

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201545018**

Release Date: 11/6/2015

CC:PSI:B5:JAHolmes
POSTF-109368-15

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 199.00-00, 199.03-00, 199.03-02

date: July 17, 2015

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subject: Section 199 Chief Counsel Request on the Qualified Film Issue and Benefits and Burdens

This Chief Counsel Advice responds to your request for assistance dated March 18, 2015. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

League =

Years at Issue =

X =

Network =

Contract =

Amounts =

Y =

Z =

Game Package =

Broadcast Area =

Means of Distribution =

Month =

ISSUE

Whether Taxpayer's share of gross receipts from the Contract with Network qualify as domestic production gross receipts (DPGR) under § 199(c)(4)(A)(i)(II) of the Internal Revenue Code from the disposition of a qualified film produced by Taxpayer.

CONCLUSION

No. Taxpayer's share of gross receipts is non-DPGR.

FACTS

Background: This advice relates to the taxable Years at Issue. Taxpayer is one of the X teams in the League. Each team is a separately owned taxable entity. No partnerships were formed between any of the teams in the League related to the playing of individual games. League acts as agent on behalf of all teams. The League entered into a Contract with Network. This Contract is not a partnership agreement. In the Years at Issue under the Contract, Network paid Amounts to the League. Taxpayer received a 1/X share of these Amounts (minus any allocable fees to the League as agent).

Each team owns its own name, colors, logo, trademarks, and related intellectual property rights. Each team plays some pre-season games and Y regular season games, (total of Z games). Some teams go on to play in the play-offs and two teams play in the Championship. Each game is played between two teams at the home team's . The games are broadcast in specific geographic regions (with a defined home and away team's territory) on multiple networks (through their local affiliates and retransmitters as required pursuant to the mandatory carriage provisions in the Communications Act of 1934) according to a pre-determined schedule based on separate pre-arranged packaged agreements between the League and the multiple networks.

Rights Fees Background: Taxpayer and the other teams each own rights to broadcast the games. , the League teams choose to pool their individual broadcast rights (except for the rights to games) in order to assign and license the collective rights for national television broadcasting.

, Congress passed the Sports Broadcasting Act (Act). The "purpose of the proposed legislation is . . . to permit the League to sell the resulting package of pooled rights to a purchaser, such as a television network, without violating the antitrust laws." The Act provides that the relevant antitrust laws "shall not apply to any joint agreement by or among persons engaging in or conducting the organized professional team sports of football, baseball, basketball, or hockey, by which any League of clubs participating in professional, baseball, basketball, or hockey contests sells or otherwise transfers all or any part of the rights of such League's member clubs in the sponsored telecasting of the games of football, baseball, basketball, or hockey, as the case may be, engaged in or conducted by such clubs." 15 U.S.C. § 1291.

As a consequence, the League has partial monopoly power through this anti-trust exemption that allows the League to sell the pooled television rights of all X teams together as the sole source for League games. The League serves as agent in negotiating the contracts with all of the networks on behalf of all teams. Taxpayer is not a party to the broadcasting contracts and does not have the right to negotiate or

unilaterally modify or cancel the broadcast contracts. Although it had no input on the contracts, it did, however ratify all of the national contracts.

Over the years, the rights fees increased dramatically. Today they are revenue source for each team, including Taxpayer. In the Years at Issue, the League licensed certain television broadcasting to multiple networks, and the networks generated revenues from the purchased television broadcasting rights directly from selling advertising aired during live distribution of game broadcasts and indirectly from fees from the retransmitters.

Network and League Contract: There are multiple television broadcasting contracts with multiple networks, and all are similar. For simplicity, this advice request is based on the television agreement between Network and the League (Contract). The Contract grants to Network the right to produce a specific package of League game broadcasts (Game Package), and deliver the broadcasts live within a defined territory as provided in the Contract. Network broadcast of a League game is deemed to begin at the end of the last Network or local commercial or promotional pod or other station break prior to the start of the game () and to end at the start of the first commercial break following the end () of the game or the commencement of the next program if there is no commercial break (Game Broadcast).

The Contract's basic grant provides that the League, as agent and on behalf of the member teams, subject to the other terms and conditions in the Contract, grants to Network the non-transferable and (except as otherwise provided in the Contract) exclusive right to distribute, in or into the Broadcast Area, a single live broadcast of each game contained in the Game Package, solely by Means of Distribution on Network. Under the Contract the rights fee payment attributable to the Game Package is allocable (appropriately and in accordance with the value thereof) over all Game Broadcasts in such Game Package.

The grant of rights is subject to some general reservations and the League's reservation of re-sale rights re-broadcast and international rights in the Game Broadcasts produced by Network.

The Contract requires Network to "produce" a specified number of game broadcasts per week and sets "minimum production requirements." For example, Network is required to use no less than cameras and sources; broadcast games in stereo and digital format, and use certain video compression standards and encryption (among other things). Under the Contract, Network is obligated to produce a single broadcast, which "shall consist of a single composite signal in which audio commentary and customary graphics specifically relating to the League game that is the subject of the Game Broadcast are integrated with video images delivered from multiple Network camera locations to produce a single continuous Standard Television program." Network is required to "produce and deliver" to the League "program feed," "clean feed," and "audio feed" as provided in the Contract. Network is

obligated to deliver the live broadcast solely as provided in the Contract within a defined geographic location.

Under the Contract, Network is generally responsible for all domestic production costs for game broadcasts. For some games played outside the United States and Canada, Network is entitled to reimbursement of costs “incremental to typical domestic production costs for similar games.” Network is also entitled to a reduction in the rights fees payable to League for “out-of-pocket production costs in connection with the canceled Game Broadcasts,” as provided in the Contract.

The Contract allows Network to exploit each Game Broadcast for advertising revenue. Network and the League agree on the amount of commercial breaks, which are generally to for each Game Broadcast. If Network schedules too many commercials and some do not fit in the game time, those commercials are scheduled at Network’s risk. The League does not guarantee the availability of a certain number of breaks, and will not make room for breaks if all the advertising sold does not get shown. This includes the more important games.

The Contract contains a “League Control of Game” provision designed to prevent Network from unduly slowing the pace of the game when airing commercials. The provision provides that League controls the start of the game and commercial breaks by providing an League television (TV) coordinator (“”) who works directly with Network’s person (“”). and “work with game officials” “on the timing of each break and to allow the required amount of commercial time.”

Taxpayer has no individual liability requirements under the Contract. The League and Network are required to cross-indemnify each other for errors and omissions and both parties are required to provide proof of insurance for the indemnification. There is no separate corresponding obligation by Taxpayer or other teams.

League Constitution Revenue Provisions: The League Constitution includes a section stating that

A resolution provides a similar agreement between the teams in the League for playoff game revenue.

Broadcast Scheduling: The game matchups for the seasons during the Years at Issue were determined by the League, with input from Network with regards to scheduling, in Month following the conclusion of the previous season. This was after Contract was entered into. Once the schedule is finalized, Network determines which games it will broadcast in specific geographic areas. The Contract provides some guidance (e.g.,) but it is Network that makes the final decisions regarding the Game Broadcasts in its Game Package for broadcast in markets outside the local area.

Taxpayer's Activities: Taxpayer (and each League team) employs its own players and coaches and is responsible for compensating them for playing games. Each team is allowed to have players . Each team has its own staff, including: the front office staff (CEO, managers, directors, presidents, etc.), coaching staff (), strength and conditioning staff, and various assistants and sport specialists.

Taxpayer has arrangements covering construction and maintenance of the , and there are other various arrangements in place for public/ private partnership for building and maintenance of the other teams' . Some of the costs are separately incurred by each League team and some are equally shared by all X League teams, which are passed to the teams in the form of annual assessments.

Taxpayer plays in the games against the other League teams subject to many technical rules and regulations (See of the League applicable to Years at Issue). These rules almost exclusively regulate the game. There are a few provisions regulating the length of and the players' appearance and behavior while in the view of the and television audience.

Taxpayer has a public relations (PR) person who is assigned to assist Network. The PR person's primary role is to help make various team members and coaches available for interviews. Taxpayer typically only provides a PR person for home games.

The employment contracts for the highest compensated players state that The duties of the players under the contracts relate exclusively to activities – attending camps, offseason training, club meetings and practices, and of course playing pre-season, regular season and post-season games.

Some of the player contracts provide incentives for players to receive additional compensation such as annually increasing the _____ in which the player participates. There are provisions dealing with the use of a player's image whereby the players grant to the League and teams ". . . the right to use . . . (their) name(s) and photos for publicity and promotion of the League" for radio, TV, print news and other types of media.

Taxpayer generates revenue in multiple ways. On the team level, the revenue generated mainly consists of sale of _____ tickets to games, trademarked merchandise, and separate license of the television broadcasting rights for games. The revenue generated at the League level consists of marketing sponsorships, licensing merchandise, and the rights fees from license of the pooled television broadcasting rights.

The rights fees are the only revenue subject to this advice, which is generated at the League level and distributed to each League team on equal basis (1/X). Pursuant to the League Constitution, even if Taxpayer did not appear in a single televised game in a given season, it would still earn its proportionate share of the rights fee under the Contract.

Network's Activities: Network prepares for a Game Broadcast several days and perhaps weeks before the game is played. Network decides what geographic area will receive a particular game shown on its Network. This is an iterative process called "mapping," which usually takes more than a month.

In the _____ before a particular Game Broadcast, Network sends several broadcast vans (or production trucks) to the _____ where the game is scheduled to be played. The broadcast vans deliver Network's production equipment and also serve as the mobile remote broadcast television studios. Network leases the broadcast vans. The number of broadcast vans used at a game depends on the matchup for the game and the anticipated viewership. Network's broadcast vans have seating for the live broadcast production crew, producers, engineers, directors as well as monitors for shot selection, replay equipment, slow-motion replay equipment, video recorders for replays, audio mixers and quality control and transmission equipment. Once the broadcast vans are in place they connect to Network's approximately 20 fixed cameras with cables which are embedded within the _____. Once all of the set-up is completed, the equipment is tested by Network personnel to ensure that everything is operational.

On game day, two teams play a game. Generally, the teams' staff and coaches remain _____ observing and directing the action on the _____ while the _____ oversee the game to ensure adherence to all technical rules. As the game is played on the _____, the fixed video cameras and microphones pick up the signals from the _____ and transmit them via the cables into the broadcasting vans for shot selection, processing, recording and live transmission. In addition to the fixed cameras, camera men from Network are positioned throughout the _____ to video tape the action on

the _____ and _____. After each game Network breaks down its entire mobile broadcast operation removing all of Network's equipment and its broadcasting vans and trucks leave the _____ area.

Network staffs each game with approximately _____ employees. These employees are responsible for everything from setting-up and testing the equipment, to recording the game, producing the game feed, monitoring to broadcast, and then eventually tearing down the production equipment. Network employees include a director, who is responsible for calling out the camera shots, a technical director who controls the cameras, and a producer, who decides on whether and when to show replays, commercials, etc. The producer is in charge of the particular broadcast. Network also brings in support staff, graphics staff, audio staff, etc. About _____ network employees work inside the broadcasting trucks, the rest are at the _____.

All costs associated with the production of a game's television programming feed are borne solely by Network. This includes the broadcast vans, cameras (such as the _____), overhead cameras, and all other equipment. It also bears the cost of all on screen graphics, such as the _____ and other broadcasting graphic technology leased by Network from third party providers to enhance the broadcast. Neither the League nor the teams pay for or share the costs of these or any other video and audio recording expenses.

The sportscasters, commentators, announcers (collectively, "talent") for each game are employees of Network. Network assigns the talent for each live game production and broadcast based on ranking designed to match the best talent with the biggest games each week. The League has no control over the assignment of talent. The announcers provide color analysis, explanations, play-by-play and "storylines" while calling the game. While the League may provide the announcers with ideas for storylines, it has no role in what is broadcast live over the airways or how the talent calls a game. The League can request Network, at Network's discretion, to mention certain events, such as _____. Taxpayer and other teams are directed to make certain coaches and players available for interviews with Network and are required to provide Network access to the _____ and hallways outside of locker rooms for player access. Taxpayer has no say in this process.

To extent there is any interaction between Taxpayer's PR personnel and Network staff it ends once the game production and broadcast starts. There is no after-the-fact quality control meeting to critique the broadcast among Taxpayer, the League and Network on a game-by-game basis. League contact occasionally may occur while the broadcast is ongoing, but if contact occurs, it is more often after the broadcast and then typically only about any contractual issues encountered.

Network is responsible for selecting the live camera shots, replays, slow motion, and all other features of the broadcast. The broadcast crew, including the talent, is exclusively responsible for all descriptions and accounts of the game during the live broadcast.

Network maintains their own facilities to review and control the Game Broadcasts for quality control and creative programming aspects. Network also reviews each live Game Broadcast and prepares its own reports after the game. Network reports do not simply evaluate violations of contract provisions, as the League reports do. Instead they document what worked well and what did not work well, what freelance personnel should be rehired, and whether there were any equipment or other problems. These reports are prepared by Network for its own use and not provided to the League.

Network recoups the Amount paid for the rights to broadcast games in the Game Package, and the amount spent on their production costs related to the Game Broadcasts primarily through advertising revenues (from sold advertising spots aired during Network's live Game Broadcast). Network has the exclusive right to sell advertising spots for television advertising to be broadcast during the live broadcast of games in its Game Package. The contracts with advertisers state "as between Agency [the advertiser] and Network, the Programs shall be produced, performed, and broadcast under Network's sole direction and control." Program is defined as "everything contained in each broadcast...with the exception of commercial, billboard and promotional material." The League is not a party to these contracts, and does not review them. The advertisers require that certain performance requirements be met as a condition of the advertising contract. These include the number of viewers and the demographics of those viewers. If the audience level is not met for a Game Broadcast, Network provides substitute performance with advertising spots during similar programs. This eliminates the possibility of new paid advertising for those advertising spots, and results in a net revenue loss for Network.

Network paid Amounts (fixed fees) under the Contract for the Years at Issue (and over the life of the Contract) for the right to broadcast the games in the Game Package. These fees are not refunded if Network does not produce a Game Broadcast of a game played, if a game is rescheduled under some circumstances, if viewership of the Game Broadcasts is below expectations, whether advertising spots actually aired, or production costs related to the Game Broadcasts exceed expectations. Network is entitled to a reimbursement for canceled games, with the refund negotiated in good faith by the League and Network. The League seeks to avoid cancellations of games except in the most extraordinary of circumstances, and did not suffer a reduction in the rights fees during the Years at Issue.

League Activities: The League executed the Contract and performs required duties as agent for all X teams. The League collects all rights fees, along with other certain fees (), and deposits them into an "Agency Account." The Agency Account consists of several bank accounts the League administers in an agency or representative capacity. The largest bank account in terms of receipts from third parties is the TV account. After deducting various non-related fees, the League distributes the net proceeds in the Agency Account in equal shares (1/X) to Taxpayer and the other teams on monthly basis. The revenue and expense activity in the Agency

Account is reported to each team on a monthly basis and summarized in a “Memo” issued by the League. Network’s Amounts paid under the Contract during the Years at Issue were distributed in this manner.

When modern were designed, the League architects and the builders collaborated about the design for fixed camera placement for the best vantage point to show the action on the and to facilitate connecting cameras to technology. Beyond the fixed camera placement, the League does not oversee any other camera location so long as it does not interfere with game play. Neither the League nor Taxpayer has a role in directing camera shot selection for any actual game broadcast produced by a Network.

Prior to the start of a season, the League holds various routine meetings with Network that last about forty-five minutes. These are the only formal meetings between the League and Network. Taxpayer and other League teams do not participate in these meetings. There are no formal meetings between Network and the League and/or teams before the games.

Additionally, the League distributes to Network basic informational materials at each game site prior to the game. These documents include: Game Summary Sheet – which lists the players, and phonetically spells unusual names; and Media Information Packet, which provides various interesting facts, statistics, and a limited amount of information for each player on both teams.

The League prohibits certain limited advertising categories by providing a prohibited advertising list, which includes any promotion of . It also notifies Network of the official League sponsors for each year. These official League sponsors still have to sign separate contracts with Network in order to have advertisements aired on the Game Broadcast.

The League operates a “broadcasting department” which is charged with negotiating and monitoring compliance with the Contract and ensuring that all Game Broadcasts adhere to the terms in the Contract. The department consists of employees. The department also monitors that Network does not interfere with the games by monitoring and commercial break points. The League broadcasting department sends very few individuals to any on any given game day. For many games, it sends no employees. For very important games, the League may send up to employees. They oversee the game officials, and provide limited oversight over Network’s adherence to the terms of the Contract (mainly with respect to and commercial breaks as explained below).

The League centralized facility League screeners sit amongst a series of TV screens to review the Game Broadcasts produced by Network to ensure Network’s compliance with terms of the Contract. The role of screeners is to protect the integrity of the contractual arrangements and the associated relationships and to prevent instances of

exploitation. Screeners are expected to monitor network broadcasts of League games and verify that the networks abide by the rules and contractual terms while remaining compliant with League policy (especially in regards to advertising and sponsorship). The League screeners are given detailed instructions on the extent and scope of their review duties and options for remedy of noncompliance. They observe and chart, among other things: (a) the lengths of every ; (b) use of logos; (c) advertising content; and (d) on-air commentary. The League screeners make detailed summaries of any observed violation. After the game is played, the League provides feedback to Network on violations of provisions of the broadcast contracts it has determined to have occurred. These reports are not provided to Taxpayer. League and Network discuss the identified violations and decide on an appropriate remedy.

The League incurs expenses related to its duties under the Contract, but does not separately allocate them to Taxpayer or any League team. Total expenses incurred by the League broadcasting department to perform all tasks required by the broadcasting contracts were \$ for the one of the Years at Issue ().

Copyrights: Network has the exclusive rights for the live broadcasts of the games as transferred in the Contract. All remaining residual rights are assigned to or are retained by the League. The recording of a game is copyrightable property, not the game itself, or the right to broadcast the game live. The copyrights relate only to the rights to the recordings that are capable of retransmission or rebroadcast, all of which are assigned to or retained by the League under the teams of the Contract. These residual rights, which are the subject of the copyrights, do not include the live broadcast rights transferred to Network as part of the Contract.

The rights to the live Game Broadcast are the most valuable aspect of any television programming comprised of a Game Broadcast. Most of the revenue from distribution of Game Broadcasts is derived in the form of advertising revenue from commercials aired during the live broadcast and about 97% of TV sports programming is viewed live.

LAW

Under § 199(a), the § 199 deduction is determined by applying a percentage to the lesser of the taxpayer's qualified production activities income (QPAI) or taxable income (determined without regard to the § 199 deduction). The applicable percentage is 3 percent for taxable years beginning in 2005 and 2006, 6 percent for taxable years beginning in 2007 through 2009, and 9 percent for taxable years beginning after 2009.

Under § 199(c)(1), QPAI is determined by taking DPGR for the taxable year less cost of goods sold (CGS) allocable to such DPGR, less other expenses, losses, or deductions, which are properly allocable to such DPGR.

Section 199(c)(4)(A)(i) provides that DPGR means the gross receipts of the taxpayer that are derived from any lease, rental, license, sale, exchange, or other disposition of: (I) qualifying production property (QPP), which was manufactured, produced, grown or extracted (MPGE) by the taxpayer in whole or significant part within the United States; (II) any qualified film produced by the taxpayer; or (III) electricity, natural gas, or potable water produced by the taxpayer in the United States.

Section 199(c)(6) defines the term "qualified film" to mean any property described in § 168(f)(3) if not less than 50 percent of the total compensation relating to the production of such property is compensation for services performed in the United States by actors, production personnel, directors, and producers. Such term does not include property with respect to which records are required to be maintained under section 2257 of title 18, United States Code. A qualified film shall include any copyrights, trademarks, or other intangibles with respect to such film. The methods and means of distributing a qualified film shall not affect the availability of the deduction under this section.

Section 168(f)(3) property is any motion picture film or video tape.

Section 199(d)(10) provides the Secretary shall prescribe such regulations as are necessary to carry out the purposes of § 199, including regulations which prevent more than 1 taxpayer from being allowed a deduction under § 199 with respect to any activity described in § 199(c)(4)(A)(i).

Under § 1.199-3(d)(1) of the Income Tax Regulations, a taxpayer may use any reasonable method satisfactory to the Secretary based on all facts and circumstances to determine whether gross receipts qualify as DPGR on an item-by-item basis (and not, for example, on a division-by-division, product line-by-product line, or transaction-by-transaction basis).

Section 1.199-3(d)(1)(i) defines the "item" as the property offered by the taxpayer in the normal course of business of taxpayer's business for lease, rental, license, sale, exchange, or other disposition (collectively referred to as disposition) to customers, if the gross receipts from such property qualify as DPGR.

Section 1.199-3(d)(1)(ii) provides that, if § 1.199-3(d)(1)(i) does not apply to the property, then any component of such property described in § 1.199-3(d)(1)(i) is treated as the item, provided that the gross receipts that are attributable to the disposition of the component of such property qualify as DPGR. Each component that meets the requirements to be treated as the item must be treated as a separate item and may not be combined with a component that does not meet the requirements of § 1.199-3(d)(1)(ii).

Section 1.199-3(f)(1), in relevant part, provides that only one taxpayer may claim the deduction under § 1.199-1(a) with respect to any qualifying activity under § 1.199-3(k)(1) performed in connection with the production of a qualified film. If one taxpayer performs a qualifying activity under § 1.199-3(k)(1) pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the qualified film under Federal income tax principles during the period in which the qualifying activity occurs is treated as engaging in the qualifying activity.

Section 1.199-3(i)(1)(i) defines the term “derived from the lease, rental, license, sale, exchange, or other disposition” is, and is limited to, the gross receipts directly derived from the lease, rental, license, sale, exchange, or other disposition of a qualified film. Applicable Federal income tax principles apply to determine whether a transaction is, in substance, a lease, rental, license, sale, exchange, or other disposition, whether it is a service, or whether it is some combination thereof.

Section 1.199-3(k)(1) provides that the term “qualified film” means any motion picture film or video tape under § 168(f)(3), or live or delayed television programming (film), if not less than 50 percent of the total compensation relating to the production of such film is compensation for services performed in the United States by actors, production personnel, directors, and producers. For purposes of § 1.199-3(k), the term “actors” includes players, newscasters, or any other persons who are compensated for their performance or appearance in a film. For purposes of § 1.199-3(k), the term “production personnel” includes writers, choreographers and composers who are compensated for providing services during the production of the film, as well as casting agents, camera operators, set designers, lighting technicians, make-up artists, and other persons who are compensated for providing services that are directly related to the production of the film. Except as provided in § 1.199-3(k)(2), the definition of a qualified film does not include tangible personal property embodying the qualified film, such as DVDs or videocassettes.

Section 1.199-3(k)(3)(i) provides, in general, that DPGR include the gross receipts from any lease, rental, license, sale, exchange, or other disposition of any qualified film produced by such taxpayer.

Section 1.199-3(k)(3)(ii) provides, in relevant part, that because a taxpayer that merely writes a screenplay or other similar material is not considered to have produced a

qualified film under § 1.199-3(k)(1), the amounts that the taxpayer receives from the sale of the script or screenplay, even if the script is developed into a qualified film, are not gross receipts derived from a qualified film.

Section 1.199-3(k)(5) provides the not-less-than-50-percent-of-the-total-compensation requirement under § 1.199-3(k)(1) is calculated using a fraction. The numerator of the fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. A taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, including all historic information available, to determine compensation for services performed in the United States and the total compensation for services regardless of where the production activities are performed. Among the factors to be considered in determining whether a taxpayer's method of allocating compensation is reasonable is whether the taxpayer uses that method consistently from one taxable year to another.

Section 1.199-3(k)(8), in relevant part, provides that only one taxpayer may claim the deduction under § 1.199-1(a) with respect to any activity related to the production of a qualified film performed in connection with the same qualified film. If one taxpayer performs a production activity pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the qualified film under Federal income tax principles during the period in which the production activity occurs is treated as engaging in the production activity.

ANALYSIS

To answer LB&I's request, our Office's analysis must address a number of § 199 requirements. Our analysis is limited to the Contract with Network for the Years at Issue. Our analysis assumes that Taxpayer's gross receipts are derived in its capacity as an individual taxpayer, and not as a partner in a partnership. Also, that the League acts as an agent for Taxpayer, and the other teams in the League.

To qualify as DPGR, Taxpayer's gross receipts from the Contract with Network must be directly derived from the disposition of a qualified film, and that qualified film must be treated as produced by Taxpayer.

What is the property offered in the normal course of business and what are the gross receipts attributable to such property?

Under § 1.199-3(d)(1), Taxpayer is required to determine whether gross receipts qualify as DPGR on an item-by-item basis. Section 1.199-3(d)(1)(i) defines "item" as the property offered by the taxpayer in the normal course of the taxpayer's business for disposition to customers, if such gross receipts qualify as DPGR.

In this case, our Office must first determine the property that Taxpayer offered in the normal course of business for disposition to customers. For the Years at Issue, the facts show the League, on behalf of all teams, entered into Contract with Network that gave Network the collective rights to produce and broadcast the games within the Game Package. As an individual taxpayer, however, our Office cannot treat Taxpayer as disposing of the entire Game Package. In our view, Taxpayer either disposed of a 1/X undivided interest in the Game Package (because of all teams agreement in the League Constitution), or the rights to broadcast its games in the Game Package.

The results of our analysis are the same under either determination. If Taxpayer is treated as transferring a 1/X interest in all games of the Game Package, Taxpayer would have to argue that it was the producer of the entire Game Package. The § 199 rules do not allow a determination that a taxpayer is the “partial” producer of a film. Our Office summarily concludes that Taxpayer is not the producer of the Game Package for purposes of § 199. As a result, § 1.199-3(d)(1)(ii) would apply to Taxpayer if Taxpayer transferred a 1/X undivided interest in all games of the Game Package. Pursuant to § 1.199-3(d)(1)(ii), if the property offered in the normal course of business does not qualify as the “item,” then any component of the property is treated as the “item,” provided the gross receipts attributable to such component qualify as DPGR. Thus, our Office must analyze whether gross receipts from any components of the Game Package qualify as DPGR for Taxpayer. For purposes of this advice, our Office analyzes whether Taxpayer’s gross receipts attributable to the Game Broadcasts in which Taxpayer participated qualify as DPGR. To the extent Taxpayer only transferred the rights related to the games in which it participated, the analysis would also have to answer this same question without applying the rules of § 1.199-(d)(1)(ii).

Before analyzing the gross receipts attributable to the Game Broadcasts in which Taxpayer participated, our Office provides LB&I advice for identifying those gross receipts. In our view, Taxpayer’s gross receipts attributable to those Game Broadcasts in which Taxpayer participated are not equal to the payment Taxpayer received. Under the Contract, Network’s “rights fee payment” attributable to the Game Package is allocable (appropriately in accordance with the value thereof) over all Game Broadcasts in such League season. Thus, Network paid a certain amount of money for the games in which Taxpayer participated. Of this amount, Taxpayer is only entitled to a 1/X share per the League Constitution. That is the amount of revenue that Taxpayer derived from its disposition of the rights to broadcast the games in which Taxpayer participated. The remainder of Taxpayer’s revenues relates to the revenue that Network paid for games in which Taxpayer did not participate. Taxpayer receives this revenue pursuant to its rights under the League Constitution. Taxpayer’s actual revenue received under this Contract for the Years at Issue is consistent with the analysis in this paragraph, and inconsistent with Taxpayer receiving gross receipts only for games in which Taxpayer participated.

Our Office expects Taxpayer to argue that based on the totality of the contracts with all networks covering all League Games (rather than just the Game Package at issue), that

its total revenue only relates to the games in which Taxpayer participated. However, this is an incorrect application of the item rule in § 1.199-3(d)(1)(i).

Whether Taxpayer's gross receipts attributable to Game Broadcasts in which Taxpayer participated relate to Taxpayer's disposition of a qualified film?

Section 1.199-3(k)(1) defines "qualified film" as any motion picture film or video tape under § 168(f)(3), or live or delayed television programming (film), if not less than 50 percent of the total compensation relating to the production of such film is compensation for services performed in the United States by actors, production personnel, directors, and producers.

Our Office considers the Game Broadcasts in which Taxpayer participated (assuming the games are played in the United States) as live or delayed television programming, and thus, films for purposes of § 199. Further, while LB&I did not provide our Office with specific compensation figures, to the extent the film production is done within the United States, it is likely that the Game Broadcasts featuring Taxpayer and its opponent will each be a qualified film. The 50% compensation requirement in § 1.199-3(k)(1) includes all compensation related to production of a film, and is not taxpayer specific. Taxpayer can rely on compensation paid by third parties to meet this requirement. The determination that a film is a qualified film is not dispositive for determining DPGR. The taxpayer deriving gross receipts from the qualified film must be the producer of the qualified film for purposes of § 199.

Assuming the Game Broadcasts are qualified films there is an issue of whether Taxpayer's (and the other League teams) transfer of rights to broadcast the Game Broadcasts constituted the disposition of qualified films. In this case, Taxpayer (and the other teams in the League) transferred the rights to broadcast the Game Broadcasts before the actual filming of any games, which is the activity necessary to create the films. Thus, there is an argument that the transfer does not relate to a qualified film, but instead, is more similar to the sale of a script or screenplay, which under § 1.199-3(k)(3)(ii) is not a disposition of a qualified film.

However, our Office thinks the property at issue requires a different conclusion. In the case of live or delayed television programming, our Office generally thinks it is necessary to dispose of the rights to the live broadcast prior to the actual live or delayed television programming being created to maximize revenue. Particularly in this case, as LB&I indicates that 97% of sporting events are viewed live. Thus, treating the sale of broadcast rights prior to filming as akin to the sale of a script or screenplay would effectively limit the § 199 revenue for producers of live or delayed television programming. Further, broadcast rights are connected to the airing of the Game Broadcasts, which is the television programming at issue. If Taxpayer produced the Game Broadcasts it participated in, then those gross receipts for the right to broadcast the Game Broadcast could qualify as DPGR. Taxpayer certainly would not have a claim

if the Game Broadcasts had not been produced, but that is not the case under these facts.

Whether Taxpayer is considered the producer of the Game Broadcasts in which Taxpayer participated?

Section 199(d)(10) provides that the Secretary shall prescribe regulations as are necessary to carry out the purposes of § 199, including regulations which prevent more than 1 taxpayer from being allowed a deduction under this section with respect to any activity described in § 199(c)(4)(A)(i). Section 199(c)(4)(A)(i)(II) defines DPGR as including gross receipts from the disposition of a qualified film produced by the taxpayer. Thus, only the taxpayer that is considered the producer of the Game Broadcasts in which Taxpayer participated can claim DPGR from the disposition of those Game Broadcasts.

Based on that, Taxpayer must be the producer of the Game Broadcasts for purposes of § 199. In this case, the potential taxpayers that have a claim are Network, Taxpayer, and Taxpayer's opponents in each of the Game Broadcasts at issue. The League in its capacity as agent would not be considered the producer because its activities should be attributed to the teams that it acts as agent. Further, our Office does not consider the remaining League teams because their activities with respect to a game where they do not participate would be limited only to any activities attributed to them by the League acting as agent on each respective team's behalf.

Our Office thinks that, unless the Game Broadcasts at issue were produced pursuant to a contract with Taxpayer, and Taxpayer had the benefits and burdens of ownership during the period the qualifying activity occurred for purposes of §§ 1.199-3(f)(1) and (k)(8), then Taxpayer is not the producer of the Game Broadcasts for purposes of § 1.199-3(k)(6) or § 1.199-3(k)(7). Taxpayer's primary activity relating to the Game Broadcast is playing the games. That activity, along with its opponent's activities, creates the games. While it is true that the playing of the games is the subject of the Game Broadcasts, it is also true that the playing of games is not television programming any more than a newsworthy event, and that the Game Broadcasts contain more content than just the game. It is Network's activities that convert the live sporting events into video/audio recording that may be copyrighted, widely distributed, and qualify as a qualified film. Further it is the Game Broadcasts that Taxpayer claims it is disposing of, not a film of the game without the additions of Network. Thus, our Office thinks that it is necessary for Taxpayer to show the Game Broadcasts were produced pursuant to a contract with Taxpayer, and that it had the benefits and burdens of ownership during the period the qualifying activity occurred for purposes of §§ 1.199-3(f)(1) and (k)(8).

Were the Game Broadcasts produced pursuant to a contract with Taxpayer?

Whether the Game Broadcasts were produced pursuant to a contract with Taxpayer for purposes of § 199 is complicated by the facts that the League acted as agent for all

teams in the League when entering into the Contract with Network, and that all teams share all revenue for each game played. Further, the Contract with Network does not “look” like a typical contract manufacturing arrangement as described in § 1.199-3(f)(1). While the Contract contemplates Network producing the Game Broadcasts, and League retaining some rights in the Game Broadcasts, there is no payment by the League (on behalf of Taxpayer or the other teams) to Network for the production of the Game Broadcasts. However, § 1.199-3(f)(1) does not explicitly require a payment, so that alone does not mean Network’s activities were not done pursuant to the Contract.

One determination that is necessary, is whether Taxpayer (and the other teams), transferred all of the valuable rights to the Game Broadcasts to Network. If a taxpayer gives up all of its potential for profit from a property to the producing party before the other produces the property, then it favors concluding that the producing party is not doing the production pursuant to the contract, but on its own behalf. In that case, our Office would conclude that Network’s activities were not done pursuant to a contract with Taxpayer within the meaning of § 1.199-3(f)(1). This is a determination that LB&I must make based on the Contract with Network, and any other relevant contracts of Taxpayer. However, to the extent Taxpayer maintains an interest in the Game Broadcasts at issue, in our view it favors treating Network’s activities as done pursuant to the Contract with Taxpayer.

Does Taxpayer have the “benefits and burdens of ownership” of its home Game Broadcasts under applicable Federal income tax principles during the period in which the production activity occurs?

If Network’s activities were done pursuant to a contract with Taxpayer, then §§ 1.199-3(f)(1) and (k)(8) are relevant. Section 1.199-3(k)(8) provides that if one taxpayer performs a production activity pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the qualified film under Federal income tax principles during the period in which the production activity occurs is treated as engaging in the production activity. Section 1.199-3(f)(1) is the more general rule, and it provides similar language that also applies to qualified films. Thus, under § 199, Taxpayer, and not its opponent or Network, must have the benefits and burdens of ownership of the Game Broadcast under applicable Federal income tax principles during the period in which the production activity occurs for gross receipts from its home Game Broadcasts to qualify as DPGR.

First, if Network’s filming activities are done pursuant a contract with Taxpayer, then Network’s filming activities are also done pursuant to a contract with Taxpayer’s opponent. Since only one taxpayer can derive DPGR from the Game Broadcast, and without comparing the teams’ activities with Network’s, it appears the only difference between Taxpayer and an opponent’s facts is a game’s location (home or away game). Our Office assumes that the home team had more activities related to a film’s production than the away team. Thus, our Office concludes that gross receipts from Taxpayer’s away games are non-DPGR.

Second, our Office concludes that Network has the benefits and burdens of ownership of the Game Broadcasts under applicable Federal income tax principles during the period in which the production activity occurs. This means that all of Taxpayer's gross receipts attributable to the Contract are non-DPGR. Our Office reaches this conclusion for the reasons that follow.

The § 199 determination relies on applicable Federal income tax principles. Taxpayer relies on the "work for hire" legal term of art under copyright law to support its claim that it is the producer of the Game Broadcasts. At the outset it must be noted that copyright provisions are not relevant or dispositive to the analysis under § 199 in determining whether Network or Taxpayer is treated as having engaged in the production activities performed under the Contract. Nevertheless, to the extent at all relevant, the fact that the networks are treated as "work for hire" creating "motion picture/ audiovisual, audio commentary, selection and arrangement of visual images" under copyright law, in fact, goes against Taxpayer's position that they perform the production activities related to the production of qualified films. "Work for hire" at most supports the proposition that the film production was done pursuant to a contract.

Section 1.199-3(f)(4) contains two examples that are relevant to this case. Example 1 provides that X designs machines and contracts with an unrelated party Y to manufacture them. The contract between X and Y is fixed price contract, specifies that machines will be produced in the U.S. using X's design. X owns the intellectual property in the design, Y has no right to exploit the intellectual property, Y controls the details of the manufacturing process while machines are being produced, Y bears the risk of loss or damage during manufacturing of the machines, and Y has the economic loss or gain upon the sale of the machines based on the difference between Y's costs and the fixed price. Y has legal title to the machines during the manufacturing process and it passes to X after the manufacturing is completed. Under these facts, the Example concludes that Y (the contract manufacturer and not the principal) has the benefits and burdens of ownership of the machines during their production process.

Example 2 provides that X designs and engineers machines that X sells to customers. X contracted with an unrelated party Y to manufacture the machines. The contract between X and Y is a cost-reimbursable type contract and the legal title to the machines is not transferred to X until the manufacturing of the machines is completed. Under these facts, the Example concludes that the principal, X, has the benefits and burdens of ownership of the machines during their production process.

Comparing the facts of this case against these examples, we conclude that the examples offer substantial support for concluding Network is considered the "taxpayer" and producer of the Game Broadcasts for purposes of § 199. Many of the factors identified in these examples overlap with the analysis from ADVO Inc. v. Commissioner, 141 T.C. 298 (2013).

ADVO is the only Tax Court case interpreting these specific regulatory provisions. See also Grodt & McKay Realty, Inc. v. Commissioner, 77 T.C. 1221 (1981). The Tax Court in ADVO applied nine non-exclusive factors to determine the benefit and burdens of ownership specifically under § 199 in the context of a direct mail producer that contracted out the printing process to third parties. Those factors were: (1) whether legal title passes; (2) how the parties treat the transaction; (3) whether an equity interest was acquired; (4) whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments; (5) whether the right of possession is vested in the purchaser and which party has control of the property or process; (6) which party pays the property taxes; (7) which party bears the risk of loss or damage to the property; (8) which party receives the profits from the operation and sale of the property; and (9) whether the taxpayer participated actively and extensively in the management and operations of the activity.

The ADVO court noted the factors it used in its analysis of the benefits and burdens of ownership in the context of § 199 are not exclusive or controlling, but that they were in that particular case sufficient to determine which party had the benefits and burdens of ownership. ADVO, 141 T.C. at 325 n. 21. No one factor is determinative. To the extent relevant, our Office analyzes each of the factors in connection with the Game Broadcasts in which Taxpayer participated:

(1) Whether legal title passes: In this case, the transfer is of intangible property, and both parties have ownership over certain rights to the Game Broadcasts. Under the terms of the Contract, the League retains copyrights in the recorded Game Broadcasts. However, Network receives the live broadcast rights to the Game Broadcasts, subject to certain conditions on Means of Distribution and Broadcast Area. Network has ownership of the most valuable right related to the Game Broadcast as a result of the rights fee payment. Further, because of the simultaneous (or close to) nature of the filming and broadcasting, Network's ownership is during the period that the qualifying activity (production of the Game Broadcast) occurs. While both parties have ownership interests in the Game Broadcast, because Network holds the most valuable rights during the time of production, our Office views this factor as either favorable to Network or neutral.

(2) How the parties treated the transaction: In reviewing this factor, it is important to look at what the parties actually intended to happen, and be less concerned with the label that parties actually gave the transaction. Id. at 326. In this context, our Office looks at whether Taxpayer intended the Contract with Network be for "film production services," or for Network to produce a film for it.

In ADVO, the taxpayer argued that the contract provided that it was for printing services, rather than for the manufacturing of a product. Id. In this case, as our Office discussed before, it still needs to be determined by LB&I whether Network was even producing the Game Broadcasts pursuant to the Contract. Beyond that, this does not appear to be an agreement for Network's film production services, which would support Taxpayer's

argument. In our view, Taxpayer's primary motivation, rather than receiving the film, appears to be receiving a large sum of money for the rights to broadcast the games in the Game Package for the Years at Issue. This sum, while related to the Game Broadcasts (it allows Network to air the broadcast and was allocable between the Game Broadcasts), was not reduced to the extent that Network did not make an actual Game Broadcast if a game in the Game Package was played. Taxpayer retained some rights to the Game Broadcasts, but at the same time the Contract granted Network the most valuable right related to the film's distribution. Taxpayer also did not pay Network anything for Network's film production activities. If Taxpayer's and Network's primary intention was for Network to provide film production services, then it seems that Network would have wanted payment to provide those services. All of these facts indicate the parties intended for Network to produce the Game Broadcast, and use its rights with respect to the Game Broadcasts to recoup the payment it made to the League (on behalf of the teams) from advertisers. Taxpayer intended to receive its share of revenue from Network based on its right to allow the filming and broadcast of its games, and retain the remaining rights to the Game Broadcasts to try to further exploit the Game Broadcast.

Providing half of the players in the game that is the subject of the Game Broadcast is not sufficient to support the conclusion that Taxpayer intended this Contract to be for film production services, or that Taxpayer is in the film production business. Taxpayer understood the game was to be filmed, but Taxpayer had other financial reason beyond film production to do this. Another main source of revenue is from ticket sales and the receipts related to game attendance. Further, the provisions related to providing the opening and closing credits, and notice of League ownership of the Game Broadcast, indicate the extent of the League's intended production. It also shows that Network's "look" is a factor in creating those, which does not support the conclusion that Network is providing film production services to Taxpayer.

Our Office finds this factor favors Network.

(3) and (4) Whether there is an equity interest created and present obligations: The ADVO court indicated that these are factors relevant in determining whether a transaction was a bona fide sale or not. Id. at 327. Our Office does not believe these factors are necessary for our analysis. Therefore, these factors are neutral.

(5) Whether the right of possession is vested in the purchaser and which party has control of the property or process: The ADVO court's discussion of this factor relates to both possession of the property at issue during the qualifying activity and which party controls the process of the creating or manufacturing the property during the period the qualifying activity occurs. Id. at 327-228.

Possession of the property in this case is less clear than ADVO as the property at issue is intangible. However, the facts support that Network is providing the Game Broadcast

to the League (as agent on behalf of the teams), while simultaneously Network is broadcasting the Game Broadcast.

Our Office views which party controls the process of the Game Broadcast's creation as the more important part of this factor. The facts supporting that Taxpayer is in control of the Game Broadcast's creation are not persuasive when compared against the control that Network exercises.

Taxpayer is in control of one of two teams playing in the game (i.e., its players and staff). Taxpayer has a PR person that helps arrange interviews when requested by Network. Taxpayer is attributed some of the activities of the League (who is acting as agent on behalf of all teams), however, those activities are limited. The League's broadcasting department consists of only employees, some of whom attend certain games live, but who more commonly monitor all of the games (the majority of which Taxpayer does not participate) at the League headquarters. The Contract requires certain minimum production requirements, but Network, can, and does, decide how far to go beyond those minimums. The League activities mostly involve determining whether Network meet the conditions of the Contract with respect to the Game Broadcast, such as not showing too many advertisements. The League has some say that allows it to protect the flow of the game being played (such as how long commercial breaks can be after a , or when happen), which in turn can affect the Game Broadcast. However, how to change the Game Broadcast so when the League exercises these rights is up to Network. The League may produce the opening and closing credits, and a notice of ownership that is aired during the Game Broadcast, but those combined are only roughly of the Game Broadcast.

There are other activities that Taxpayer relies on to say it controls the production of the Game Broadcasts. First, Taxpayer argues providing statistics and other team information to Network for the broadcast, and requesting that the announcers acknowledge events such as amounts to some control. The facts acknowledge that the League may ask Network to have the announcer talk about a certain players as part of some storyline, however, it is ultimately Network's chosen announcers' decisions to choose what to say and how to say it with the Game Broadcast. Second, Taxpayer points to the League's control of the start time for the games, when the commercial breaks are allowed, and when the game ends, as some aspect of control. Game schedules determine when the game is shown to the TV audience, but do not change the Game Broadcast. For example, viewers with digital video recorders can make the same decisions. Finally, the League has stated that it has a direct line to Network's Producer and Director of the live Game Broadcast, and could provide direction, if necessary. Our Office has no facts indicating this direct line is used in a manner during Game Broadcasts that would indicate any kind of control of the production.

There are many facts that support the conclusion that Network is in control of the Game Broadcasts both from a creative side and personnel side. Network controls almost all

aspects of the creative production of a Game Broadcast. This makes sense as Network has the broadcasting expertise relating to how to film the game, and how to incorporate that film into the refined and complex Game Broadcast at issue. Network makes the decisions on when to zoom, when to show a replay (in slow or real-time motion), which players to focus on, and when to pan to the live audience, benches, , etc. Network also adds the graphics, sound effects music, and of course commentary and the actual calling of the game action. Network, and not the League (or Taxpayer), can decide to use various technologies depending on the game, such as the . All of these activities are part of creating the Game Broadcast, which is a different film and experience than just recording a game.

Network provides and controls all equipment essential to the broadcast and a game day staff of employees and freelance contractors. These employees are responsible for everything from setting-up and testing the equipment, to recording the game, producing the game feed, monitoring the broadcast, and then eventually tearing down the production equipment. Network employees include a director, who is responsible for calling out the camera shots, a technical director who controls the cameras, and a producer, who decides on whether and when to show replays, commercials, etc. The producer is in charge of the particular Game Broadcast. Network also brings in support staff, graphics staff, audio staff, etc. About network employees work inside the broadcasting trucks, the rest are at the . No representative of the League or Taxpayer advises, or assists Network producer or director during the Game Broadcast and no League or Taxpayer representatives are in the broadcasting trucks. Network's graphics team prepares thousands of graphics to be shown at specific times throughout a broadcast.

Our Office finds this factor favors Network.

(6) Which party pays the property taxes: LB&I did not develop facts with respect to the implications of property taxes. Our Office does not believe this factor is significant in determining who is the producer of the Game Broadcasts. Thus, our Office finds this factor is neutral.

(7) Which party bears the risk of loss or damage to property during the production: In reviewing this factor, the ADVO court really looked at three sub-factors. First, whether the risk of loss or damage to the materials transferred to the contracting party before the contract manufacturer gave up possession, or whether that risk transferred after the products were given to the contracting party. Id. at 329. Second, the ADVO court recognized by citing the examples in § 1.199-3(f)(4) that the type of contract, fixed-price or cost-plus, can play a role in determining who has the benefits and burdens. Id. Third, the ADVO court took into account economic harm that the taxpayer's business would suffer if the products were lost or damaged before taxpayer could provide the products to its customers under existing contracts.

In this case, application of the ADVO court's first sub-factor is not straightforward. In trying to apply it, our Office thinks the most applicable analysis is how the parties are financially affected under the Contract if the Game Broadcast is not produced or interrupted during the course of production. If the game is played but the broadcast is not produced or the broadcast is interrupted, Network is not reimbursed for any production costs incurred, or any of the rights fee payment made to Taxpayer. Taxpayer's only economic risk is if its game is cancelled, and the League is not able to make a substitute game available to be broadcast. If that happened, then Taxpayer would be liable for its share of the reduction. On balance, Network has more economic downside to the extent an individual Game Broadcast is not produced.

The second sub-factor under the analysis looks at whether the contracts were fixed-price or cost-plus. A fixed price contract supports finding that the contract manufacturer has the risk of loss, while a cost-price contract supports that the contracting party has the risk of loss. In this case, this sub-factor clearly supports Network. The Contract provides that Network is responsible for all production costs for Game Broadcasts in the United States. The League (on behalf of the teams) does not pay Network for any of their activities.

The third sub-factor takes into account economic harm to the extent that the contracting parties business would suffer if the products were lost or damaged. The ADVO court looked at the consequences of the property not being delivered to customers' of the parties that are not subject to the contract manufacturing contract. Id. at 329-330. This case is different from ADVO in that both parties have rights related to the disposition of the Game Broadcasts. To the extent a Game Broadcast was not produced, Network would suffer great harm, as it has no protections for its contracts with advertisers in the Game Broadcasts under the Contract. Not broadcasting a game could have serious revenue consequences. Our Office limited our analysis in this advice to the Contract, and did not review any of other Taxpayer's contracts related to disposition of the film, and therefore, do not know the economic harm Taxpayer would suffer. The facts our Office considered do not indicate that there would be substantial economic harm to Taxpayer under other contracts to the extent a Game Broadcast is not produced.

Our Office also considered indirect harm to the parties, but believe that cancels out. Network uses the Game Broadcasts to promote other Network television programming, while the League (and Taxpayer) use the Game Broadcasts to promote the games to a wider audience.

While the fines discussed in this paragraph are not based on Federal income tax principles, Network has other potential real economic risks based on their production of the Game Broadcast. Network bears the risk of fines for what it airs in the live broadcast from the Federal Communications Commission (FCC). The FCC's enforcement powers include fines and broadcast license revocation. The FCC is responsible for regulating live television broadcasts, and only regulates licensed broadcasters. If Network violates any of the FCC's rules (e.g., fleeting expletives,

required closed captioning, and infringement of third-party copyrights) during a live broadcast, it bears the risk of a fine or a revocation of their broadcast license. LB&I indicates that the FCC disclosed no FCC action against the League as a producer or programmer under a subcontract manufacturing theory or otherwise.

Our Office finds this factor favors Network.

(8) Which party receives the profits from the operation and sale of the property: The ADVO court, in analyzing this factor, referenced § 1.199-3(f)(4). Id. at 330. The ADVO court looked at whether the contract manufacturer would enjoy the economic gain or loss from the sale of the produced property according to the difference between the company's costs of production and the fixed contract price. Id. To our Office, this analysis focuses on whether Network was paid for its labor by Taxpayer, or whether Network had the chance to profit under the Contract by finding efficiencies in its labor operations. Here, Taxpayer did not pay for Network's production services (in fact, as described, Network paid Taxpayer large amounts of money so that Network could perform the production activities and broadcast the game). Network has the opportunity to profit from the sale of the Game Broadcast if it is able to more efficiently produce the game. Network's opportunity to profit from its efficiencies comes in the form of payment from advertisers, rather than from Taxpayer. This is different from a typical contract manufacturing arrangement, and more persuasive than even a fixed-price contract to our Office when determining who can receive the profit from the operations under the Contract.

Our Office finds this factor weighs in favor of Network.

(9) Whether the taxpayer participated actively and extensively in the management and operations of the production activity: Under the facts in the case, the ADVO court found that the analysis in factor (5), "Right of Possession and Control," overlapped with the analysis required under this factor. Id. In this case, our Office thinks that there is additional analysis relevant. The test evolved under § 936 and asks whether Taxpayer actively and extensively participated in the management and operations of the activity.

While under factor (5), our Office finds that Network controlled the Game Broadcasts, and thinks it is clear that Network also participated actively and extensively in the management operations of the production activity, our Office also thinks that this factor is the appropriate one to consider Taxpayer's participation in the Game Broadcast. Taxpayer performed the activities discussed in factor (5), but more importantly for this factor, Taxpayer appeared in the games that were the subject of the Game Broadcasts. In our view, while our Office found that the intent of the parties in factor (2) was for Network to produce the Game Broadcast, it is also true that Taxpayer was aware that by playing in the game it was going to be subject to filming and part of the Game Broadcast. Our Office notes that Taxpayer's participation in the Game Broadcast was essentially equaled by Taxpayer's opponent's participation.

Our Office finds this factor is neutral.

Based on the examples in § 1.199-3(f)(4) and analyzing the factors described in the ADVO case, our Office determines that it is Network that has the benefits and burdens of ownership of the Game Broadcasts at issue under applicable Federal income tax principles during the period in which the production activity occurs under §§ 1.199-3(f)(1) and (k)(8).

Summary of Analysis

Ultimately, the determination that Taxpayer is not the producer of the Game Broadcasts means that none of Taxpayer's gross receipts from the Contract in the Years at Issue qualify as DPGR. Our analysis also addresses several other issues when applying § 199 to the facts that would limit Taxpayer's gross receipts even if Taxpayer were found to be the producer. In our view, the most reasonable characterization of this arrangement is that Network is paying for the rights to broadcast, and agreeing to produce the Game Broadcasts at no charge as part of that agreement. Network then gets the opportunity to profit from the sales of advertising with respect to the live Game Broadcast aired on its Network, and Taxpayer retains the remaining rights to the Game Broadcast in order to be able to profit from the Game Broadcast in alternative ways if possible.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call 202-317-4137 if you have any further questions.