

26 CFR 601.601: Rules and regulations

(Also Part 1, §§ 61, 165, 167, 197, 1001, 1011, 1012, 1231, 1245; 1.167(a)-3, 1.167(a)-8.)

Rev. Proc. 2019-18

## SECTION 1. PURPOSE

This revenue procedure provides a safe harbor for a professional sports team to treat certain personnel contracts and rights to draft players as having a zero value for determining gain or loss to be recognized for federal income tax purposes on the trade of a personnel contract or a draft pick that is within the scope of this revenue procedure.

## SECTION 2. BACKGROUND

### .01 Applicable law.

(1) Section 61(a)(3) of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including gains from dealings in property.

(2) Section 165(a) allows a deduction for any loss sustained during the taxable year that is not compensated for by insurance or otherwise. Under § 165(b), the basis for determining the amount of the deduction for any loss is the adjusted basis provided in § 1011.

(3) Section 167(a) allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business, or of property held for the production of income. Section 1.167(a)-3(a) of the Income Tax Regulations provides that 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 of time, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. However, see §§ 167(f), 197, 1.167(a)-14, and 1.197-2 for amortization of goodwill and certain other intangibles acquired after August 10, 1993.

(4) Section 1001(a) provides that gain from the sale or other disposition of property is the excess of the amount realized on the disposition over the adjusted basis provided in § 1011 for determining gain, and loss is the excess of the adjusted basis over the amount realized. Under § 1001(b), the amount realized from the sale or other disposition of property is the sum of any money received, plus the fair market value of the property (other than money) received, with certain adjustments. Section 1001(c) provides that except as otherwise provided, the entire amount of gain or loss determined on a sale or exchange of property is recognized.

(5) Section 1012 generally provides that the basis of property is the cost of such property, with certain exceptions.

(6) Section 1231 provides rules for determining whether gain or loss on sales or exchanges of property used in a trade or business is capital or ordinary.

(7) Section 1245(a)(1) generally provides that, upon the disposition of section 1245 property, the amount by which the lower of (A) the recomputed basis of the

property, or (B) the amount realized in the case of a sale, exchange, or involuntary conversion, or the fair market value of the property in the case of any other disposition, exceeds the adjusted basis of such property is treated as ordinary income. Such gain is recognized notwithstanding any other provision of Subtitle A of the Code.

.02 Trades of player contracts, staff-member contracts, and draft picks.

(1) Professional sports teams (teams) generally engage the services of players and staff members, such as managers and coaches, through the use of employment contracts that provide agreed upon compensation to the employed individual in return for future performance of specified services for a defined period of time, usually longer than one year (personnel contract). During the term of a personnel contract, the value of that contract may fluctuate based on a variety of factors, including player performance, the changing needs of the team, the changing needs of other teams, a player's effect on fan attendance, and the number of years until a player becomes a free agent and is able to sign a contract to play for any team in a league. Other considerations affecting the value of a player contract include the size of the team's market (whether a smaller city or a major urban population), the cost of player development, and the impact of injuries and slumps on player performance. Players may underperform or outperform the expectations of their teams, and the performance of other players on the team, or future prospects, may cause the team to develop a different view as to the value of the player and the contract. In addition to these unique factors, the market in which personnel contracts are traded is small and private. From time to time, teams trade one or more personnel contracts to other teams in exchange for one or more personnel contracts for the services of other personnel. Trades may

include the transfer of a right to draft players in the league's player draft (draft pick) or a cash payment. Some trades involve only draft picks.

(2) In general, a team does not agree to a trade of one personnel contract (or set of personnel contracts) or a draft pick (or set of draft picks) unless the team believes that it is receiving something of equal or greater value to what it is giving up in light of the team's circumstances and priorities at the time. The exact value that a team places on the future performance of services by the personnel it is receiving in a trade is highly subjective and may be influenced by the team's specific needs at the time rather than by whether the compensation provided for under the contract may be viewed as at market value, over market value, or under market value. In addition, for the reasons stated above, judgments as to whether the amount of compensation agreed to in the personnel contract is at, above, or below what a willing third-party would pay at a particular point in time to the personnel member for services to be performed in the future are highly subjective. Indeed, these judgments may fluctuate often depending on the performance of a player or staff member and the circumstances under which each individual team in a league is operating. The subjective needs of each team will differ for particular players at different points in time throughout a league's season and is highly dependent on the particular needs of each team. Financial considerations, including leagues rules and regulations, and the market in which a personnel contract may be traded may impact the valuation of a personnel contract. As a result, although each team may believe it is receiving something of equal or greater value to what it is giving up in a trade of personnel contracts or draft picks in light of its particular

circumstances and priorities at the time, it is unusually difficult to assign an objective monetary value to the personnel contracts or draft picks.

(3) In order to avoid highly subjective, complex, lengthy, and expensive disputes between professional sports teams and the IRS regarding the value of personnel contracts and draft picks for the purpose of determining the proper amount of gain or loss to be recognized for federal income tax purposes on the trade of one or more personnel contracts or draft picks, this revenue procedure provides a safe harbor permitting teams to treat the value of traded personnel contracts and draft picks as zero if certain conditions are satisfied.

### SECTION 3. SCOPE

This revenue procedure applies to trades of personnel contracts and draft picks by professional sports teams (trades) that meet all of the following requirements:

.01 All parties to trade must use safe harbor. The parties to the trade that are subject to federal income tax in the United States must treat the trade on their respective federal income tax returns consistent with this revenue procedure;

.02 Only personnel contracts, draft picks, and cash. Each team that is a party to the trade must transfer and receive a personnel contract or draft pick. In the trade, no team may transfer property other than a personnel contract, draft pick, or cash;

.03 No amortizable section 197 intangibles. In the trade, no personnel contract or draft pick may be an amortizable section 197 intangible; and

.04 Accounting treatment. The financial statements of teams that are parties to the trade must not reflect assets or liabilities resulting from the trade other than cash.

### SECTION 4. SAFE HARBOR

.01 In general. This revenue procedure provides a safe harbor for determining the amount of gain or loss to be recognized on a trade by a professional sports team of personnel contracts or draft picks. For a team making a trade of a personnel contract or draft pick within the scope of this revenue procedure, the value of the personnel contract or draft pick is treated as zero for purposes of this section 4.

.02 Application of safe harbor.

(1) No gain or loss on a trade. Except as provided in paragraph (5), below, for a professional sports team making a trade of a personnel contract or draft pick within the scope of this revenue procedure, because the contract value of each personnel contract or draft pick is treated as zero for purposes of this revenue procedure, no gain or loss is recognized on the trade for federal income tax purposes.

(2) Receipt of cash in a trade, computing amount realized. Under § 1001, a team receiving cash in a trade includes in amount realized the cash the team receives from another team in the trade. Under this revenue procedure, because the contract value of each personnel contract or draft pick is treated as zero for purposes of this revenue procedure, a team that does not receive cash in a trade has an amount realized of zero.

(3) Providing cash in a trade, computing basis. Under § 1012, a team providing cash to another team in a trade has a basis in the personnel contract or draft pick received equal to the cash the team provides in the trade. Under this revenue procedure, because the contract value of each personnel contract or draft pick is treated as zero for purposes of this revenue procedure, a team that provides no cash in the trade has a zero basis in the personnel contract or draft pick received in the trade.

(4) Providing cash in a trade for multiple personnel contracts or draft picks, allocating basis. A team providing cash to another team in a trade for two or more personnel contracts or draft picks must allocate its basis to each personnel contract or draft pick received from such team in the trade by dividing the basis by the number of personnel contracts or draft picks received from the team.

(5) Trades of personnel contracts or draft picks, determining gain or loss. Under §§ 1001 and 1.167(a)-8, a team making a trade of a personnel contract or draft pick recognizes gain to the extent of the excess of the amount realized under section 4.02(2), over the unrecovered basis (if any) of the personnel contract or draft pick traded, subject to the rules of §§ 1231 and 1245. Under §§ 1001, 165, and 1.167(a)-8, a team making a trade of a personnel contract or draft pick recognizes a loss to the extent of the excess of the unrecovered basis of the personnel contract or draft pick traded, over the amount realized under section 4.02(2), subject to the rules of § 1231. A team's unrecovered basis in a personnel contract or draft pick is the team's basis in such contract or draft pick as determined under § 167(c).

.03 Limited applicability. This revenue procedure applies only to trades of personnel contracts or draft picks among teams in professional sports leagues and has no application to transactions not described in this revenue procedure. In addition, this revenue procedure does not apply to trades of a team for another team or a sale of a team.

.04 No inference. No inference is intended with respect to the federal income tax treatment of transactions similar to, but outside the scope of, those described in this revenue procedure.

.05 Examination. Nothing in this revenue procedure precludes the examination and adjustment, if appropriate, of amounts reported in income in connection with trades of personnel contracts or draft picks in order to ensure that this revenue procedure is properly administered.

.06 Substantiation. Teams making trades to which this revenue procedure applies must retain books and records to substantiate that all requirements of section 3 of this revenue procedure have been met. Pursuant to § 6001, teams making trades to which this revenue procedure applies also must make available to the IRS, upon request, all documentation substantiating compliance with this revenue procedure.

## SECTION 5. EXAMPLES

The following examples illustrate the application of the safe harbor described in section 4 of this revenue procedure. Unless otherwise provided, the teams in the examples have a \$0 basis in the player contracts being traded. In addition, assume the requirements of section 3 of this revenue procedure are met, and the player contracts with signing bonuses were entered into on the first day of the applicable team's taxable year.

Example 1. Trade with no cash. In 2018, Team A trades Player Contract 1 to Team B for Player Contract 2. The teams apply the safe harbor in this revenue procedure. Under section 4.02(1), neither Team A nor Team B has an amount realized or gain on the trade because neither team received cash in the trade. Under section 4.02(3), Team A has a \$0 basis in Player Contract 2, and Team B has a \$0 basis in Player Contract 1.



Example 2. One team provides cash in the trade. The facts are the same as in Example 1, except Team A trades Player Contract 1 and \$10x to Team B for Player Contract 2. Under section 4.02(1), Team A has no amount realized or gain on the trade because Team A did not receive cash in the trade. Under section 4.02(2), Team B has a \$10x amount realized on the trade because Team B received \$10x from Team A in the trade. Under section 4.02(5), Team B must recognize \$10x of gain, the excess of Team B's \$10x amount realized over its \$0 basis in the Player Contract 2 it traded. Team B's \$10x gain is subject to the rules of §§ 1231 and 1245. Under section 4.02(3), Team A has a \$10x basis in Player Contract 2, the amount of cash Team A provided to Team B in the trade. Team A's \$10x basis is recovered through depreciation under § 1.167(a)-3(a) over the life of Player Contract 2. Under section 4.02(3), Team B has a \$0 basis in Player Contract 1 because Team B provided no cash to Team A in the trade.

Example 3. No cash in the trade, one team has an unrecovered basis. (i) In 2019, Team C signs Player 3 to a contract (Player Contract 3) for 5 years. Under the terms of Player Contract 3, Team C pays Player 3 a \$25x signing bonus in 2019. In each of 2019 and 2020, Team C takes a depreciation deduction under § 1.167(a)-3(a) of \$5x for the \$25x it paid to Player 3. In 2021, Team C trades Player Contract 3 to Team D for Player Contract 4, and the teams apply the safe harbor in this revenue procedure.

(ii) Under section 4.02(1), neither Team C nor Team D has an amount realized or gain on the trade because neither team received cash in the trade. Because neither team provided cash in the trade, under section 4.02(3), each team has a \$0 basis in the contract it received in the trade. Under section 4.02(5), Team C may deduct in 2021 a

\$15x loss under §§ 165 and 1.167(a)-8, the excess of its unrecovered basis in Player Contract 3 over its amount realized of \$0. Team C's \$15x loss is subject to the rules of § 1231.

Example 4. One team provides cash and one team has an unrecovered basis.

The facts are the same as in Example 3, except Team D trades Player Contract 4 and \$20x to Team C for Player Contract 3. Under section 4.02(2), Team C has a \$20x amount realized on the trade because Team C received \$20x from Team D in the trade. Under section 4.02(1), Team D has no amount realized or gain on the trade because Team D did not receive cash in the trade. Under section 4.02(5), Team C must recognize \$5x of gain, the excess of Team C's \$20x amount realized over its \$15x basis in the Player Contract 3 it traded. Team C's \$5x gain is subject to the rules of §§ 1231 and 1245. Under section 4.02(3), Team C has a \$0 basis in Player Contract 4 because Team C provided no cash to Team D in the trade. Under section 4.02(3), Team D has a \$20x basis in Player Contract 3, the amount of cash Team D provided to Team C in the trade. Team D's \$20x basis is recovered through depreciation under § 1.167(a)-3(a) over the life of Player Contract 3.

Example 5. Allocation of basis among multiple contracts. (i) In 2019, Team E trades Player Contract 5 and \$30x to Team F for Player Contract 6, Player Contract 7, and Player Contract 8. The teams apply the safe harbor in this revenue procedure.

(ii) Under section 4.02(1), Team E has no amount realized or gain on the trade because Team E did not receive cash in the trade. Under section 4.02(3), Team E has a \$30x basis in Player Contract 6, Player Contract 7, and Player Contract 8, collectively. Under section 4.02(4), Team E has a basis of \$10x in Player Contract 6, \$10x in Player

Contract 7, and \$10x in Player Contract 8 because Team E allocates the \$30x cash provided to Team F in the trade by dividing the basis equally among the three player contracts received in the trade. Team E's \$10x basis of each player contract is recovered through depreciation under § 1.167(a)-3(a) over the life of the respective player contract.

(iii) Under section 4.02(2), Team F has a \$30x amount realized on the trade because Team F received \$30x from Team E in the trade. Under section 4.02(5), Team F must recognize \$30x of gain, the excess of Team F's \$30x amount realized over its \$0 basis in the Player Contract 5 it traded. Team F's \$30x gain is subject to the rules of §§ 1231 and 1245. Under section 4.02(3), Team F has a \$0 basis in Player Contract 5 because Team F provided no cash to Team E in the trade.

#### SECTION 6. EFFECTIVE DATE

This revenue procedure is effective only for agreements involving trades of personnel contracts or draft picks entered into by a professional sports team after April 10, 2019. However, a team may choose to apply this revenue procedure in any open taxable year.

#### SECTION 6. DRAFTING INFORMATION

The principal authors of this revenue procedure are Edward C. Schwartz, Suzanne R. Sinno, and Stephen J. Toomey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding the revenue procedure, contact Mr. Schwartz at (202) 317-7006, or Ms. Sinno or Mr. Toomey at (202) 317-4718 (not toll-free numbers).