

Office of Chief Counsel
Internal Revenue Service
Memorandum

Release Number: **20133901F**

Release Date: 9/27/2013

CC:LB&I:

POSTF-112954-13

date: August 26, 2013

to:

Revenue Agent
(Large Business & International)

from:

Attorney
(Large Business & International)

subject:

- Amortization of Player Contracts

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our view.

This memorandum is in response to your request for our assistance in determining the proper period over which the taxpayer must amortize the bonuses paid to its players when they entered into a contract with the taxpayer.

ISSUE

Whether _____ (“Taxpayer”) is entitled to amortize signing bonuses paid to its minor league players over a period of years less than the seven-year term of the player’s contract?

CONCLUSION

No. The signing bonus should be amortized over the useful life of the player’s contract, which is the seven-year term of the player’s contract.

FACTS

Taxpayer operates a professional baseball team under a franchise granted by _____. Taxpayer is affiliated with several minor league baseball teams. Two of those teams, _____ and _____, are

included on Taxpayer's tax return. The other affiliates are separate legal entities not owned by Taxpayer. However, Taxpayer operates under an agreement whereby it incurs and pays the payroll expense and certain operating costs as defined under Major League Baseball rules for all of its affiliates.

When a player signs a contract to play for one of Taxpayer's teams, a signing bonus may be paid. These signing bonuses can range from _____ to _____ dollars. Taxpayer capitalizes and amortizes the signing bonuses of its major league players over the life of the players' contracts. Taxpayer capitalizes and amortizes the signing bonuses of the players that sign with the minor league teams over a _____ year life. Taxpayer chose to use a _____ year life based on the average of the actual life of the contracts disposed of during the years under examination.

A Disposal Report furnished by Taxpayer shows that the average life of the minor league contracts disposed of during its _____ tax year was _____ years. The number of years in service for those contracts ranged from _____ years through _____ years. A second Disposal Report furnished by Taxpayer shows that the average life of the minor league contracts disposed of during its _____ tax year was _____ years. The number of years in service for those contracts ranged from _____ to _____ years. In Taxpayer's _____ and _____ tax years combined, the average life of the disposed minor league contracts was _____ years.

The players that agreed to play for Taxpayer's minor league teams signed the Minor League Uniform Player Contract, Article IV of which provides that the player is required to provide services to the team for seven separate championship playing seasons. Unless the player contract is terminated under Article XIX, the agreement continues until the player has played for Taxpayer for seven championship seasons. Under Article XIX, the player can apply to the Commissioner of Major League Baseball to have the contract terminated only if Taxpayer is in arrears to the player for any payments due for more than fifteen days or if Taxpayer fails to perform any other obligations required of it for more than fifteen days. The Commissioner will only terminate the agreement if Taxpayer fails to remedy the situation by a fixed date. Taxpayer may terminate the player contract by written notice if the player at any time shall:

1. Fail, refuse or neglect to conform Player's personal conduct to high standards of good citizenship and good sportsmanship;
2. Fail, refuse or neglect to keep himself in first-class physical condition;
3. Fail, refuse or neglect to obey Club's requirements respecting Player's conduct and service;
4. Fail in the judgment of Club to exhibit sufficient skill or competitive ability to qualify or to continue as a professional baseball player as a member of Club's teams; or
5. Fail, refuse or neglect to render Player's services hereunder, or in any other manner to materially breach this Minor League Uniform Player Contract.

Minor League Uniform Player Contract, Art. XIX, Sec. B. Taxpayer may also terminate the player's contract if the player becomes disabled. After the player has completed seven championship seasons for Taxpayer, the player becomes a minor league free agent. Major League Rules 55(a).

LAW AND ANALYSIS

I.R.C. § 167 defines depreciable property as property used in a trade or business or held for the production of income, and may include intangible property. An intangible asset may be the subject of a depreciation allowance if it 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. Treas. Reg. § 1.167(a)-3(a). A baseball player contract is intangible property eligible for amortization under I.R.C. § 167(a). Selig v. United States, 565 F. Supp. 524, 542 (E.D. Wis. 1983); Rev. Rul. 67-379, 1967-2 C.B. 127. A signing bonus paid to a player is required to be capitalized and amortized over the useful life of the player's contract. Rev. Rul. 67-379.

Under Treas. Reg. § 1.167(a)-1(b), "the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of income." The useful life of an asset should be determined "by reference to [the taxpayer's] experience with similar property taking into account present conditions and probable future developments." Treas. Reg. § 1.167(a)-1(b). The useful life for a baseball player's contract generally is the period over which the team controls the player's ability to sign a contract with another team. See Rev. Rul. 67-379. Under Treas. Reg. § 1.167(a)-14(c)(1)(ii), the cost or other basis of a taxpayer's right to receive an unspecified amount of tangible property or services over a fixed period is amortizable ratably over the period of the right.

In this instance, Taxpayer and each player enter into a Minor League Uniform Player Contract. Generally, this contract binds the player to the organization for a term of seven years. At the end of this seven year term, if the player has not entered into another contract with the same team, he becomes a free agent. Major League Rule 55(a). It is at this point that Taxpayer no longer controls the player. Thus, because Taxpayer controls the player for the term of the contract, the useful life of the player contract is that term, seven years. Additionally, the player bonus is amortizable over the seven-year right of Taxpayer to receive services from the player.

Taxpayer's situation is different than the taxpayer's situation in Rodeway Inns of America v. Commissioner, 63 T.C. 414 (1974), acq., 1975-2 C.B. 1. In Rodeway Inns, the taxpayer, Rodeway Inns, was in the business of operating a chain of motor hotels. On July 1, 1964, in order to develop the chain, Rodeway Inns entered into a territorial agreement with RIS, giving RIS the exclusive right to construct or cause to be

constructed Rodeway Inns hotels within a specific area. Under the agreement, RIS would obtain sites approved by Rodeway Inns for the construction of the motor hotels, and would construct the motor hotels at those sites. The territorial agreement was to expire on June 30, 1966, unless the agreement had already been terminated or renewed. RIS could cancel the agreement at any time by giving 90 days written notice to Rodeway Inns. If RIS failed to perform under the agreement, Rodeway Inns could cancel the agreement after giving 90 days written notice to RIS. RIS was given options to renew the agreement at 2-year intervals, and the agreement could be extended until July 1, 1994. On August 30, 1968, shortly after RIS had exercised its option to renew for a second time (for the period July 1, 1968 through June 30, 1970), the parties entered into a cancellation agreement. Rodeway Inns paid \$100,000 to RIS and gave it the option to purchase shares in consideration for the cancellation agreement. Rodeway Inns chose to cancel the agreement because it determined that RIS was not developing the territory fast enough for Rodeway Inns to maintain its competitive position. Other motel chains were also quickly expanding, and choice locations in RIS's territory were rapidly disappearing. At the time the territory agreement was cancelled, it appeared that the choice hotel sites in RIS's territory would be taken within the next five years. Rodeway Inns deducted the \$100,000 payment it made to cancel the agreement on its 1968 tax return. The Court determined that the amount was a capital expenditure that could be amortized over the remaining useful life of the territory agreement. The Service argued that the useful life of the agreement should extend for the entire period that it could be renewed, through July 1, 1994. Rodeway Inns, on the other hand, first argued that the useful life should only be 22 months, the period until the agreement was next subject to renewal. The Court determined that neither of these periods represented the useful life of the territory agreement. Instead, it stated that it "must determine how long the agreement would have been useful to Rodeway, had it not been canceled." Rodeway Inns, 63 T.C. at 422. The Court found that the useful life of the agreement was the period following the cancellation of the agreement until all the desirable locations in the area would likely be taken, approximately five years.

In this situation, to determine the useful life of a player contract under the reasoning of Rodeway Inns, we "must determine how long the agreement would have been useful to [Taxpayer], had it not been canceled." Rodeway Inns, 63 T.C. at 422. In Rodeway Inns, RIS could terminate the agreement at any time it wished and Rodeway Inns was the party that lacked control over the situation. Additionally, the initial term of the territory agreement had already passed and the parties were continuing the agreement under its second renewal. The parties could continue to renew the agreement for as long as it thought the agreement would be beneficial, but no later than July 1, 1994. Once RIS no longer thought the agreement to be profitable, it would likely not exercise its option to renew and the agreement would no longer be useful to Rodeway Inns. Rodeway Inns presented evidence that this would likely happen five years after the agreement was cancelled. Conversely, in the situation here, Taxpayer has control over the player until the player has played seven championship seasons with Taxpayer (generally, a term of seven years). The player cannot unilaterally terminate the contract with Taxpayer—even if the player opts to not play for Taxpayer,

he cannot play with another team until he is released by Taxpayer or finishes playing the required seven championship seasons for Taxpayer. The player cannot choose to play for a different team after entering into a contract with Taxpayer. Although a player contract may be terminated if a player signs a major league contract or if the player is released or traded by Taxpayer, under Rodeway Inns, the useful life is determined by how long the player contract would have been useful to Taxpayer if the contract was not terminated. It appears that if the player contract is not terminated, then it is useful to Taxpayer for the seven-year term of the contract because during that time, Taxpayer has control over the player and the player is prevented from playing for a competitor of Taxpayer. Thus, the useful life of the player contract is seven years.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call _____ if you have further questions.

Associate Area Counsel
(Large Business & International)

By: _____

Attorney
(Large Business & International)