INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-169084-01/CC:PSI:B6

Director, Field Operations,

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Year Involved:
Date of Conference:

LEGEND:

Taxpayer :

Team A :

B :

C :

D :

E :

F :

G :

H :

j% :

k% :

L :

M :

N :

p% :

r% :

Agreement Z :

Date 1 :

Date 2 :

Date 3 :

Date 4 :

Date 5 :

Date 6 :

Date 7 :

Date 8 :

Date 9 :

Date 10 :

ISSUES:

(1) Whether E's Transferred Broadcast Rights (constituting a j% undivided interest in broadcast rights of Team A) acquired by Taxpayer are amortizable under § 197 of the Internal Revenue Code?

(2) If the Transferred Broadcast Rights are excluded from § 197, are they, or any part of them, amortizable under § 167?

CONCLUSION:

1. E's Transferred Broadcast Rights acquired by Taxpayer were acquired in connection with Team A. The Transferred Broadcast Rights are excluded from amortization under § 197 pursuant to the explicit language of § 197(e)(6).

2. With the purchase of Transferred Broadcast Rights, Taxpayer acquired participation in certain media rights, including the current broadcast contract with F. While this current broadcast contract covers a distinct, ascertainable period ending on Date 4, the asset represented by this contract is inclusive in Taxpayer's right to broadcast revenue. These rights to broadcast revenues, or media rights, do not have a limited useful life and are not wasting assets. Individual contracts themselves are merely links in a continuous, indefinite chain of media-related income. While the term of a particular contract will expire, it will be either renewed with the current broadcaster or replaced with a contract with a competing broadcaster. The revenue flow will continue and Taxpayer's right to share in or receive that revenue will continue, unaffected by changes in the contract or parties to the contract. The asset, the right to broadcast revenue, is inherent in the underlying franchise and has no determinable expiration. Therefore, these rights are not depreciable under § 167.

FACTS:

Team A is a professional sports team and a member of B. On Date1, C, the owner of Team A, assigned a j% undivided interest in all local broadcast rights of Team A's games ("Transferred Broadcast Rights") to D, a partner in C. C retained k% undivided interest in all local broadcast rights of Team A ("Retained Broadcast Rights"). D subsequently assigned these rights and obligations to E, an entity owned by D. The interests in the Transferred Broadcast Rights held by E and the Retained Broadcast Rights held by C were subject to an existing term agreement with F for the broadcast of select Team A games on cable.

About Date 2, G acquired Team A, along with the Retained Broadcast Rights. On Date 3, F exercised its rights under its then existing Pay TV Rights Agreement with G and E to extend the term to Date 4.

On Date 5, H executed a Memorandum of Understanding ("MOU") with E and other entities owned by D. H, a partnership, was owned by p% by entities directly or indirectly owned by L and r% by entities owned by M. Under the MOU, H had the right to acquire E's Transferred Broadcast Rights. On Date 6, N was formed to acquire Team A from G. Negotiations for this purchase had commenced with H, N's predecessor in interest. On Date 7, G sold Team A, along with its Retained Broadcast Rights, to N.

On Date 8, N (as successor of H) and E, executed Agreement Z. Pursuant to this Agreement Z, E agreed to sell to N all of E's TV rights associated with Team A, which included the Transferred Broadcast Rights, an interest in the F Pay TV Rights Agreement, and an interest in the Local TV Rights Agreement. The latter agreement called for D and E to use their best efforts to cause F, or its successor in interest, or some other entity, to enter into new broadcasting agreements. Agreement Z specified

a purchase price and a scheduled closing of Date 9. Agreement Z states, in part, "...it would be of great benefit to N to be able to unify the E TV Rights with the Remaining Rights; that N has derived substantial tangible and intangible benefits, including but not limited to, its ability to promote and market N to the general public by use of the Remaining Rights in cooperation with E and use of the E TV Rights."

On Date 10, however, E executed an assignment of the Transferred Broadcast Rights, and other rights specified in Agreement Z, to Taxpayer. Thus, E sold to Taxpayer the same broadcast rights that were subject to Agreement Z of Date 8 between N and E. At the time of the assignment, Taxpayer was indirectly wholly owned by L. Taxpayer has provided a number of business and financial reasons, unrelated to taxation, as to why the transferee of the Transferred Broadcast Rights was changed from N to Taxpayer.

LAW AND ANALYSIS:

Sections 167 and 197 provide the rules for depreciation or amortization of intangible assets. Section 197 provides for a 15-year amortization period and generally applies to a broad range of purchased intangible assets. Section 197 is effective for intangibles acquired after August 10, 1993. Section 167 provides for depreciation of intangible assets not covered by, or specifically excluded from, § 197.

Section 197(c)(1) provides that the term "amortizable section 197 intangible" generally means any section 197 intangible which is acquired by the taxpayer after {August 10, 1993}, and which is held in connection with the conduct of a trade or business or an activity described in section 212. The term "section 197 intangible" is defined in § 197(d)(1) as including (in part) the following intangible items: business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers); any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item; any customer-based intangible; any supplier-based intangible; and any other similar item; any franchise, trademark, or trade name. The term "customer-based intangible" is defined in § 197(d)(2)(A) as meaning - composition of market, market share, and any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.

Section 197(e)(6) provides that the term "section 197 intangible" shall not include a franchise to engage in professional sports, and any item acquired in connection with such a franchise.

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. The property must be an intrinsically wasting asset, <u>Griswold v.</u>

Commissioner, 400 F.2d 427, 433 (5th Cir. 1968), however, its useful life is not necessarily the useful life inherent in the asset but it is the period over which the asset may reasonably be expected to be useful in the taxpayer's trade or business. See § 1.167(a)-1(b) of the Income Tax Regulations. The term "property" includes intangible assets, and § 1.167(a)-3 provides that where an intangible asset is known from experience or other factors to be of use in the business for only a limited time, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation deduction. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life.

Application of § 197

Two months prior to the acquisition of Team A by N, H, the predecessor of N, entered into a MOU with E to purchase the Transferred Broadcast Rights. Eight months after N acquired the Team A from G, N executed Agreement Z with E for the purchase of E's Transferred Broadcast Rights. Notwithstanding Agreement Z, E sold the Transferred Broadcast Rights to Taxpayer. Taxpayer asserts that G, the seller of Team A along with the Retained Broadcast Rights, was a different, unrelated party to E, the seller of the Transferred Broadcast Rights, that the transactions occurred at different times, and that only one of the two owners of N (L) was also the owner of Taxpayer. In addition, there were valid business reasons for Taxpayer to purchase the Transferred Broadcast Rights rather than N. Taxpayer argues that the § 197(e)(6) should apply only to the acquisition of intangibles concurrent with the acquisition of a sports franchise by the same parties.

However, § 197(e)(6), excludes from a section 197 intangible, any intangible "acquired in connection with such a franchise." The phrase "in connection with" is a significantly broader inclusion than "acquired with the acquisition of a sports franchise". See, for example, Snow v. Commissioner, 416 U.S. 500 (1974). There need only to be a nexus between the intangible acquired and the professional sports franchise for exclusion from § 197 to apply. The Transferred Broadcast Rights and the sports franchise need not be acquired simultaneously for the exclusion provisions of § 197(e)(6) to apply. Where the language of a statute is clear, the courts will look no further in deciding its meaning. Sullivan v. Stroop, 496 U.S. 478, 482 (1990); Palay & Sons Inc. v. Commissioner, 114 T.C. 473 (2000); Roundtree Cotton v. Commissioner, 113 T.C. 422 (1999).

In this case, the language of the statute, "in connection with" is clear. "Connection" means, as appropriate here, "a relationship or association in thought (as of...mutual dependence or involvement.)" Webster's Third New International Dictionary, 481 (16th ed. 1971). Here, the Transferred Broadcast Rights are dependent on the existence of the sports franchise. As such, the Transferred Broadcast Rights was an

item acquired in connection with the sports franchise and is therefore excluded from § 197 amortization under § 197(e)(6).

Even if § 197(e)(6) were read more narrowly to require related acquisitions of the Transferred Broadcast Rights and the sports franchise, the results would be the same in this case. The same buying party was involved in the negotiations during the same time period to acquire both Team A and the Transferred Broadcast Rights. The delay between the closings of the two acquisitions was contemplated by the buying party. The valid business reasons for different buyers of Team A and the Transferred Broadcast Rights are not relevant for application of § 197. Consequently, in this case, the acquisition of the Transferred Broadcast Rights did in fact occur in connection with the acquisition of Team A, a sports franchise. Accordingly, the Transferred Broadcast Rights acquired by Taxpayer are excluded from treatment under § 197 pursuant to § 197(e)(6).

Application of § 167

The acquisition of Team A admits the purchaser into membership of B in which the sports team competes. Membership in B carries with it substantial and valuable rights. One of the most financially significant rights of a franchisee is media broadcast rights, including sharing in national broadcast revenue (if any) and ownership of local broadcast rights. These interests are a perpetual right that exists for as long as the franchise exists.

The owner of Team A, in conjunction with the owner of the Transferred Broadcast Rights, has the right to negotiate local broadcast contracts. The current contract to televise Team A's game with F has a term running until Date 4.

In order to qualify for the depreciation deduction under § 167(a), the taxpayer must establish that the intangible asset has an ascertainable value separate and distinct from goodwill, and has a limited useful life, the duration of which can be ascertained with reasonable accuracy. Houston Chronicle Publishing Co. v. U.S., 481 F.2d 1240, 1250 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974). In Newark Morning Ledger Co. v. U.S., 507 U.S. 546 (1993), the Court held an intangible asset that would otherwise fall within the concept of goodwill is depreciable provided it has an ascertainable value and a limited useful life that can be determined with reasonable accuracy. In order to determine whether the intangible assets at issue herein satisfy this test, one must determine whether these properly identified intangibles have an ascertainable value and a limited useful life.

Taxpayer argues that Newark Morning Ledger renders the older case law obsolete. The resolution of this issue turns on what is the asset: either the Broadcast Rights in general (meaning the Transferred Broadcast Rights plus the Retained Broadcast Rights), or a combination of the current Pay TV contract with a stated life

plus the continuing Broadcast Rights.

In contrast with other types of customer-based or supplier-based contracts, the rights and interest in underlying contracts acquired by Taxpayer are dependent only upon Team A's membership and participation in B. The only qualification of Taxpayer's right to share in the income from the Pay TV contract is Team A's continued membership in B. This membership could cease only upon the elimination of Team A as a member club, or, alternatively, the demise of B as an organization.

Under the terms of the broadcast agreement then in place, the contract is not automatically renewable. However, past practice within the industry shows these media contracts are always renewed, whether with the then current contracting network or with a competitor. See generally, United States Football League v. National Football League, 842 F.2d 1335 (2nd Cir. 1988). The life of an asset can not be limited by the remote, speculative possibility that renewal of a contract might not occur. Richmond Television Corp. v. U.S., 354 F.2d 410, 412 (4th Cir. 1965).

Rather than merely acquiring an interest in an existing contract, Taxpayer acquired certain media rights. While the current contract covers a certain distinct, ascertainable period, the asset represented by this contract, the Taxpayer's right to broadcast revenue, does not have a limited useful life and can not be considered a wasting asset. The right to contract for the local broadcast of games is a right inherent in the franchise. Therefore, these rights have an indeterminate useful life, coextensive with the life of the franchise itself.

National media rights valuation and amortization were addressed in E. Cody Laird v. U.S., 556 F.2d 1224 (5th Cir. 1977), cert. denied, 434 U.S. 1014 (1978). The Court found that the taxpayer's television rights were to last as long as the Atlanta Falcons remained a member of the NFL. While the existing contract provided a measure of the taxpayer's television rights over a specific period of time, those rights were to continue indefinitely. Accordingly, the television rights were found to have an indeterminate useful life and could not be amortized. In First Northwest Industries v. Commissioner, 70 T.C. 817 (1978), rev'd and remanded on other grds., 649 F.2d 707 (9th Cir. 1981), the Court addressed a National Basketball Association team's right to share in revenues from national television broadcast of NBA games. The Court held there was reasonable expectation that the NBA would continue to have a favorable national television contract and, since such rights could continue indefinitely, they were not amortizable. The Court found that the rights under the then current television contract were only a link in a continuing chain of national television income. These rights would last as long as the team held an NBA franchise and the source of the rights was the NBA membership. The contract only provided a measure of value for the acquired rights to the NBA television revenue. Such rights continued indefinitely, and therefore, could not be

amortized.

The case of McCarthy v. U.S., 807 F.2d 1306 (6th Cir. 1986), aff'g in part and vacated in part, remanded, 622 F.Supp. 595 (N.D. Ohio, 1985), also dealt with the amortization of broadcast rights acquired in the purchase of a sports franchise, a professional baseball team. Both national and local broadcast contracts were acquired, and the taxpayer attempted to characterize the broadcast rights acquired (as is the case herein) as being comprised of two components: the current broadcasting contracts existing at the time of the purchase, and the future broadcasting rights inherent in the franchise which had yet to be contracted for. The taxpayer argued that the current rights had a limited useful life represented by the unexpired term of the existing contracts, and had ascertainable values, and thus met the test of Houston Chronicle, supra, and was subject to amortization. The Court reached the opposite conclusion. It found the rights did not have a limited useful life which could be ascertained with reasonable accuracy and, therefore, could not be amortized as wasting assets. Both national and local broadcast contracts were found to be links in a perpetual chain of broadcasting revenues. As long as the team remained a major league baseball franchise, the club would have the rights to share in the revenues produced by the national contract. Upon expiration of each contract, a new contract providing for further revenues would be executed. Although the then current broadcast contract covered a distinct ascertainable period, the asset represented by the contract, each franchise's national broadcasting rights, did not have a limited useful life and, therefore, could not be considered a wasting asset. The same was found to hold true for local broadcast contracts. The team's right to contract for local broadcast of games was a right inherent in the franchise and had a indeterminate useful life coextensive with the life of the franchise. The right to broadcast games locally and nationally was still extremely valuable to the franchise at the expiration of the current contracts. While the franchise will certainly become a party to a new broadcasting contract at the expiration of each preceding contract, it does not do so in order to reacquire an asset; rather it does so in order to obtain revenues from an existing asset.

Applying the McCarthy Court's analysis to the facts of this case, the outcome is the same. The current local broadcast contract is a link in a continuing chain of broadcast revenues of indeterminate duration that Taxpayer is entitled to share in revenues as long as Team A is a member of B. The term of a particular contract will expire and a new contract entered into with either the same broadcaster or a competitor. The revenues flowing from a contract would continue; the asset, the media rights, never expires.

In Newark Morning Ledger Co., supra, the Supreme Court dealt with the identification, valuation, and depreciability of intangible assets. The Court held that an intangible asset that would otherwise fall within the concept of goodwill is still

depreciable, provided it has an ascertainable value and a limited useful life that can be determined with reasonable accuracy. However, this holding does not alter our determination that the assets acquired by Taxpayer is not a individual contract, but are the media rights which do not have a limited useful life, and therefore are not depreciable. In Newark, the taxpayer acquired groupings of paid subscribers to its various newspapers, valuing the subscribers based on the estimate of future profit to be derived from the continuation of subscriptions into the future, and depreciating this value over the expected remaining life of current subscriptions. The government argued that the valuation of the subscriptions represented the continuation of customer patronage, a core definition of non-depreciable goodwill. The Court held that an allowance for depreciation is permissible where the intangible has an ascertainable value separate and distinct from goodwill and has a measurable, limited useful life. "The significant question for the purposes of depreciation is not whether the asset falls 'within the core of the concept of goodwill' but whether it is capable of being valued and whether that value diminishes over time." 507 U.S. at 566.

Here a clear distinction can be drawn between the customer-based intangibles in Newark Morning Ledger, the subscriptions, and the intangible here, the media rights. The at-will subscribers in Newark were of a finite number that would waste, and not self-regenerate. One customer might be replaced with another, but the replacement would not self-regenerate, and would be a different customer, unrelated to the subscriber list. In the situation at issue here, a new contract would replace the current contract, for the same media right, but for a subsequent time period. And the user of this media right (the broadcaster) is not the source of the asset being valued. The source is the right to receive the local broadcast revenue, from whatever broadcaster, and this right is based upon Team A's membership in B. The individual contract might end, but the right to broadcast and its derivative revenue, inherent in the franchise, would continue to exist and would still be valuable. The asset is singular in nature, and a contract to use the asset is replaced (or expected to be replaced) one for one as it expires. The media rights are thus self-regenerative. Therefore, the media rights are intangible assets with indefinite lives, and not subject to depreciation under § 167.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.