Taxation of Professional Sports Teams After 1976: A Whole New Ballgame

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1976 marked a dramatic alteration in the taxation of professional sports teams. Owners of professional teams now find themselves forced from a state of grace within the tax laws that had helped promote the incredibly rapid growth of the sports industry. Owners now must learn to cope with seemingly oppressive limits on their tax advantages if they are to survive. This Article provides guidance in facilitating adjustment to the new laws and looks into the altered

1. The aura that protected professional sports from more severe taxation is manifested in the exemption of sports from the normal rules governing the taxation of the sale or exchange of franchises. Like other capital assets, the gain from the sale or exchange of a franchise was held to constitute long term capital gains if the franchise was held at least six months. I.R.C. § 1221. See also Dairy Queen of Okla., Inc. v. Commissioner, 250 F.2d 503 (10th Cir. 1957). Thereafter, Congress enacted a new rule which provided that if a franchisee retained significant powers, rights, or continuing interests in the transferred franchise, the gain from the sale or exchange would be ordinary income. I.R.C. § 1253(a). However, a special exemption was provided for franchises to engage in "professional football, basketball, baseball, or other professional sport." I.R.C. § 1253(e). When Dr. Lawrence Woodworth, then Chief of Staff of the Joint Committee on Taxation, was asked why sports franchises were given the special treatment, he responded:

I think that when this treatment was provided in 1969, the exception was made for sports enterprises, primarily because of uncertainty as to what its effect would be on the sports industry. If I recall correctly, it was the desire or feeling which I think was generally prevalent then in the Congress, that the sports industry should probably get a little special treatment relative to other industries, in part because it was thought of as not so much a business but a sport.

Whether that treatment should be continued or not is a question.


2. The rapid growth of professional sports may be seen in statistics from the four major sports: hockey, baseball, basketball, and football. Between 1959 and 1974, these sports expanded from five leagues and 42 teams to eight leagues and 114 teams. Note, The Professional Sports Team as a Tax Shelter-A Case Study: The Utah Stars, 1974 Utah L. Rev. 556, 557 [hereinafter cited as Utah Stars], citing Libby, A Look at Professional Sports, Salt Lake Tribune, Sept. 1, 1974, at D-3, Col.6. Although the American Basketball Association has merged into the National Basketball Association and the World Football League has ceased operations, the growth of professional sports has been dramatic.
future of professional sports taxation.  

The dramatic change in the tax posture of professional sports teams was precipitated by significant changes in the restrictions on player mobility imposed by sports leagues and the enactment of the Tax Reform Act of 1976. These changes interplay with both the structure of the professional sports team and those features of the tax law that traditionally governed the industry's financial status. Consequently, the structure of the industry and its basic tax treatment are an essential framework upon which the future of sports taxation will be built.

The Structure and Operation of the Professional Sports Team

Any professional team sport operates within the structure of a league and its authorized franchises. The league is the governing organization; the franchises are the governed entities. The athletes are merely employees of the governed franchises. The professional sports league is a tax-exempt organization normally established as a corporation or association. It is governed by a constitution, by-laws, and rules which detail league functions of any magnitude.

3. This Article addresses only the developments in the taxation of professional sports teams. The changes that affect the taxation of professional athletes themselves, though interesting and important, are beyond the scope of this Article and deserve their own treatment. Briefly, however, the nature of the athlete's short career and relatively high salary makes it important to consider such recently altered problems as the maximum tax on personal service income and its application to deferred compensation, the minimum tax on tax preferences, the new rules on estate planning, and the new limitations on tax-sheltered investments.


5. See I.R.C. § 501(c)(6).

(c) List of exempt organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Id. Although the language of § 501(c)(6) specifically mentions football leagues as tax exempt entities, other professional sports leagues apparently receive tax exempt status because they are "business leagues." See generally Treas. Reg. § 1.501(c)(6)-1 (1960). There are no cases on record in which the Internal Revenue Service has challenged the tax exempt status of professional sports leagues.

6. The location of all major decision-making authority in the league, rather than in the teams, has been attributed to the "unique economics of professional sports." STAFF OF THE HOUSE SELECT COMM. ON PROFESSIONAL SPORTS, 94TH CONG., 2D SESS., PROFESSIONAL SPORTS AND THE LAW 8 (Comm. Print 1976) [hereinafter cited as SELECT COMMITTEE STUDY]. Among the factors determined at the league level are geographic division of the market area, rules of practice limiting competition and the selling of the industry, and distribution of admissions revenues, broadcasting revenues, and franchise rights. Id. See also STAFF OF THE JOINT COMM.
The league normally is headed by a commissioner who exercises the
powers granted him under the aforementioned instruments.\(^7\) Although the professional sports team operates within the struc-
ture of league rules and decisions, the team is the unit with which
the public most readily can associate.\(^6\) The team is actually a fran-
chise right by which the owners or franchisees are granted exclusive
authority to present sporting events in a given geographical area.\(^8\) The franchise is acquired either from the league or from other fran-
chisees and may be organized in any of the typical forms of business
enterprise including proprietorship, general or limited partnership,
and ordinary or Subchapter S corporation.\(^9\) The franchisees may

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\(^7\) Joint Committee Print, supra note 6, at 1; Horvitz & Hoffman, supra note 6, at 176.

\(^8\) The league not only controls the daily operations of the franchises but also distributes
franchise rights and regulates admission and expulsion from the league. Select Committee
Study, supra note 6, at 8-9.

\(^9\) The franchise right's monopoly on sporting events in a designated area makes it a
valuable commodity. The relative value of the monopoly right, however, differs among teams
in the league:

In most areas the monopoly means very little; it has little tangible value particu-
larly in areas that are small. The monopoly value of being able to provide the
only baseball game in Oakland is minuscule in comparison to being able to
provide the only game in New York City. New York City is a very large city that
creates monopoly revenues because of that territorial restriction.

In the absence of that territorial restriction there might be something on the
order of five or eight teams that could viably survive. So the territorial restric-
tion that is enforced by the antitrust immunity creates an uneven monopoly
profit depending upon the size of the city.

Select Committee Hearing, supra note 1, pt.2, at 118. See also Joint Committee Print, supra
note 6, at 1; Okner, Taxation and Sports Enterprises, in Government and the Sports
Business 159, 162 (R. Noll ed. 1974); Weill, Depreciation of Players Contracts—The Govern-
ment is Ahead at the Half, 53 Taxes 581, 586-90 (1975); Note, Professional Sports Franchising

\(^10\) In 1976, for example, the National Baseball League's dozen teams were organized as
two Subchapter S corporations, a Canadian partnership, three ordinary corporations, and six
"d.o." (dual ownership) corporations. The American Baseball League's dozen teams were
organized as a sole proprietorship, two Subchapter S corporations, a limited partnership,
three ordinary corporations, and five "d.o." corporations. Tax Reform Act of 1975: Hearings
on H.R. 10612 Before the Comm. on Finance of the Senate, 94th Cong., 2d Sess. pt. 2, at
642 (1976) [hereinafter cited as Senate Finance Hearings]. In 1971, professional basketball
reflected a similar diversity; the two leagues were composed of four partnerships, ten Sub-
chapter S corporations, four publicly held corporations, four subsidiary corporations, five
corporations of unspecified characteristics, and one business trust. Professional Basketball:
Hearings on S. 2373 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm.
on the Judiciary, 92d Cong., 2d Sess. 995 (1971) [hereinafter cited as Basketball Hearings].
use any financial structure that meets their needs, including varying debt-equity ratios, subject only to league rules. Additionally, the franchise may possess a large number of assets of varying characteristics and importance. These assets may have been the greatest contributor to the Congressional sentiment that professional sports franchises were tax-sheltered investments and may have led to the sports team restrictions contained in the Tax Reform Act of 1976.

The franchise right is the most basic and essential asset of the professional sports team. It is a contract with the league guaranteeing not only the exclusive right to produce a certain type of sporting event in a particular locale but also the right to participate in player drafts and other player acquisitions, to share in the proceeds of league contracts with television networks, to have the benefit of league settlement of both interteam and team-player disputes, to have the services of league officials, and to be governed by the league constitution, by-laws, and rules. The most important fea-

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11. In professional baseball, for example, little debt is used to finance the acquisition of franchises. In the last six years, only seven baseball franchises were sold and the average purchase price of $10 million was composed of an average $7 million in equity and $3 million in debt. Senate Finance Hearings, supra note 10, at 636. In the American Basketball Association, however, there were some acquisitions by debt financing, notably the Utah Stars franchise which was acquired for $175,000 basis stock and $240,000 in debt. Utah Stars, supra note 2, at 564. The debt/equity ratio and the use of nonrecourse debt financing is important because, by leveraging the investment with large amounts of nonrecourse debt, the investor can generate tax deductions in excess of cash expenditures. See Select Committee Hearings, supra note 1, pt. 2, at 323; Joint Committee Print, supra note 6, at 1.

12. See, e.g., H.R. Rep. No. 1515, 94th Cong., 2d Sess. 419-20 (1976); S. Rep. No. 938, 94th Cong., 2d Sess. 86-91 (1976); H.R. Rep. No. 658, 94th Cong., 1st Sess. 68-85 (1975); Joint Committee Print, supra note 6; Staff of the Joint Committee of Internal Revenue Taxation for the Use of the Committee on Ways and Means, 94th Cong., 1st Sess., Overview of Tax Shelters 1, 8-9 (1975) [hereinafter cited as Overview of Tax Shelters]. "Tax Shelter" usually implies an investment tailored to allow taxpayers to offset certain artificial losses (that is, noneconomic losses but losses which are available as deductions under the present tax laws) not only against the income from those investments but also against the taxpayer's other income, usually from his regular business or professional activity. A major purpose of these investments for most taxpayers is to reduce the tax liability on their regular income. Overview of Tax Shelters at 1. Tax-sheltered investments accomplish this objective through three major devices: "deferral" of taxes by accelerating deductions, increasing them in early years of the venture with the concomitant reduction in later years; "leverage" of the acquisition with large amounts of nonrecourse debt financing; and "conversion" of ordinary income into capital gains through taking deductions against ordinary current income but realizing capital gains at disposition. See id. at 1-5.

ture of the franchise right, however, is the monopoly factor.\textsuperscript{14}

Each franchise is guaranteed a secure monopoly for its services in a distinct area by league rules which normally require consent of all or most of the present franchise owners prior to admission of a new franchise or movement of an existing franchise.\textsuperscript{15} The operative value of this protected monopoly right may be seen in both current income production and in special payments. The current income is derived from advertising revenues, gate receipts,\textsuperscript{16} radio and local television contracts, concessions, parking, and films of sporting events.\textsuperscript{17} Occasionally, a special payment will be made to a team for lost exclusivity when another team is added to the league by merger or expansion.\textsuperscript{18}

Broadcasting rights, a facet of the team's franchise rights, play a prominent role in the finances of sports teams.\textsuperscript{19} The value of the television rights is enhanced by league regulation and control over

\textsuperscript{14} Select Committee Hearings, supra note 1, pt. 2, at 111, 118-20, 164-66; Weill, supra note 9, at 584-88.\textsuperscript{15} These guarantees of a secure monopoly usually are contained in the league constitution and are one of the owners' most vital rights. See Select Committee Report, supra note 13, at 45; Select Committee Study, supra note 6, at 45.\textsuperscript{16} Gate receipts constitute one of the major sources of any team's revenues, and attendance differences have been considered a major reason for one team's success and another team's failure. Select Committee Study, supra note 6, at 9; Noll, The U.S. Team Sports Industry: An Introduction, in Government and the Sports Business 1, 15-16 (R. Noll ed. 1974).\textsuperscript{17} See Joint Committee Print, supra note 6, at 1; Select Committee Report, supra note 13, at 93; Jones, supra note 13, at 784; Weill, supra note 9, at 584-88. See also Laird v. United States, 391 F. Supp. 656 (N.D. Ga. 1975), appeal docketed, No. 75-213 (5th Cir. Apr. 17, 1975), cross appeal docketed, (5th Cir. May 28, 1975); Internal Revenue Service Manual, Audit Coordination Digest No. 65 (January 2, 1973), suspended by Manual Supplement No. 45G-213 (September 10, 1974) [hereinafter cited as IRS Manual].\textsuperscript{18} When the American Football League merged into the National Football League, two NFL teams received special indemnity payments in addition to their share of the ordinary entrance fees paid by AFL teams. The New York Giants received $10 million for the introduction of the New York Jets into their area, and the San Francisco 49ers received an additional $8 million for the introduction of the Oakland Raiders. Weill, supra note 9, at 584-85. When the American Basketball Association was merged into the National Basketball Association, the New York Nets had to pay the New York Knicks an additional $4 million for their "infringement." Select Committee Report, supra note 13, at 34. The Internal Revenue Service treats this compensation for infringement of territorial rights as a capital gain. See Rev. Rul. 71-583, 1971-2 C.B. 112.\textsuperscript{19} In 1975, for example, the national television contracts between the networks and professional baseball produced $9.6 million in revenues, and local contracts with baseball produced $26.495 million. This averaged to $1.504 million per team. In that same year, professional football received $50.1 million from its national contract and $2.948 million from its local contracts, averaging out at $2.04 million per club. Select Committee Report, supra note 13, at 688.
national broadcasting, which is permitted by federal legislation.\textsuperscript{20} The revenues from these league contracts with television networks are shared by all teams equally, regardless of relative success in athletics during any season.\textsuperscript{21} Local television and radio broadcasting, however, are controlled by the team, and league rules reinforce the exclusive rights of a team to negotiate local contracts for any sporting event not included in the national contract.\textsuperscript{22}

Most of the acquisition capital of a team is allocated to the player service contracts rather than to the franchise right, making these contracts one of the team's most significant assets.\textsuperscript{23} The contracts bind a player or coach\textsuperscript{24} to perform services for the team for a single year, a term of years, or even for an indefinite or perpetual period.\textsuperscript{25} The current trend in many sports, however, is toward multi-year contracts.\textsuperscript{26} These contracts actually are one-year contracts bound

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\textsuperscript{21} Select Committee Study, supra note 6, at 9. In certain cases, however, a new team or group of new teams will be excluded from standing national contracts with television networks. This occurred in 1968 when the American Baseball League expanded to admit teams in Seattle and Kansas City. See Papers filed in Kaufman v. United States, No. 289-76, (Ct. Cl., filed July 16, 1976). In 1976, when the American Basketball Association was merged into the National Basketball Association, the four ABA teams taken into the NBA were forbidden to participate in the national television contract pool for five years. Select Committee Report, supra note 13, at 34.

\textsuperscript{22} Select Committee Study, supra note 6, at 9.

\textsuperscript{23} A 1971 study of basketball revealed that 69.4\% of the acquisition cost of a franchise in the American Basketball Association was allocated to player contracts and 85.4\% of the cost of a National Basketball Association team was allocated to these contracts. Basketball Hearings, supra note 10, pt. 2, at 615. The average allocation was between 70\% and 75\%, with one franchise allocating 98.4\% of the acquisition cost to player contracts. Okner, supra note 9, at 162-63. In a number of cases awaiting litigation at this time, the percentages of consideration allocated to these contracts have also been quite high. See Kaufman v. United States, No. 289-76 (Ct. Cl., filed July 16, 1976) (98\% allocation); Philadelphia Hockey Club, Inc., No. 7486-74 (T.C., filed Sept. 9, 1974) (97\%); Charles O. Finley & Co., No. 8342-71 (T.C., filed Dec. 16, 1971) (83\%); id., Nos. 7219-73, 7220-73 (T.C., filed Sept. 27, 1973) (83\%); Charles O. & Shirley Finley, No. 8343-71 (T.C., filed Dec. 16, 1971) (83\%). In the only reported decision on point, the allocation sought by the owners was approximately 84\%. Laird v. United States, 391 F. Supp. 656, 658 (N.D. Ga. 1975).

\textsuperscript{24} Although player service contracts may be used to secure the services of either a player or coach, most are used for players. All references herein are to contracts for the services of players.

\textsuperscript{25} These contracts may take different forms depending upon the sport and the status of the player. Rookies and veterans do not necessarily desire or receive the same standard contracts, and the terms of the contract with respect to duration may depend upon the relative playing ability of the athlete. The different contracts normally used are discussed elsewhere in this Article.

\textsuperscript{26} Select Committee Report, supra note 13, at 32. This trend is particularly visible in
together by a common set of conditions. If the athlete is injured in the third year of a so-called five-year contract, he may be paid for the services rendered during the remainder of the third year. However, no payments will be made in the fourth or fifth year unless the player can again meet the health and medical requirements of the contract.\textsuperscript{27}

The assets of the team are used to produce current operating revenues and long term disposition revenues for the franchise owners. Current profits are derived from the rendition of services through a joint venture with other teams to produce an exclusive sporting event which is marketed to the public. The gate receipts are divided between the home team and challenger according to league rules, which may vary widely from sport to sport.\textsuperscript{28} In addition, the teams derive current revenue from national and local broadcasting rights, concessions, parking, and advertising. Indirect benefits also can accrue to the franchise owner from publicity given to his other business interests.\textsuperscript{29}

The franchise also generates revenue when it is sold or exchanged. This gain is measured by the difference between the acquisition

\textsuperscript{27} Select Committee Hearings, supra note 1, pt. 1, at 304-05. Martin Blackman, a noted player representative, explained:

\begin{quote}
When you hear that someone signed a 3- or 4- year contract, these are actually a series of 1- year agreements. The signing of a 5-year contract does not really bind the obligations for 5 years. It is a year-to-year contract. It is five single contracts . . . so that in the first year of a contract, let's assume on the first day of that football exhibition season a player is injured and he has signed a 5-year contract. He will get compensated that first year and his medical bills will be paid that first year. But if he is unable to make the club the second year, the contract stops.
\end{quote}

\textsuperscript{28} In baseball, the split is 85/15 in favor of the home team in each game. In football, the split is 60/40 in favor of the home team. In basketball and hockey, the home team receives all of the gate receipts. Select Committee Report, supra note 13, at 45.

\textsuperscript{29} One commentator noted:

\begin{quote}
Who is to distinguish between profits of Auggie Busch's brewery and the St. Louis Cardinals? One has to treat them as a kind of joint enterprise. The financial position of the St. Louis Cardinals cannot be viewed independently to what is happening to the brewery since it can be shown that . . . the position of St. Louis and its relative league standing affects the amount of beer that is sold in the greater St. Louis area.
\end{quote}

Select Committee Hearings, supra note 1, pt. 2, at 121. Charles O. Finley stated that one of the reasons he acquired the Kansas City Athletics and moved them to Oakland, California, was to obtain the indirect advertising and public relations benefits for his insurance company. Brief for Appellant, Charles O. Finley & Co., No. 8342-71 (T.C., filed Dec. 16, 1971).
cost, adjusted for capital additions or asset depreciation, and the
sales price received by the owner.30 The acquisition cost would be
either the amount paid another owner for the team or, if the team
is acquired in league expansion, the amount paid the league and
thereafter distributed among the existing teams. The income tax
problems of the team owner stem from structuring the acquisition
or disposition of the franchise in a manner primarily designed to
lighten the tax burden. The owner’s ability to do this has been
altered significantly by the events of 1976. To understand these
changes, it is necessary to examine the general tax treatment of a
professional sports team.

**GENERAL TAX TREATMENT OF PROFESSIONAL SPORTS**

The taxation of the professional sports team as an entity is largely
an incident of the tax treatment accorded individual franchise as-
sets, particularly the player contracts and franchise right. Other
assets, notably the television rights and stadium lease, contribute
toward the financial operations of the franchise, but the essence of
a franchise’s tax planning must center on the franchise and con-
tracts. The franchise right historically has been treated as a capital
asset31 that is nonamortizable because its useful life is incapable of
reasonable ascertainment.32 If the franchise had been held at least
six months before disposition, the gain or loss from its sale or ex-
change was treated as a long term capital gain or loss.33 The Tax
Reform Act of 1976 extended the holding period to nine months for
1977,34 but any gain or loss realized will continue to be treated as a
long term capital gain or loss.

For the last ten years, player contracts have been treated as amort-
zable business property under section 1231.35 Early judicial deci-

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32. Treas. Reg. § 1.167(a)-3 states: "If an intangible asset is known from experience or
other factors to be of use in the business or in the production of income for only a limited
period, the length of which can be estimated with reasonable accuracy, such an intangible
asset may be the subject of a depreciation allowance." However, if there is no limited useful
life or the useful life of the asset is not capable of reasonable estimation, it may not be
amortized.
33. I.R.C. § 1231.
34. After 1977, the holding period will be one year. Tax Reform Act of 1976, Pub. L. No.
C.B. 227; Rev. Rul. 137, 1971-1 C.B. 104. These rulings apply to major league player contracts
specifically. Because minor league teams hold their players for sale to the major leagues in
sions and rulings of the Internal Revenue Service (IRS) held that the contracts had a maximum useful life of one year; thus, they could be expensed rather than capitalized. In 1967, the IRS ruled that because the league rules and the reserve clause in the standard form baseball contract had the effect of binding a player to one team for his entire career, the contract had a useful life beyond one year and would have to be capitalized and amortized. In 1971, a similar ruling stated that because football players tended to remain with one team for their entire careers, the standard football contract would have to be capitalized and amortized as well. These rulings were viewed generally as extending to other sports as well, and all player contracts were considered amortizable section 1231 assets.

The basis a team was required to take in its player contracts was the total of any payments made to acquire the contract, including both indemnity paid to another team as compensation for loss of the athlete and bonuses paid to the athlete for signing the contract. A bonus not paid in the year of acquisition, however, could be treated in the ordinary course of their business, these contracts constitute neither "section 1231 assets" nor capital assets. Gain from the sale or exchange of a player contract by a minor league normally would constitute ordinary income. Hollywood Baseball Ass'n v. Commissioner, 423 F.2d 494, 503 (9th Cir. 1970). See also Klinger, Professional Sports Teams: Tax Factors in Buying, Owning and Selling Them, 39 J. Tax. 276, 277 n.2 (1973).

36. Commissioner v. Pittsburgh Athletic Co., 72 F.2d 883 (3rd Cir. 1934), aff'd 27 B.T.A. 1074 (1933), acq. in CH XIV-2, 17 (1935); Commissioner v. Chicago Nat'l League Ball Club, 74 F.2d 1010 (7th Cir. 1935); Helvering v. Kansas City Am. Ass'n Baseball Co., 75 F.2d 600 (8th Cir. 1935). But see Dallas Athletic Ass'n, 8 B.T.A. 1036 (1927); Houston Baseball Ass'n, 24 B.T.A. 69 (1935).

37. C.B. XI-2, 17 (1935); Rev. Rul. 441, 1954-2 C.B. 101. Although the 1954 ruling held that individually purchased or acquired player contracts should be expensed, it also held that this rule was inapplicable to the acquisition of an entire roster of player contracts. Rosters had to be capitalized, and, when any individual contract was disposed of, the taxpayer reduced his basis. When the basis was reduced to zero, proceeds from the sale or exchange of subsequent contracts were ordinary gains. Rev. Rul. 441, 1954-2 C.B. 101, 102. See Klinger, supra note 35, at 277.

38. As one court noted: "Such an option might readily enhance the value of the . . . [contract] but it could hardly be supposed to change the period during which the . . . [contract] would become exhausted." Pittsburgh Athletic Co., 27 B.T.A. 1073, 1078 (1933).


41. Rev. Rul. 379, 1967-2 C.B. 127, 128; Rev. Rul. 137, 1971-1 C.B. 104. Bonuses are not paid to a large percentage of athletes but indemnity payments frequently may be assessed. A 1971 study showed that only 10 of the top 14 rookies drafted and signed by the American Basketball Association received bonuses and these averaged only $31,000 each. Okner, supra note 9, at 170. The league rules in hockey and basketball, as well as football's "Rozelle Rule", permit some form of indemnity to be paid by a team signing an athlete who had formerly been under contract to another team.
as a non-qualified deferred compensation agreement. This treatment results in disallowance of the deduction until actual payment of the bonus and precludes capitalization of the bonus amount. This treat-ment results in disallowance of the deduction until actual payment of the bonus and precludes capitalization of the bonus amount.

Gain on the sale or exchange of a contract is treated as capital gain; loss is treated as ordinary loss under the normal rules applicable to section 1231 assets.

Because the franchise right and player contracts have such different characteristics for tax purposes, the entire tax future of a team can depend upon the portion of its capital that is invested in each of the two assets. Because the franchise right and a large number of the team's player contracts are acquired with the initial transfer of the team, this transfer becomes critical to tax planning for the professional sports franchise. When a franchise is acquired, both the purchaser and the seller must allocate the consideration paid or received among the various assets transferred. The competing tax interests of the parties tend to compel different allocations. The buyer normally allocates as much of the consideration as possible to those assets that can be amortized or depreciated in future years, including player contracts and office and sports equipment. The seller, on the other hand, will allocate as much of the acquisition consideration as possible to those assets, such as the franchise right, that will give him long term capital gains without depreciation re-capture.

42. See Joint Committee Print, supra note 6, at 3; Klinger, supra note 35, at 277 n.6. Even the rulings on capitalization of signing bonuses paid athletes refer to the requirement that a franchisee capitalize bonuses "paid" to the signing athlete. Bonuses deferred would not fall within the ambit of these rulings. See Rev. Rul. 379, 1967-2 C.B. 127; Rev. Rul. 137, 1971-1 C.B. 104. See also Rev. Rul. 31, 1960-1 C.B. 174, 181. Even if a deferred bonus is not added to the basis of the contract, it does permit financing team improvement with deferred payments.

43. I.R.C. § 1231(a).

44. See Williams v. McGowar, 152 F.2d 570, 572 (2d Cir. 1945).

45. Okner, supra note 9, at 165-66; Horvitz & Hoffman, supra note 6, at 177; Klinger, supra note 35, at 278; Note, Professional Sports Franchising and the IRS, supra note 9, at 323. For example, the buyer of one basketball franchise allocated 94% of the acquisition cost to player contracts and nothing to the franchise right. Utah Stars, supra note 2, at 561-62. The IRS has noted that most franchise owners allocate only a "nominal sum", usually $50,000, to the franchise right itself; most of the remainder of the acquisition cost is allocated to player contracts. IRS Manual, supra note 17.

Prior to 1977, the buyer and seller were permitted to make independent allocations subject only to a requirement of "reasonableness." The ability of the buyer and seller to make different allocations often resulted in a much criticized "whipsaw" of the government. The IRS first attempted to restrain the clubs from allocating most of the consideration to player contracts by contending that the substantial economic value of the franchise right made such an allocation unreasonable. Recently, the IRS has de-

47. I.R.C. § 167(a). The deduction for depreciation or amortization of an asset permits a "reasonable" allowance for wear and tear. The likelihood of change on audit has been thought by some to be relatively low. Okner, supra note 9, at 166; Klinger, supra note 35, at 278. Nevertheless, the IRS has 130 pending audit cases, so this assessment appears to be slightly erroneous. Select Committee Hearings, supra note 1, pt. 2, at 282.

When the franchise is exchanged directly for another franchise, no allocation is required because the taxpayer has engaged in a like-exchange in which no gain or loss is recognized. I.R.C. § 1031.

48. Different allocations can work to benefit either the government or the taxpayers. One recent study noted:

The potential for "whipsaw" exists whenever two (or more) taxpayers have adverse interests in the manner in which a specific item or transaction is taxed. "Whipsaw" becomes a problem:

(1) for the Government, when the tax liabilities of the taxpayers are determined on the basis of inconsistent treatment of the item or transaction, enabling each to receive a tax benefit to the detriment of the Government; and

(2) for the taxpayers, when their liabilities are determined on the basis of such inconsistent treatment to their mutual disadvantage to the benefit of the Government.

In the former case consistent treatment would indicate a tax deficiency to at least one of the taxpayers, while in the latter case consistent treatment would indicate that at least one of the taxpayers is entitled to a refund of tax.

Final Report of the Special Committee on Whipsaw, Section of Taxation, American Bar Association, 30 Tax Law. 127 (1976).

49. The IRS has notified its auditors to use a higher valuation for the franchise right and a lower one for the player contracts than most franchisees use. It rationalizes its determination on the basis of the economic value of the franchise. First, the franchise right is asserted to be the vehicle for obtaining rights to:

Territorial rights
Specified location
Share of TV income
Radio income
Gate receipts
Concessions
Advertising
Parking fees
Pay TV
Films
Player slots to be continuously filled
League membership

(a) Participation in Draft
emphasized this argument, contending instead that the transferee of a franchise acquires a roster of players rather than individual contracts. The roster is treated as a "mass asset" which has no reasonably ascertainable useful life because it is continually renewed. Moreover, the Government contends that the roster is non-mortizable because it has neither independent valuation nor useful life separate from the franchise right itself, which provides the means for marketing and replenishing the roster of players.\footnote{50}

This argument was rejected in the only case in which valuation of player contracts was in issue. The court stated that it did not "accept the Government's contention that it is impossible to establish, except in an arbitrary manner, a reasonably accurate basis for depreciation of the player contracts acquired."\footnote{51} Furthermore, the majority of courts that have considered the "mass asset" argument in non-sports cases have rejected it.\footnote{52}

\begin{itemize}
\item (b) Future Expansion
\item (c) Personnel to Officiate
\end{itemize}

\begin{itemize}
\item Going concern [value]
\item (a) Scouting system
\item (b) Operating business management structure
\item (c) Affiliation agreement
\item (d) Lease arrangements.
\end{itemize}

Select Committee Hearings, supra note 1, pt. 2, at 306. These rights are supposed to make the franchise right the most valuable asset held by the team.

Second, if the underlying assumptions about the relative value of assets are correct, the auditors are to use the Service's "prudent investor approach" to value the player contracts. Under this approach, the value of the total player contracts is equal to the present value of a $1.00 annuity for the average useful life of the contracts multiplied by the anticipated annual predepreciation cash flow of the franchise. For example, a $16 million purchase of a football team is expected to generate a cash flow of $1.2 million, and the player contracts have a five year useful life. Under the Service's formula, the total value of the player contracts would be only $5,000,000 ($1.2 million multiplied by 4.21236, the present value of a $1 annuity for five years). IRS Manual, supra note 17, at \___. This approach has been suspended pending the appeal in Laird v. United States, 391 F. Supp. 656 (N.D. Ga. 1975), appeal docketed, No. 75-2113 (5th Cir. Apr. 17, 1975), cross appeal docketed, (5th Cir. May 28, 1975).

\begin{itemize}
\item 50. Jones, supra note 13, at 779.
\item 51. Laird v. United States, 391 F. Supp. 656, 670 (N.D. Ga. 1975), appeal docketed, No. 75-2113 (5th Cir. Apr. 17, 1975), cross appeal docketed, (5th Cir. May 28, 1975). Thereafter, the court allocated 35% of the total consideration to the player contracts. \textit{Id.} at 671.
\item 52. Houston Chronicle Pub. Co. v. United States, 481 F.2d 1240, 1249-50 (5th Cir.), \textit{cert. denied}, 414 U.S. 1129 (1973); Securities-Intermountain, Inc. v. United States, 460 F.2d 261, 262-63 (9th Cir. 1972); Super Food Services, Inc. v. United States, 416 F.2d 1236, 1240 (7th Cir. 1969); Commissioner v. Seaboard Fin. Co., 367 F.2d 646, 653 (9th Cir. 1966); KFOX, Inc. v. United States, 510 F.2d 1365, 1378 (Ct. Cl. 1975); Richard S. Miller & Sons, Inc. v. United States, 75-2 U.S. Tax Cas. (CCH) § 9874 (Ct. Cl. 1975). A few courts, however, have accepted the theory. \textit{See} Boe v. Commissioner, 307 F.2d 339 (9th Cir. 1962); Golden State Towel \& Linen Serv., Ltd. v. United States, 373 F.2d 938 (Ct. Cl. 1967); Westinghouse Broadcasting
Courts generally have upheld the taxpayer's ability to amortize an intangible asset acquired as part of a going business as long as the asset has an independent value and ascertainable useful life.\textsuperscript{53} Although the IRS has conceded this point,\textsuperscript{54} it continues to contest the principle's applicability to player contracts.\textsuperscript{55}

**RECENT DEVELOPMENTS**

A series of judicial decisions and labor agreements has caused dramatic changes in the nature of player contracts. Because of these changes and the new treatment of professional sports in the Tax Reform Act of 1976, the entire framework of professional sports team taxation must be re-evaluated.

**Impact of Labor and Antitrust Changes in Player Contracts**

The terms of the player contracts in the four major sports (baseball, hockey, basketball, and football) have been changed recently by judicial decisions and collective bargaining agreements. Baseball and hockey clubs previously kept their players perpetually tied to one team through indefinitely renewable option clauses and through league reserve clauses forbidding other teams to “tamper” or negotiate with players under contract to another team.\textsuperscript{56} Football and
basketball teams kept their players tied to one team indefinitely by nonrenewable option clauses and league rules requiring indemnification by a team acquiring a player formerly under contract with another team. If a player played out his option year, became a free agent, and signed with another team, the acquiring team had to make a mutually agreeable payment to the player's former team. If no agreement were reached, the commissioner of the league could mandate any indemnification in cash, draft choices, or other players. This practice so restrained other teams from signing free agents in the absence of satisfactory interteam negotiations that player mobility was substantially eliminated.

In professional baseball, the reserve system was altered significantly by judicial affirmation of the Messersmith-McNally arbitration. The arbitrator held that the renewal clause in the standard baseball contract was not perpetually renewable but that it provided only an option of renewal for one additional year after the initial contract term. After that year, the player became a free agent and could negotiate a new contract with another team. Furthermore, the arbitrator held that the baseball league's rule precluding "tampering" with players under contract to other teams applied only to the contract term and single option year. Faced with the prospect of other players becoming free agents, the league undertook negotiations with the players' union and, on July 12, 1976, entered into a tentative collective bargaining agreement.

58. A player who refused to renegotiate his contract and played out the option period undertook a number of risks, including the risk of injury during the option year, a decline in performance, and the risk that another team would not hire him because the potential indemnity payment to the former contract owner would be too great. Noll, supra note 16, at 14.
61. Id. at 53-54.
62. The failure of the leagues to finalize the tentative agreement led the Major League Baseball Players Association to file an unfair labor practice grievance under section 8(d) of the National Labor Relations Act. 29 U.S.C. § 158(d) (1973).
Under the tentative agreement, contracts not governed by the *Messersmith-McNally* arbitration will contain a renewable option clause, but league rules will not permit the clause to become perpetual. After five years of major league service, a player may demand to be traded or, after six years of service, he may become a free agent and enter the player draft.\(^3\) If a player demands to be traded, he has a veto over six clubs; if no trade is consummated, he then becomes a free agent.\(^4\)

Hockey, unlike baseball, had a relatively quiet 1976 but saw hectic years earlier in the decade. In 1973, after a series of inconsistent decisions as to the validity of hockey contracts and rules under federal antitrust laws,\(^5\) the reserve system was replaced by a combination of an option clause contract and an indemnity provision.\(^6\) These changes permit a player to sign a contract for one year or for a term of years with a single option year.\(^7\) If the player signs with

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\(^3\) Three rules govern players under contract when the agreement is reached. If the player was under a 1975 contract renewed for 1976, he becomes an automatic free agent at the end of the 1976 season. If the player was under a 1976 contract renewed for 1977, he automatically becomes a free agent at the end of the 1977 season unless a new contract is signed. If the player was under a multiyear contract signed prior to ratification of the new collective bargaining agreement, he automatically becomes a free agent at the end of the season following a one year renewal of the contract unless a new contract is signed. *Select Committee Hearings, supra* note 1, pt. 1, at 417 (copy of the tentative agreement). The first free agent draft under the tentative agreement was held November 4, 1976. Each free agent could negotiate with a maximum of 12 teams, but each club was restricted to signing the greater of one player for each 14 in the draft or the number of free agents the team lost. *Id.* at 421-22.

\(^4\) Although a player may demand to become a free agent after serving in the league for six years, he may not repeat this demand before another five years of service. Similarly, a player who demands to be traded after five years may neither become a free agent for an additional five years nor demand to be traded again for another three years. A player who elects to become a free agent may elect to demand a trade after another three years. *Id.* at 418.


\(^6\) National Hockey League By-Law Section 9A (adopted Nov. 27, 1973).

\(^7\) Paragraph 9A.2 of the NHL by-laws provides that the standard form player contract shall contain the new section 17. This clause states:

(a) The Club may no later than August 10th of the final year of this contract, tender the Player a Player's Termination Contract and notify him that he has
another team after playing out his option and becoming a free agent, an indemnity payment is required. This payment, if not reached by agreement of the teams, is to be settled by arbitration rather than by commissioner fiat. 68

Basketball contracts have been changed dramatically by the settlement in Robertson v. National Basketball Association. 69 Pursuant to this settlement, the standard form basketball contract, with a few exceptions, need not contain an option clause of any type. 70 Veterans whose contract terms lapse may become free agents and negotiate with another club, while rookies enter the player draft. If a player becomes a free agent by playing out his contract and signs with another team, indemnification is required. This may be set by agreement or, if not agreed to, will be ordered by the league commissioner for any transaction before the end of the 1980-81 season. 71 After that season, but before the end of the 1986-87 season,

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the choice of executing said Player's Termination Contract and delivering it to the Club on or before September 10th of that year or automatically being unconditionally released from any further obligation to provide services under this contract as of midnight, September 10th of that year. The Player's Termination Contract shall be on the same terms and conditions as this contract except that it shall be for only one additional season at the Player's previous year's salary and shall provide for the Player's unconditional release from any further obligation to provide services under said Player's Termination Contract effective the following June 1st.


68. The indemnity provision, referred to as an "equalization" clause, states:

- Each time that a player becomes a free agent and the right to his services is subsequently acquired by any Member Club other than the club with which he was last under contract or by any club owned or controlled by any such Member Club, the Member Club first acquiring the right to his services, or owning or controlling the club first acquiring that right, shall make an equalization payment to the Member Club with which such player was previously under contract, as prescribed by section 8 of this By-Law. Each Member Club may acquire the right to the services of as many free agents as it wishes, subject to the provisions of subsection 9 of this By-Law.


70. The option clauses in contracts in force as of April 29, 1976, the date of the Robertson settlement, were declared invalid except for those clauses that were to be exercised on or before August 1, 1976 for the 1976-77 option year and clauses that were the subject of specific negotiation on substantive matters such as economic terms. Id. at 302-03. Option clauses were also permitted for one year options in either veteran or rookie contracts as long as the option is exercisable only once for not more than one year and for not less than 100% of the player's previous salary. Id. The Robertson settlement was incorporated into the collective bargaining agreement subsequently accepted by the players' association and the NBA.

71. Id. at 304-05.
no indemnification is required, but the player’s old team is given a right of first refusal if it can substantially match the offer of the competing team.\textsuperscript{72} Rookies who enter the player draft also are given new rights. If a team drafts a rookie and cannot negotiate a contract within one year during which the rookie is not playing for any other team, the rookie enters the player draft again the following year. The team drafting that rookie the second time also will have only one year to sign him. After two years, the rookie becomes a free agent and may negotiate with any team.\textsuperscript{73}

In football, amidst the onslaught of two major federal court decisions\textsuperscript{74} that held the “Rozelle Rule” of compelled indemnification unenforceable under federal antitrust law, a new collective bargaining agreement was signed by the National Football League Management Council and the Players’ Association on March 1, 1977. Under this new agreement, the option clause is eliminated from all football contracts except for rookie one-year contracts and contracts of other players when the clause is specifically negotiated between the team and player. When the option clause is contained in the contract, it must provide that the player will receive 110% of present compensation in the option year.\textsuperscript{75} If a player completes his option year he may sign a contract with another team, but the team for which he presently plays has a right of first refusal if it desires to match the major terms of the new team’s offer. If, on the other hand, the team on which the athlete plays does not desire to match the new team’s offer, it has a right to compensation in the form of draft choices, computed on a special scale based on the salary paid by the new team. The compensation may range from a third round draft choice to two consecutive first round choices.\textsuperscript{76}

These new contracts and league rules must be considered in evaluating proper treatment of player contracts for federal income tax purposes. In baseball, for example, the IRS no longer can argue that the contract terms and league rules result in a contract in which the

\textsuperscript{72} \textit{Id.} at 305-11. Because the offer need be only substantially the same rather than identical, problems will likely arise as to the equality of offers. These disputes will be settled by arbitration. \textit{Id.} at 308.

\textsuperscript{73} \textit{Id.} at 299-302.


\textsuperscript{76} \textit{Id.} Art. XV, § 12.
player "expressly bind[s] himself to play only for the club which owns his contract for the entire period of his useful life as a player in organized baseball." Nevertheless, the contracts still should retain a useful life "extending substantially beyond the taxable year in which the contract is acquired," requiring capitalization and amortization, rather than expensing of the cost of the contract. It should be readily apparent that if players are now assured of substantial transfer rights after five years in major league service, the useful life of a contract to the team acquiring it must be shortened significantly. Consequently, amortization deductions in a given year should be increased.

A similar analysis should prevail for hockey, football, and basketball, in which limited indemnification rules currently prevail. Although the IRS has not issued a ruling on the capitalization of either basketball or hockey contracts, a 1971 ruling that a football contract extends over one year should apply to hockey and basketball as well. This ruling demonstrates, however, that the IRS did not realize precisely why players remained with one team throughout their careers. Clearly the lack of player mobility was caused by the Rozelle rule: the rule made most teams reluctant to hire players who had played out their options and had become free agents, for fear of extraordinary indemnification requirements. Because professional basketball will use a commissioner-ordered indemnity through the end of the 1980-81 season, it too should be governed by the IRS's 1971 declaration. The first refusal requirement for basketball after 1981, the arbitrated indemnification for hockey, and the permanent first refusal for football, though compensated with draft choices only, take them out of the ambit of the IRS's published position and raise new questions about the treatment of these contracts.

The effect of these rule changes generally will be a significant reduction in the playing time an athlete spends with each team, though probably not below one year. As a result, the useful life will be shortened and the amortization will be made more rapid. If, on

78. Id. at 129.
80. The IRS merely asserted that in many cases "the player remains with the team with which he originally contracted for the duration of his playing career." Id.
81. See generally Joint Committee Print, supra note 6, at 2 n.3; Noll, supra note 16, at 4. But see text accompanying notes 74-75 supra.
the other hand, these new rules have no real effect on player mobility and leave players subject to their contract terms, the rules from early sports cases should apply and the contracts would be subject to current deduction rather than capitalization. The option for a second year would increase only the value of the contract, not its useful life. The more likely result of these new rules will be capitalization and amortization of player contracts over a shorter useful life. Yet, until accurate data concerning the effect of the rule changes are compiled, the position the IRS will take is mere speculation.

The Tax Reform Act of 1976 and Sports Team Taxation

In addition to changes in the terms of player contracts, the Tax Reform Act of 1976 affects team sports taxation by attempting to restrict substantially tax advantages that professional sports formerly enjoyed. The professional sports franchise is affected by numerous parts of the new tax law, especially by the sections restricting tax shelters. These new rules address the problems of whipsaw, unreasonable allocations of acquisition consideration to player contracts, and recapture of deductions taken with respect to player contracts.

The new law first codifies the rule that the transferee of a professional sports franchise takes an adjusted carryover basis in player contracts. The court in Pittsburgh Athletic Co. reviewed the option clause in professional baseball, a clause which was similar to the football option clause absent the Rozelle Rule and other special rules on tampering. The court noted:

By a parity of reasoning, the option to renew the players' contracts in the instant case might enhance the value of the contracts but would not change the period during which the contracts would become exhausted. Since 1931 the Board [of Tax Appeals] has applied the ruling in Bonwit Teller & Co. v. Commissioner [53 F.2d 381 (2d Cir. 1931), cert. denied, 284 U.S. 690 (1932)] and has held that the cost of a contract containing an option to renew is a business expense in the year when paid, and that the sum derived from the sale of a contract is income in the year in which received.

72 F.2d at 884.

82. See Commissioner v. Chicago Nat'l League Ball Club, 74 F.2d 1010 (7th Cir. 1935); Helvering v. Kansas City Am. Ass'n Baseball Co., 75 F.2d 600 (8th Cir. 1935); Commissioner v. Pittsburgh Athletic Co., 72 F.2d 883 (3d Cir. 1934), aff'd 27 B.T.A. 1074 (1933), acq. in XIV-2 C.B. 17 (1935). The court in Pittsburgh Athletic Co. reviewed the option clause in professional baseball, a clause which was similar to the football option clause absent the Rozelle Rule and other special rules on tampering. The court noted:

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72 F.2d at 884.

83. For example, the holding period extension for long term capital gains treatment will affect the taxation of franchise sales if the franchises were held less than nine months in 1977 or one year after 1977. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1402, 90 Stat. 1520 (1976) (amending I.R.C. § 1222). See note 34 supra & accompanying text. The restrictions on consideration of nonrecourse financing in the basis of a partner in a limited partnership also will affect any franchises organized in that form. Id. § 213(e).

84. Id. § 212.

85. See note 48 supra & accompanying text.
contracts received as part of the franchise.\textsuperscript{86} This basis, which in most cases should equal the sales price attributable to the contracts, is the transferor's basis increased by any gain recognized by the transferor on the sale or exchange. There is no downward adjustment for the transferor's recognized losses.\textsuperscript{87}

There are three exceptions to this general carryover basis rule. First, the transferee receives an unadjusted carryover basis if the transfer takes the form of a like-kind exchange.\textsuperscript{88} Second, if the transferor is a decedent dying after December 31, 1976, the transferee takes a carryover basis modified by various provisions of the Tax Reform Act, most notably by the section providing for a "fresh-start" basis as of December 31, 1976.\textsuperscript{89} Furthermore, if the transferor is a corporation that has adopted a plan of liquidation by which its assets will be sold and the proceeds distributed to the shareholders without recognition of gain at the corporate level, the basis adjustment is for the gain recognized by the transferor's shareholders rather than that recognized by the transferor.\textsuperscript{90}

In addition to the modified carryover basis rules, the Tax Reform Act requires the transferor to file with both the Secretary of the Treasury and the transferee a statement noting the basis he claims in the player contracts transferred and any gain recognized on the transfer.\textsuperscript{91} Subsequent modifications of either of these two factors must be reported also.\textsuperscript{92} This statement is binding on both the transferor and transferee, thereby preventing different allocations and potential whipsaw of the government.\textsuperscript{93}

The provisions eliminating whipsaw are coupled with a limitation on the transferee's allocation of consideration paid for player contracts. No more than fifty percent of the consideration paid for a

\begin{itemize}
\item \textsuperscript{86} Id. § 212(a)(1) (adding I.R.C. § 1056(a)).
\item \textsuperscript{87} Id. (adding I.R.C. § 1056(a)(2)).
\item \textsuperscript{88} Id. (adding I.R.C. §§ 1056(b)(1) & 1031(a)).
\item \textsuperscript{89} Id. (adding I.R.C. § 1056(b)(2)).
\item The new law provides that the former stepped-up basis for property received from a decedent is eliminated for property received from a decedent who dies after December 31, 1976 and replaced with a modified carryover basis. The carryover basis is adjusted for the appreciation prior to January 1, 1977, for a minimum basis adjustment of $60,000, and for other statutory adjustments. Id. § 2005(a) (adding I.R.C. § 1023).
\item \textsuperscript{90} Id. § 212(a) (adding I.R.C. § 1056(a)). This appears to be logical because the corporation recognizes no gain in a liquidation qualifying under section 337 of the Internal Revenue Code.
\item \textsuperscript{91} Id. (adding I.R.C. § 1056(c)(1) & (2)).
\item \textsuperscript{92} Id. (adding I.R.C. § 1056(c)(3)).
\item \textsuperscript{93} Id.
\end{itemize}
franchise is presumed properly allocable to player contracts unless the transferor or transferee establishes to the satisfaction of the Secretary that a larger allocation is proper. An allocation of less than fifty percent of the consideration paid will not necessarily be permissible; the IRS can still apply its test of "reasonableness" to such allocations.

The third major restriction in the new law removes the treatment of a sale of an entire franchise or of a substantial portion of a franchise's player contracts from the ordinary recapture rules. The new act imposes a far stricter set of rules. Whereas former law required treatment of gain on the sale or exchange of a player contract as ordinary income to the extent of post-1972 depreciation or amortization, the new law applicable to the sale of an entire franchise treats as ordinary income the greater of the amortization and casualty loss deductions on those contracts transferred or the amortization and casualty loss deductions on contracts initially acquired with the franchise, although these contracts may no longer be held by the owner.

Perhaps the greatest burden imposed by these new rules is that

94. Id. (adding I.R.C. § 1056(d)).
95. Id. Because the new law does not clarify the question of how player contracts and franchise rights are to be valued for income tax purposes, this is likely to remain a much litigated area. There is no reason for the IRS to grant automatically the taxpayer an allowance of 50% of the franchise value to player contracts when this is more than it has formerly been willing to allow. In Laird v. United States, 391 F. Supp. 656 (N.D. Ga. 1975), appeal docketed, No. 75-2113 (5th Cir. Apr. 17, 1975), cross appeal docketed, (5th Cir. May 28, 1975), for example, the Service's auditor allocated about 12% of the franchise cost to the player contracts and the District Court settled on about 34%. Both figures are, of course, substantially below the 50% figure given in the new law. Consequently, the IRS probably will continue to contest franchise allocations even below the 50% level.
96. I.R.C. § 1245(a).
97. Casualty losses are taken when a player under contract with a franchise is injured and becomes worthless for competitive purposes. The contract may then be considered a total loss and any remaining basis may be written off as a casualty loss. I.R.C. § 123. Actually, this is not technically a casualty loss because such losses are found only in nonbusiness situations; it is an abandonment loss. Id. § 1231.
98. Tax Reform Act of 1976. Pub. L. No. 94-455 § 212(b), 90 Stat. 1520 (1976) (amending I.R.C. § 1245(a)(4)). A drafting error appears in new subsection 1245(a)(4)(C), which reads: "(ii) the aggregate of the amounts treated as ordinary income by reason of this section with respect to prior dispositions of such player contracts acquired upon acquisition of the franchise." The reference to "prior dispositions" of the contracts on which recapture has occurred, taken literally, would mean that the section would apply to player contracts formerly disposed of by the franchise and then reacquired. Because this is not a likely situation, apparently some drafting error has occurred which probably will be cured by a technical amendments bill in the Ninety-fifth Congress. A measure to this effect is awaiting action by the House Committee on Ways and Means. H.R. 6715, 95th Cong., 1st Sess. (1977).
they will require far more extensive recordkeeping for professional sports teams than for most other industries. The new recapture rules alone will require every franchisee to maintain records of the amortization and casualty loss deductions taken on every contract ever held regardless of when the franchise was acquired. Because many sports franchises are held in excess of twenty years, particularly baseball franchises, this can amount to a significant accounting and bookkeeping burden.

Another question that should be raised about the provisions of the Tax Reform Act pertaining to taxation of sports franchises is why professional sports were singled out for this special treatment. Admittedly, no extensive factual examination produced a reason for treating sports differently and more strictly than other businesses, and the Treasury Department itself did not seek these restrictions. The only logical answer is that Congress was swayed by the prevalent opinion that professional sports teams were tax-sheltered investments. This opinion, however, can be disputed, and analysis of the actual operations of many sports teams shows that they are not primarily tax-oriented investments.

99. A memorandum submitted by the Commissioner of Baseball noted that the San Francisco Giants had been retained by the present owners for 57 years, the Chicago Cubs for 44 years, the Philadelphia Phillies for 33 years, the Los Angeles Dodgers for 26 years, the Pittsburgh Pirates for 26 years, the Minnesota Twins for 56 years, the Boston Red Sox for 42 years, and many other clubs for 14 or more years. Only 10 clubs of the 24 in the major leagues had been owned for less than 10 years. *Select Committee Hearings*, supra note 1, pt. 1, at 136.

100. See *Senate Finance Hearings*, supra note 10, pt. 2, at 89. The Secretary of the Treasury noted:

> These proposals are arbitrary since they apply only to sports franchises. Allocating the purchase price among the assets of a sport franchise is no different from allocating the purchase price among the assets of any other business. Applying special rules to sports franchises to deal with a problem that the Internal Revenue Service can handle adequately is not warranted. Further, the unique depreciation recapture rule goes far beyond the usual asset-by-asset recapture rules in the Code. Here, too, there is no apparent reason to isolate sports franchises for special treatment.

*See also Select Committee Hearings*, supra note 1, pt. 2, at 257-84.

101. See *Select Committee Hearings*, supra note 1, pt. 2, at 264-65. The Deputy Assistant Secretary of Treasury for Tax Policy, William M. Goldstein, stated:

> I think it [sports teams] can be marketed as such [tax shelters], particularly where a new franchise is being sold or where a new league is being started and the investors are encouraged, that although it may not work out financially at least they will get some tax benefits even if it doesn't work out. But as far as the new sports are concerned, whether it is lacrosse or soccer or tennis, it is just not a tax shelter to put up $100 and lose it all even if you are in the 70-percent bracket.

*Id.* at 264.
By viewing the new law's restrictions as an entirety, however, it is possible to speculate that they may lead to a diminution of the slight trend toward operating the franchise in a tax-advantageous manner, even to the point that the caliber of the sports show produced would be diminished. A reduction in transfers of franchises is likely because of the increase in amortization and casualty loss recapture and the inability of a new owner to allocate most of the consideration paid to player contracts. In turn, this should mean that franchises will remain in one place longer, contributing to the betterment of the sport and the enjoyment of the fans.

Coping with the Taxation of Sports Teams After 1976

The Tax Reform Act unquestionably has limited the tax advantages open to the professional sports franchise. Many of the changes in player contract provisions occurring after the drafting of the Tax Reform Act, however, appear to have created some offsetting tax benefits.

First, in the four major sports, the appropriate useful life for amortization purposes should drop significantly because of the new contract provisions and league rules. This should be offset somewhat by the continuing trend toward multi-year contracts. The multi-year contract will still permit total write-off when the athlete becomes injured but, if there is no injury, it may result in the athlete's remaining with a team beyond the period he would have stayed under the year-plus option contracts. Consequently, multi-year contracts should take useful lives in excess of those on one-year contracts. Because the basis for new contracts will be lower, the shorter life may result in an unchanged amortization deduction rate under the maximum allocation rule.

Second, some tax planning opportunities exist within the ambit of the new mandatory allocation rules for player contracts even in sports in which such contracts must be capitalized and amortized. For example, owners could split the rights contained in a professional sports franchise into separate identifiable assets, each with an ascertainable useful life. Although the television pooling agreement easily could be identified as such an asset, this would be of little help because it is normally viewed as an asset with an indefinite useful life and thus avoids amortization in much the same fashion as the franchise right itself. Local broadcasting agreements of a predecessor franchisee, however, easily could be subject to amortization if they are not shown to be renewed repeatedly with the
same party. Similarly, contracts for advertising or for concession percentages could be itemized and identified; such a process could give rise to a greater amortization deduction for franchise owners than if these contracts were included merely as part of the franchise right.

These techniques will require some experimentation, and the owners will bear the burden of proving that their factual interpretations are correct. The techniques do show that the professional sports team can retain some tax vitality in the future despite the Tax Reform Act of 1976 and, at least in part, because of the recent nontax changes in the world of professional sports.