their playing careers will need to last them, and their families, for the rest of their lives. It is all too easy to overlook the fact that a personal guarantee signed at age 27 can very well be called by a creditor at age 47, well after the athlete's prime earnings have ended. The athlete's retirement stage may last half a lifetime or more. Athletes, like all wealthy individuals, must take steps to manage their monetary risks, such as safeguarding their fortune where it will be free from various pitfalls.

By way of a simple illustration, if the athlete wants to maintain during retirement a lifestyle that takes $1 million per year, the athlete will need savings of $25 million, assuming a 4% payout on savings (which might even prove a tad aggressive given the young age and many post-retirement years the athlete will have to support himself or herself). This illustration ignores the havoc that inflation over so many years of retirement would cause to the financial needs of the athlete. Unless there is some confidence that endorsements will continue or that a second career will provide a stable level of earnings, this example can help the athlete realize that today's fun may mean tomorrow's none.

Professional athletes earn millions of dollars playing a game they love; however, only a small fraction of athletes have finance or business backgrounds. Unfortunately, many athletes simply do not know what they are doing with their money and end up losing it all. NBA star Baron Davis summed it up best when he said, "You get your paycheck, but you don't get any instructions with it."[7] The end result is that athletes are often forced to sell valuable items that might have priceless memories, such as World Series and Super Bowl rings, Heisman Trophies, homes, cars, and anything of value for the sole purpose of paying creditors. The key to avoiding this scenario is to institute preventative measures and safeguards on the athlete's fortunes early on, or face the long-term consequences of failing to do so.

Wealth planning components

As with any client, the three major components of the professional athlete's wealth planning are:

1. Financial and investment management.
2. Tax planning (both income tax and transfer tax).
3. Creditor protection (including protection from divorcing and dissident spouses or significant others).

Creditor protection is as essential a part of the planning process as the other elements of the wealth planning process. However, it is often the least addressed. Creditor protection should be incorporated into all business and estate planning, and has an increased importance when planning for the young, vulnerable professional athlete. Simply put, the importance of creditor protection in the planning process cannot be overstated. Failure to engage in creditor protection could prove to be the undoing of the balance of the athlete's wealth planning.

Independent estate and financial planning team

The most important consideration affecting pro athletes, and perhaps the hardest circumstance or planning consideration for the star athlete to absorb, may be the most obvious. They need core planning to address the same common issues as the average client. This does not require star-power advisors that have a stable of other well-known athletes; it requires an estate and financial planning team that is comprised of, at a minimum, a competent accountant, wealth manager, estate planning attorney, and insurance consultant.

Certainly, the athlete needs a bevy of specialists to review, negotiate, and manage sports and endorsement contracts, but the estate and financial planning team should address the solid basics of any high net worth client. An independent estate planning team, one not beholden to anyone other than the athlete, can be a powerful safety net, keeping the pro athlete safe and providing the ideal system of checks and balances to help maintain a sound financial foundation. An independent team can also evaluate the performance and recommendations of the athlete's manager and other advisors, thus maximizing the chances of future success without having to worry about stepping on toes.

Too often athletes and others achieving star power retain or rely on a limited group of advisors who do not provide objectivity, independence, and real concern for their client. Given what appears to be the common occurrence of predatory investment partners, having an independent check-and-balance

[7] Wachter, "Pro Athletes, Amateur Money Managers," Businessweek, 10/7/2010, available at http://www.businessweek.com/magazine/content/10_42/b4199089775733.htm (last visited on 12/20/2011).

system is essential to the athlete's financial security.

Further, proper planning may enable the athlete to pursue business start-up dreams in a safe manner. For example, if the athlete's star power is to serve as the draw for a proposed enterprise, others should be willing to invest funds to share in the value of the star power the athlete contributes. Promoters who seek to capitalize on the athlete's star power while having the athlete also finance the venture, should be viewed with a great degree of skepticism and scrutiny. What most athletes should seek in investments is a diversified portfolio of investment assets managed by an independent institution or wealth management firm in a fiduciary manner. Although leveraging one's own name in a new venture may be worth the risk, mortgaging the athlete's financial future has almost never proven to be wise.

If the athlete has an independent CPA firm, a knowledgeable estate planner, an insurance consultant with a separate firm, a wealth manager with a track record and true fiduciary perspective on advising, and a bank or trust company with a solid reputation, the athlete will have the independence to truly evaluate options and recommendations presented to him. Having a planning team of independent advisors creates a process that is not susceptible to the financial and legal maladies that sink so many athletes.

The added benefit of a strong financial team is that it can help the athlete adhere to the formalities of the estate and business plans. As all attorneys know, legal formalities must be honored. If the athlete does not respect the structure of the estate or business plan, then the IRS, creditors, and other potential predators will also disregard those plans.

Athletes are generally less inclined to be structured than businessmen who need structure to operate their business and often have capable staff they see day to day to maintain that structure. No matter how well designed an estate or business plan might be, failure to respect the formalities of that planning will result in failure of the plan itself. The athlete must have a team to help him or her design, implement, and follow up on all aspects of the planning so that it can be executed correctly.

Planning options to limit risk

Traditional planning endeavors to manage estate tax exposure, avoid probate costs, and assist the client during times of incapacity. More modern asset protection planning seeks to fulfill a broader list of objectives that clients wish their estate plan could provide, providing meaningful tax and asset protection with more control and flexibility than traditional planning. Modern asset protection techniques are essential and should always be incorporated into overall tax and estate planning management strategies.

The advisory team should help educate the athlete about the reasoning for some of these goals (discussed below), and then tailor them to the athlete's wishes.

Manage property with consideration to the range of planning issues. This is a multifaceted planning concept. For most clients, management focuses on a business and securities portfolio. For many athletes the securities portfolio may be an objective and not a current reality. Sports contracts have to be managed. This requires experts and planning techniques different from those for managing more traditional investments, and often different from those for managing endorsement contracts. The athlete might also have houses in multiple states, raising property management, domicile, potential probate, and other issues.

Control the ownership of property. The ownership structure for the athlete's property is critical to address in achieving asset protection, tax protection, privacy, and other goals. In most instances this requires a combination of at least several trusts and entities in combination. Investments and endorsements should be isolated in separate entities, typically limited liability companies, whose interests in turn are owned by various trusts designed to meet different planning objectives. Enhanced creditor protection may be obtained by domiciling each entity in a state

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that has superior creditor protection statutes, for instance a state which has a "charging order" as the exclusive remedy of creditors and which insolates LLCs from creditor attack. Control will be exercised through the governing instruments for the entities and the various fiduciaries of each trust (institutional trustee, investment advisor, trust protector, etc.).

In significant contrast to many clients, the professional athlete should have more safeguards and more independent fiduciaries to protect against the sycophants and others seeking to enrich themselves at the athlete's expense. For example, while many clients might name an individual as the independent trustee of an irrevocable trust established for tax purposes, it should be de rigueur in trusts established for athletes to have an institutional co-trustee and an independent attorney or CPA with no ties to any of the athlete's investments or business endeavors. Some consideration may even be given to eliminating direct control by isolating a portion of the athlete's wealth beyond where it can be re-acquired, thus hedging against complete exhaustion of the athlete's wealth. In doing so, the advisor has created a sort of "rainy day fund."

Plan the use of property. If the athlete heeds the warnings to protect and safeguard his or her assets, significant assets are likely to be in LLC or trust solutions. For personal-use assets such as a personal residence, the structure needs to permit use of the property. For some personal-use assets such as a boat or airplane, the liability risk might be viewed as so significant that in addition to isolating the property in a separate LLC, that LLC may intentionally be held outside any trusts created for the athlete.

Use income derived from property. Most clients tend to focus on having access to the cash flow from their assets, and if irrevocable trusts are used, receiving cash flow may be their primary concern. An athlete may have a short initial wealth accumulation phase so that for some period, no cash flow is required but rather new assets are to be added. When the athlete retires, cash-flow needs are likely to vary.

Some 60% to 80% of marriages involving professional athletes end in divorce, and most of those divorces occur after retirement, when the athlete's income stream has stopped.

For example, there may be a period with little or no compensation from playing, but endorsement income might suffice. The endorsement income may wane as the years following retirement from playing increase, creating a need for more significant cash flow. At some point, the athlete might transition to a more permanent second career as a sports announcer, coach, or other business position and again the need for cash flow from trust-held savings may change. Thus, athletes' financial needs tend to follow a more variable course than that of the typical client.

Save taxes to the greatest extent possible. Most clients undertaking a comprehensive plan have traditionally focused on minimizing future estate taxes. The considerations facing the athlete present a significant shift in the tax planning dynamic. No matter how fiscally savvy the athlete, it is not reasonable to expect a 20-year-old client to focus with much intent on possible estate taxes to be incurred more than 50 years in the future. Further, history and statistical evidence suggest that the real issue for the athlete is running out of money, not paying a large estate tax. Thus, minimizing income taxes during the high-earning years and protecting those net earnings for the future—including the asset protection component of the athletes plan—should receive more attention than estate tax planning.

Current income tax savings should often be the focus of tax planning for athletes. Minimizing what will undoubtedly be a substantial current income tax is often critical. A popular step is to create an entity that will enable an athlete to use a qualified retirement plan. Alternatively, using family limited partnerships or LLCs to shift income to taxpayers in a lower tax bracket has its advantages from both an income tax reduction and a gift tax avoidance prospective. While this might involve the use of an entity for endorsements that has proactive accounting advice to maximize income tax planning, this might not be appropriate for an athlete. For a young athlete, with children out of wedlock with various mothers, shifting income to lower-tax-bracket family members may be completely inadvisable.

The high-earning athlete faces gift tax problems not faced by a majority of the population. How often do we hear that an athlete, shortly after signing a substantial contract, announces that he or she is buying a home for his or her mother, or cars for all of his or her friends? Athletes also often make large cash gifts. The gift is taxable to the extent it exceeds the annual gift tax exemption amount of $13,000. A gift tax return is

legally required, and use of the lifetime exemption is necessary in order to avoid paying tax. Proper planning can reduce or eliminate this gift tax problem. Failure to file returns means that the statute of limitations will not begin to run, thus allowing the IRS to audit even years down the road.

State tax savings is a critical planning issue for athletes, and it involves considering and planning for where the athlete's residence and domicile should be. This may not be simple if the athlete owns several homes in different states and spends time in each due to training, travel, and promotional schedules. State tax planning must also address in detail how earnings should be allocated to the activities that occur in different states (e.g., games, training time, event appearances, etc.).

The sensitive nature of taxes is particularly important, considering that states have been rather aggressive in taxing income from athletes. By way of example, Nat Moore, a wide receiver for the Miami Dolphins, went to Buffalo, New York, for one day a year to play the Buffalo Bills. New York audited Moore's tax return and argued that since he played 16 games in a year, $^{1}/_{16}$th of his income should be taxable in New York State because he played $^{1}/_{16}$th of his games in New York. A New York court upheld the state's position. Although salary cannot be protected by planning, ancillary income can and should be protected.

Control bequests. Ultimately, all clients hope to bequeath property to whomever they want, whenever they want, however they want. While controlling the ultimate bequests or other transmission of property to heirs is as important for the athlete as any client, the young age of the typical athlete makes this less of a priority. The statistical and historical evidence suggests that the greatest difficulty in athlete estate planning is assuring adequate financial resources for the athlete over his or her life, before considering the bequests to children or other heirs. Also, considering the high divorce rate of athletes, maintaining control through irrevocable trusts with limited powers, careful use of pre- and post-nuptial agreements, and the deliberate and focused definition of heirs is particularly important.

For example, how should modern reproductive technology be considered? What difference, if any, should there be for a bequest to an heir expressly identified in a will or trust by name versus an heir subsumed under a general definition of "child." In contrast to many other clients, the athlete may wish to carefully delineate individuals whom he or she considers to be children rather than others who may be provided for in a different manner. The increased potential for children out of wedlock may require the planner to address this issue.

Protect assets from lawsuits using trusts. An athlete's asset protection goals are similar to those of many clients, but with a host of very important differences. The typical client engaging in asset protection planning endeavors to sell hard assets to a trust to remove future appreciation in those assets from his or her estate and the reach of creditors. However, an athlete's real and primary "asset" is really his or her limited duration, high-earning power. The assignment-of-income doctrine and other tax theories may prevent the effective transfer of interests or rights to income. However, careful planning can identify or structure transactions to create assets more readily susceptible to tax shifting and asset protective transfers. Endorsement contracts, equity in businesses, an investment partnership, or a limited liability company structured to hold a portion of savings as it accrues may be capable of gift or sale in more traditional asset protection techniques. Creative uses of life insurance to grow cash-value policies inside the protective envelope of an irrevocable life insurance trust or the use of split-dollar arrangements, perhaps with the athlete's own loan out or other entity, may facilitate funding insurance purchases with gift tax and asset protection advantages. A practitioner clearly has special challenges when planning for an athlete.

Using entities to protect assets. Most athlete clients understand that they use should use the legal structure of a business entity, such as an LLC, if they are going to own a business. Few clients, however, realize that the directional arrow of asset protection does not point in both directions without more planning. If an athlete owns properly structured and maintained business entities, but loses a personal lawsuit after an "event," all of those business interests will be in jeopardy of being reached by the successful claimant. The personal creditors of an athlete may be able to reach all of his or her unprotected assets, including the athlete's ownership interest in business entities, such as a wholly owned LLC. A personal creditor, which can take the form of a bad debt, ex-spouse, or someone who has personally sued the athlete, would have almost unfettered access to the assets held in the athlete's name.

The approach to protect against this situation is to create real, multimember partnerships that provide grounds for arguing for charging order protection. Further, using only multi-member LLCs is especially important for the athlete

client. Even if the host state provides complete protection for single-member LLCs, practitioners should favor the use of multi-member entities.

Unfortunately, many athletes are not aware of the ability to engage in forum shopping for a jurisdiction that can provide a more protective legal environment for the entity used. For example, a jurisdiction that provides a charging order as the sole remedy against an LLC should be selected when forming an LLC. This will shield personal assets from the business's potential creditors if the formalities of the entity are properly respected. Here again is a reason for the selection of a quality estate and financial planning team and regular meetings to coordinate their actions. If the entity is sued, the total exposure should be limited to the entity and its assets, and the athlete is less likely to jeopardize any of his or her homes and other personal assets.

The star power of an athlete attracts scrutiny, sycophants, and a gaggle of opportunists. If there is a suit or claim relating to an athlete's single-member LLC, the athlete's personal income tax return may be the only independent information available to demonstrate the economic results of the venture. However, if the athlete's ventures, even including passive investment LLCs, are all structured as multi-member entities that file their own Form 1065 partnership income tax returns, the athlete could strongly argue (and hopefully successfully) that the only information the claimant should be permitted to access is the income tax return for the specific entity.

Thus, for athletes who benefit from added privacy, the tendency should be towards separate entities for each venture and endeavor, and each should be structured as a multi-member entity that files its own partnership return. Also, because of the scrutiny that the media and others will likely place on the athlete, intercompany transactions should be intentionally limited (e.g., have an independent bank loan one entity funds to address a shortfall, instead of a brother-sister entity making the loan) to minimize the trails connecting all entities in the event of an investigation or worse.

Investments and endorsements should be isolated in separate entities, whose interests in turn are owned by various trusts designed to meet different planning objectives.

Life insurance

One asset which has tremendous virtue for the athlete in particular is life insurance, particularly cash value life insurance (CVLI). Life insurance, other than term life insurance, has two distinct components: the "death benefit" and the "inside build-up" or investment component, which grows in a tax-free manner analogous to a qualified retirement plan. Both elements may benefit the athlete. If the professional athlete dies prematurely, his or her family will have insufficient wealth to support themselves for the rest of their lives without advance planning, especially if they have become dependent on the athlete's high earnings. In addition, many athletes have debt problems (such as a large mortgage) as a result of leveraging many of their assets, and those debts are generally not extinguished on death. In fact, death may be a term of default and accelerate the problems faced by the athlete's heirs.

Well-planned life insurance can play a significant role in not only mitigating these problems, but helping to create peace of mind during an otherwise traumatic period. Thus, for a younger athlete who is still accumulating wealth, insurance may have a far more important role than for most other clients.

If a professional athlete lives for a normal life expectancy, the tax-free investment accumulation inside of the policy may provide a safer investment alternative for the athlete and his or her family. In the era of 401(k) plans losing astonishing amounts of value, the guaranteed investment portion of the CVLI policy with a quality carrier is very compelling. Because many investments made by athletes often contain high risk and exposure, the safety feature of the policy is particularly appealing and could be a reliable source of funds when other investments are losing value.

Given the sordid history of athletes not holding onto to their wealth, the periodic payments of insurance premiums and the tax-advantaged growth during high tax years inside the protective envelope of a trust could be an optimal plan. Life insurance, in some states may itself provide a measure of creditor protection. Psychologically, life insurance may also provide a disincentive from spending that a securities account does not.

Appropriate types of trusts

Myriads of trusts and variations of trusts can be used to accomplish different goals. Although many practitioners often seize on the use of a particular type of trust for a particular purpose, the use of different types of trusts for different athletes is often a better solution. As with all clients, these trusts should be tailored to the athlete's

individual circumstances. While such techniques may be used by practitioners more generally in planning, their combination and application to the athlete is unique.

Although athletes commonly face similar challenges with their asset protection, tax, and other planning, the athlete client is not a uniform planning challenge. There are considerable differences in planning for different athletes, and practitioners have to develop a plan based on the level of wealth already accumulated, the nature of the assets involved, and other factors. In some instances, planning techniques used for a typical wealthy client can be generally applied to serve the athlete client, but in other instances planning should proceed in a somewhat different manner.

A threshold concept about which most athletes need to be educated and acclimated, is that in light of the athlete's unique challenges, owning assets in trust is generally preferable to owning those assets outright. Properly drafted, trusts can be powerful mechanisms for many of the financial and legal risks facing athletes.

ILIT vs. APT

The most common irrevocable trust drafted by estate planners is the irrevocable life insurance trust (ILIT). A well-funded mix of top company, permanent life insurance policies inside an ILIT may be an ideal planning technique for athletes. This standard technique can safeguard cash that might otherwise be spent, secure growth inside an irrevocable trust of an asset, provide a conservative investment return on those funds that compares favorably to what most athletes achieve, and assure funds for the inheritance of the heirs if the athlete spends down his or her entire estate. As a strictly defensive tool, the ILIT is often an excellent option considering the risk of death due to a sports accident or the other risks. In an industry where the professional athlete is taught that he or she is invincible, however, straight life insurance can be a difficult sell.

An attractive alternative or addition to an ILIT is a self-settled asset protection trust (APT). A self-settled trust is a trust the athlete client establishes for himself or herself. These trusts are typically established in one of four key states, each of which has established strong asset protection statutes:

1. Alaska.
2. Delaware.
3. Nevada.
4. South Dakota.

An athlete who has assets that can be protected may establish a self-settled APT in one of these jurisdictions and transfer assets to that trust. The athlete could remain a discretionary beneficiary of the trust, and an independent trustee would control distributions from the trust. As a result, the athlete's creditors should have no ability to reach the assets if there is no fraudulent conveyance.

An APT could be funded by the athlete making incomplete gifts. A gift is deemed incomplete if the transferor retains certain interests in that gift, such as the ability to change the gift's beneficiary. In this manner, the athlete could simply transfer assets into the trust and gain the statutory protections offered by it.[8] The most significant drawback to an incomplete gift is that assets are not removed from the athlete's taxable estate. However, this trust is established for asset protection purposes, not for tax efficiency. Also, this concern may be less than for other clients, as realistic projections may reveal that a large estate is unlikely to be accumulated.

The second method of funding an APT is with a completed gift. Using this method, the athlete would transfer assets to the APT using some portion (or all) of the current $5 million gift exemption. A note sale transaction can also be used to transfer larger assets to the trust. In using a completed gift transaction, the athlete would realize not only the statutory benefits afforded by the APT, but those assets transferred would be outside of the athlete's taxable estate.

One application that may be of significant interest to the athlete is the use of a cash-value life insurance policy inside of a completed-gift APT. Use of such a technique should provide:

1. Creditor protection as to both the policy cash value and the proceeds.
2. Tax-free accumulation similar to a qualified retirement fund.
3. Estate tax avoidance similar to an ILIT.

Unlike an ILIT, however, this technique can be established by the athlete and, when properly structured, benefit the athlete. This is a potentially powerful strategy. The application of the APT has the potential to add significant benefit to the athlete/client.

Beneficiary defective irrevocable trust

The beneficiary defective irrevocable trust (BDIT) may be the optimal technique for some athletes' planning. This technique could enable the trust to provide gifts for family/friend beneficiaries, which

[8] Athletes, due to the nature of their work, often have contact with numerous jurisdictions. If there is any doubt that the athlete does not have strong connections to a strong APT state, it may be advisable to insulate such a trust with one (or even two) LLCs organized in that jurisdiction. In doing so, the athlete gains better contact with that jurisdiction and also benefits from the protections afforded by the LLC, in addition to those afforded by the trust itself.

may not trigger gift tax issues. A BDIT may help the athlete transfer assets outside of the transfer tax system. However, as with each phase of planning, modifications to more typical BDIT planning might be essential to tailor it to the athlete's needs. There are also special concerns with the use of a BDIT for an athlete's plan that should be considered. To illustrate the use of a BDIT with athletes, here is an overview of the more typical BDIT plan with athlete-tailored modifications and issues to address.

Typically, a third-party (most commonly a parent) establishes the BDIT for the benefit of the client. Because the parent is the settlor of the trust, the BDIT provides a greater measure of asset and estate tax protection for the client because the client is not establishing the trust for himself or herself (i.e., a BDIT is not a self-settled trust). Instead, a third party forms the trust and makes the initial gift, typically $5,000, into the trust to seed it. The BDIT grants the client the right to withdraw the gift for a limited duration (commonly called a "*Crummey* power"). This right results in the client being characterized as the "grantor" of the BDIT for income tax purposes. As the BDIT is treated as a grantor trust to the client, the client can sell appreciated assets to the trust without triggering capital gains tax exposure.

The BDIT gives the client a note for the purchase price of the asset, but any appreciation in the value of the asset after the initial sale would be outside the client's estate, thus freezing the value of what can be taxed in the client's estate. As the BDIT was funded by someone else, the income and growth in assets inside the BDIT can benefit the client and all future descendants while never being subject to estate, gift, and GST taxes (assuming proper allocation of GST exemption), or the reach of creditors if the client never makes a gratuitous transfer to the trust. The athlete also has the substantial use, enjoyment of, and reasonable control over the trust assets. The athlete should be able to receive the right to use the trust assets for any purpose, as well as the right to determine who uses the trust assets, without adversely affecting the tax or creditor benefits derived from a third-party trust with a proper spendthrift clause. The athlete does not have the right to initiate distributions, however, or make self-serving tax elections.

As the trust is a grantor trust for income tax purposes, the client also has to pay the income tax on all trust earnings, even if there is no distribution back to the client. In doing so, the beneficiary allows trust asset to grow and spends down assets within an otherwise taxable estate.

With a BDIT, the client can be given a limited power of appointment to designate who will ultimately receive the assets in the trust at death, and granting this right should not taint the client's asset protection and estate tax benefits. The ability to defer the decision of who receives the property, and how they will receive it (preferably in a continuing trust) is an important benefit for anyone. This benefit is magnified for professional athletes due to the youth, immaturity, potential for substantial wealth, and future uncertainty.

Using the BDIT technique for athletes raises several particular issues. Some who challenge the viability of the BDIT technique have argued that having the beneficiary serve as a trustee, even just a management trustee, presents a tax or creditor protection risk. Given the athlete's unique social pressures, it may be advisable to opt not to serve as his or her own BDIT trustee. In this manner, someone independent of the athlete can refuse a request for a distribution from a family member or other person.

In order for the BDIT to be respected for both tax and creditor protection purposes, the trust must be funded by a third party, and not reimbursed either directly or indirectly by the athlete. The athlete's family may not have the financial wherewithal to make the $5,000 gift to the trust, and may not understand the planning. In many instances, the funds used by the athlete's parent will have come from the athlete himself or herself. If this is proven later, it could become the Achilles heel of the entire plan. Care may have to be taken to assure that the parent or other benefactor funding the trust had independent funds. If this is not the case, perhaps the parent may be legitimately employed in one of the athlete's businesses to earn funds. An athlete's charitable foundation might prove to be an ideal vehicle for parental involvement and compensation.

As many athletes provide significant support to their families, parents should have independent counsel to review and assist in establishing the trust to minimize the likelihood of challenges at a later date. Alternatives to funding from family members might include help from a caring teammate, a booster, or a mentor.

As previously mentioned, salary income is generally not appropriate for wealth shifting, at least in team sports. Revenue from exhibitions, clinics, and outings, etc. may be susceptible to shifting. Ancillary income from commercials, autograph shows, licensing fees, etc., have often been transferred into entities that have enabled the athlete to create qualified plans and shift the income in a tax efficient manner. That income

is movable for both team sports and individual sports athletes. The ability to shift income and other wealth earned in this manner is a planning opportunity for assets that can be transferred into a BDIT.

Protective BDIT—illustration

To illustrate the potential power of a BDIT-based planning system, an illustration may be useful. Assume that the athlete earns $6 million in annual salary. Capitalizing on his good reputation, this athlete is earning an additional $4 million annually through business ventures. The athlete's total income is $10 million, but he is trapped in a 40% tax bracket that results in his annual payment of $4 million in individual income tax.

Assume further that rather than owning his business ventures outright, the athlete owns these business ventures inside a BDIT that was initially seeded with a benevolent gift from his high school coach. The athlete can either maintain control of these investments or retain broad power to hire and fire those who will manage these investments for him.

In a second BDIT, the trust owns cash-value life insurance on the life of the athlete. The trust names an independent trustee, but the athlete has the ability to fire that trustee and replace him or her with an independent bank or trust company with a predetermined minimum of assets under management. This policy could be funded by the athlete using 5% of the salary over the course of an estimated ten-year playing career.

As a result of this planning, the athlete realizes some significant benefits. First, his or her business ventures are sheltered from his or her personal creditors. The taxes from these ventures are paid from the athlete's otherwise unprotected and taxable estate, thus reducing it over time. The businesses, however, will grow without the impediment of income taxes. As they grow and shift from one venture to another, all of this growth is captured outside of the wealth transfer system. Eventually, the restaurants, car dealerships, and consulting ventures may be transformed into more traditional investments and passed onto future beneficiaries without the imposition of transfer taxes.

Section 2042 provides that the retention of a power of appointment in a life insurance policy makes the proceeds of that policy includable in the insured's taxable estate—a very bad result. With the athlete's BDIT, he or she can retain a special power of appointment for a period (e.g., ten years). Alternatively, he or she can retain a special power of appointment that is releasable. Retention of such powers exposes the insurance policy to estate tax inclusion for the period in which the power is retained (or if released, the time released plus three years), but it enables the athlete to change the disposition of the policy. The risk associated with the insurance during the inclusion period is significant, especially because the insurance amount is typically large. However, that risk can be hedged with low-cost term insurance coverage.

Drafting and structuring considerations

Consider each of the following planning considerations:

Multiple trusts. While it may be feasible for many wealthy clients to rely primarily on a single type of trust, such as a BDIT or a grantor insurance trust that may also purchase assets, athletes generally are best served by having multiple independent trusts. The risks of lawsuit, the media scrutiny, the myriads of opportunists, and the frequency with which their own advisors have taken advantage of them, all suggest that the old adage "don't put all your eggs in one basket," should be adhered to. Using multiple trusts in different jurisdictions with different names may make the structure more complex, but may serve the athlete's goals and objectives in a more effective manner.

Control. Many clients are adamant about retaining as much control as is feasible for their assets, even after a transfer to a trust. From this perspective, the BDIT presents a wonderful planning opportunity. However, the situation may be different for athletes. With family, sycophants, and an entourage all potentially hounding the athlete for largesse, the athlete may be best protected by not serving as his or her own trustee during the period of initial fame and possibly even during peak earning years. An application of the BDIT concept with the athlete expressly precluded from serving as trustee until a set time after retirement from full-time employment with a major sports team may be a safer approach. The athlete could be given the limited power to replace the institutional trustee during such period with another independent institutional trustee so that he or she could exert significant influence over the trust.

Not serving as trustee during the initial years of success can provide a period for the athlete and those around him or her to acclimate in a reasonable way to fame and fortune. The athlete might find it difficult to reject a request for financial assistance made by a family member or other loved one; the athlete could find it easier to hide behind the guise of an independent institutional trustee.

Then, after a predetermined period of time, the athlete could assume the role of a co-trustee. In all events, tax-sensitive decisions related to the trust, including distributions, must be controlled by an independent trustee to safeguard asset protection and tax benefits. Given the family and interpersonal dynamics, consideration should be given to vesting these powers in an institutional trustee, although anyone who is independent of the athlete may serve.[9]

Grantor trust status. The estate depletion resulting from the grantor trust status of a BDIT is important and powerful for the athlete. It can tax burn even some of the largest salaries. It may deplete exposed personal wealth through taxes, lawsuits, and divorce in a way the athlete cannot otherwise do himself. There are unique twists to the application of this planning technique to the athlete. Most self-settled trusts are structured as grantor trusts so that the client does not recognize gain on the sale of assets. Yet for many athletes, this may not be a significant issue, as they may largely have cash or investable assets from recent earnings that have not highly appreciated. So while a grantor trust is the likely assumption for such trusts, the decision should be carefully evaluated because the circumstances may be different for the athlete.

The second half of the grantor trust equation is that characterization of the trust as a grantor trust results in the grantor/athlete paying income tax on the earnings of the trust. For most clients, this is positive in that it further reduces the estate, thereby saving estate taxes and retaining more assets in the protective envelope of the trust. For athletes, however, these considerations too may differ from the norm. If the age of the typical athlete client is in the 20s or 30s, the potential for a future estate tax may be perceived as being so remote that the estate reduction (referred to as "burn" by some commentators) may be irrelevant to the decision process. Further the strain on the athlete's cash flow may make it untenable. The concept is outstanding for many clients, but not necessarily appropriate for the athlete.

In crafting many grantor dynasty or self-settled trusts, often a right to substitute is included to create grantor trust status. That power can be turned off, possibly by a trust protector terminating the power to substitute. For an athlete that is still in early phases of wealth accumulation, the opposite approach might be preferable. If there is no significant appreciation in assets and cash flow is a concern, the trust might be drafted to include a power to substitute that can be turned on at an appropriate future date by a trust protector. In that way, the athlete's cash flow might not be further stressed, and flexibility can be preserved for future estate tax minimization planning and the appropriate transfer of appreciated assets by note sale at a future date.

Timing is everything

Professional athletes appreciate how critical timing can be. In sports, fractions of a second can mean everything. For proper estate planning, timing can also mean everything. Most people wait too long to implement proper estate planning and asset protection. Athletes are as guilty of this as the typical client. Athletes have more to lose by waiting to plan because their earning potential is high for a very short period. The benefit of capturing marketing rights in a trust when the athlete is right out of college, for example, is much more tax efficient than doing so after winning three championships.

Early on, the athlete has a manageable investment portfolio and reasonable expenses. This is the stage when planning is most efficient. Too many athletes wait until a divorce or until finances are out of control. That is a poor environment to engage in planning—and planning done under such circumstances often fails for a multitude of reasons.

Other documents and planning steps

Other core planning steps may be important for an athlete to address. These might include the ones discussed below.

Domicile. For athletes, planning to ascertain supportable domiciles is an important part of state income tax planning, and it may have a profound effect on the application of rules governing the spousal right of election and a range of other planning considerations.

Revocable living trust. While the purported privacy protections afforded by living trusts are far from the assured results proponents claim, the proper use of a living trust can provide some measure of protection. This trust might be especially effective if the athlete wishes to benefit a particular paramour, out-of-wedlock child, or other person. Having these people provided for under a separate legal document, one that the probate process should not make public baring suit or other challenges, can prove quite advantageous.

Also, given the high risk of injury facing many athletes, using a revocable living trust to provide for the management of any assets not transferred to irrevocable trusts can

[9] See Section 672(c).

prove valuable. Further, holding remaining assets in a living trust to attempt to minimize the publicity probate might otherwise provide is worthwhile. With an inter vivos trust, an athlete has some flexibility in establishing the situs for the trust and should select a jurisdiction with strong secrecy and nondisclosure laws and plan to have adequate nexus to that state. This might be important to minimize disclosure of trust information to those claiming to be heirs or beneficiaries.

Power of attorney. The athlete-client may grant certain powers to an agent, and perhaps a different person or firm to handle endorsements and other matters. Whatever the arrangements, they need to be addressed by drafting durable powers of attorney to assure the right line of decision making. Thus, the athlete's power of attorney may have to be coordinated with management or agent agreements, and a separate personal power may have to be crafted that addresses other matters.

Living wills/health proxies. It is vitally important that athletes create and update health proxies to avoid the publicity of a court-appointed guardian. This is especially important if there are changes in the athlete's matrimonial or relationship status. For some athletes, there may be unique but very important personal wishes to convey. For example, there has been much talk recently about the impact of head injuries among football players. Thus, a football player may have a strong desire to donate brain tissue for research. An estimated 60% of NFL players have suffered at least one concussion during their professional careers, and 26% have experienced three or more concussions.[10] For boxers, the statistics are more shocking—90% of boxers sustain a brain injury.[11] An NFL player or boxer might wish to expressly provide for tissue donations to fund research to help others. Different athletes may have other personal objectives that standard forms and planning also ignore.

Disability planning. While everyone faces disability risk, the likelihood of a disabling injury to an athlete is obviously far greater. Unlike the average person, however, simply purchasing a disability policy is unlikely to provide anywhere near adequate protection. While contractual rights and payments from their team and other sources should be analyzed, these too are likely to be inadequate. Advisors need to inform and educate athletes about the risk and importance of saving significant portions of their salary to assure a viable future in the event of injury. Careful use of a living trust, with an institutional trustee and appropriately planned disability clauses, should be addressed.

Private foundation. Athletes may well realize the good fortune that has shined on them and desire to give back and help others. Curtis Granderson's establishment of the Grand Kids Foundation is an example of proactive and planned charitable giving. Since many athletes earn tremendous wealth at a very young age, establishing a foundation is an excellent way to safeguard money, create a future opportunity for meaningful involvement following retirement, provide current income tax deductions, and more. This is ideal for young athletes because it may take years, even decades, for their full charitable desires and objectives to solidify. For example, basketball great Brian Grant would likely never have realized his desire to help the Michael J. Fox Foundation for Parkinson's Research early in his career. He certainly never would have imagined being diagnosed with young onset Parkinson's disease. Even if he did not establish a private foundation, the technique would have likely served him well.

A private foundation can facilitate setting aside funds and defer the charitable decision making. While a donor-advised fund is also feasible, the flexibility and control a foundation affords may be worth the incremental cost in terms of professional fees and administration. As a note of caution, consider that athletes, like other clients, must understand that the use of charitable planning tools is technically complex, and the penalties for abuse are substantial.

Conclusion

The key to success for a professional athlete lies within the athlete, in his genes, and in his work ethic. But the key to long-term financial success for a professional athlete is recognizing that the mistakes of others must serve as a lesson and not be repeated. In the world of professional athletes, tremendous wealth is at stake, and many predators and creditors seek an opportunity to grab an unearned piece of fame and money. In order to protect and preserve hard-earned wealth and secure a financially stable future, planning needs to happen in the present. Specifically, the athlete must engage a qualified estate and financial planning team, and implement asset protection, tax management, and estate planning steps in order to assure financial well being. ■

[10] "Head Injuries in Football," NY Times, updated 10/21/2010, available at http://topics.nytimes.com/top/reference/timestopics/subjects/f/football/head_injuries/index.html (last visited on 12/20/2011).

[11] Kennard, "Boxing Injuries," updated 3/28/2006, available at http://menshealth.about.com/od/fitness/a/boxing.htm (last visited on 12/20/2011).