October 24, 2003

MEMORANDUM FOR LMSB INDUSTRY DIRECTORS
DIRECTORS, FIELD OPERATIONS
COMMUNICATIONS, TECHNOLOGY & MEDIA
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE

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SUBJECT: Examination Procedures for Sports Franchise Acquisitions

In a simultaneously issued field directive titled "Examination of Sports Franchise Acquisitions" examiners are provided with a compliance measure tool to be used in the classification and examination of taxpayers who acquire sports franchises. This tool allows agents to resolve sports franchise acquisitions issues in limited and expedited examinations. This memorandum provides examiners with directions in applying the compliance measure to cases within the classification and in the examination process.

A taxpayer's acceptance of the Service's use of the compliance measure still requires examiners to conduct a review of the acquisition to verify that the taxpayer falls within the scope of the measure. Revenue agents assigned sports franchise acquisition cases should complete and forward referrals to the Engineering program during their pre-examination analysis. Examiners in conducting their review should utilize the procedures outlined below.

VERIFY THE EXISTENCE, BASES AND USEFUL LIVES OF ACQUIRED INTANGIBLE ASSETS

1. Verifications and Examination Techniques

Taxpayers are required to allocate the purchase price among the acquired intangibles. In any case in which a taxpayer claims amortization deductions for an intangible asset, the taxpayer is required to verify the existence, value and useful life of the asset to establish that the asset qualifies for amortization. Therefore, taxpayers are expected to have an appraisal, which is to be requested and reviewed by the examiner. When a taxpayer makes an amended return to claim additional amortization deductions, the taxpayer is expected to provide a new or revised appraisal.

Examiners in conducting their review of the appraisal should use the following audit steps and request the following documents:

a. Request and reconcile the appraised values and useful lives to the values and lives reported on the return, the taxpayer's financial statements and depreciation schedules.

b. Request, review and reconcile player contracts to the lives detailed on the taxpayer's appraisal and depreciation schedules. Due to the volume of contracts, examiners may elect to review and reconcile a sampling of the contracts.

c. Request, review and reconcile contracts for the sale of luxury suites, club seats, in-stadium advertising, naming rights, and other acquired assets to the lives detailed on the taxpayer's appraisal and depreciation schedules. Due to the volume of contracts, examiners may elect to review and reconcile a sampling of the contracts.

d. Request and review sales documents including the due diligence letter, if any. Reconcile the sales price (including a reconciliation of liabilities assumed) to the value reported in the appraisal.

In examining the useful lives of acquired intangible assets, agents generally should expect to see the following:

- Player contracts with a composite useful life between four and five years.

- Other amortizable assets (not including any media rights) with a composite useful life of between nine and 10 years.

With respect to a purchase price allocation for an existing franchise, agents generally should see allocations to:

- Player contracts of approximately 55% of the total amount allocable to all intangibles.

- Other amortizable assets (not including any media rights) including, but not limited to, playing facility naming rights, concession agreements, club seat contracts, and luxury suite contracts of approximately 15% of the total amount allocable to all intangibles.

- Non-amortizable intangible assets (exclusive of media rights) such as equity interests in related entities, franchise rights, and goodwill and going concern value of approximately 10% of the total amount allocable to all intangibles.

- Media rights of approximately 20% of the total amount allocable to all intangibles, split relatively evenly between the current value of the rights represented by the contracts in place as of the date of acquisition, and the residual (terminal) value of all rights in all future media contracts.

2. Expansion Teams

A taxpayer who acquires an expansion team will normally have allocations different than those described above. When a taxpayer acquires an expansion team, the taxpayer, unlike a taxpayer who acquires an existing team, generally does not acquire pre-existing agreements that provide the taxpayer the contractual rights to income sources such as those generated by the sale of luxury box seating or playing facilities naming rights. Instead, the grant of an expansion team provides the owner with the right to continually enter into and renew such agreements. Agents should therefore expect to see a lower allocation to amortizable assets relative to such allocation for an existing team that has exercised its rights to enter into and renew amortizable agreements.

3. Media Rights

Taxpayers usually determine the acquisition cost allocable to acquired media rights in one of two ways. Taxpayers may use a discounted cash flow analysis to value both current and future media rights. In using this approach, the taxpayer bifurcates the media rights value between the rights represented by the current media contacts and the rights represented by all expected future media contracts. Taxpayers claim amortization deductions for the cost allocated to the value of media rights represented by the current contracts. Amortization claims are not made for the cost allocated to the ongoing rights to revenues from expected future contracts because those rights do not have an ascertainable useful life. In the other approach, the taxpayer does not independently value the media rights and instead considers the value to be in the "residual" class of assets. Under this approach, taxpayers do not claim amortization deductions for media rights.

A taxpayer's media rights may include national TV rights, local TV rights, national radio rights, local radio rights, foreign TV and radio rights, and satellite broadcast rights. Examiners are not to allow any amortization deductions for any media rights. Taxpayers will be free to pursue any claim for amortization deductions from media rights in Appeals or in the courts. We encourage the use of Fast Track procedures to resolve the issue in the field.

4. Closing Agreements

Examination must secure a closing agreement that sets out the resolution of the acquisition issues under the compliance measure. The closing agreement will reflect the limited nature of the compliance measure. Thus, the closing agreement will reflect that application of the measure in and of itself will not preclude the Service from subsequent examination of the basis of any specific asset as may be necessary in applying any provision of the Code.

The language of the closing agreement will vary depending on the treatment of media rights. If at the close of an examination, the issue of the amortization of media rights has not been considered under the Fast Track procedures, the closing agreement prepared in Examination would set out the determination of the taxpayer's amortization deductions for all acquired amortizable intangible assets (not including any media rights) under the compliance measure. The closing agreement must also set out the purchase price allocation to media rights as determined under the compliance measure, and that the taxpayer has not conceded in Examination any amortization claim for media rights represented by current media contracts. Taxpayers will be free to pursue any denied deduction for amortization of the purchase price allocable to current media rights (as determined under the compliance measure) in Appeals or in the courts. Alternatively, if the taxpayer chooses to concede in Examination all claims for amortization deductions for all media rights in all years, that concession must be included in the closing agreement. If, during the time the acquisition issues are in the jurisdiction of Examination, the issue of the allowance of amortization deductions for any media rights was resolve in Appeals under the Fast Track procedures, the resolution must be set out in the closing agreement.

PRESENT VALUE CALCULATIONS AND BASIS ADJUSTMENTS

After verifying the existence, bases and useful lives of the acquired amortizable intangible assets, the next step to be taken by examiners is to determine whether the taxpayer's present value percentage of the amortizable intangible assets comes within the compliance measure. An adjustment must be made to the bases of the taxpayer's acquired amortizable intangible assets if the taxpayer's present value percentage is greater than the compliance measure percentage. In such case, a corresponding adjustment will be made to the bases of the remaining (non-amortizable) intangible assets.

Calculating the taxpayer's present value percentage and any necessary bases adjustments is a multi-step process that requires the following determinations: (1) the percentage of total intangibles represented by each intangible asset, (2) the present value table factor for each amortizable intangible asset, (3) the present value of the deductions to recover the cost allocable to the amortizable intangible assets individually and as a group, (4) the basis reduction needed in order to come within the compliance measure percentage and the allocation of that basis reduction to each of the amortizable intangible assets, and (5) a reallocation of the basis reduction so as to step up the bases of the remaining (non-amortizable) intangible assets.

Step One - CALCULATE EACH AMORTIZABLE INTANGIBLE ASSET'S PERCENTAGE OF TOTAL INTANGIBLE ASSETS AND GROUP TOTAL: The applicable percentage is determined by dividing the cost allocable to each intangible asset by the total cost allocable to all intangible assets. Add the result for each amortizable asset together to calculate the group total.

Step Two - DETERMINE THE PRESENT VALUE FACTOR FOR EACH AMORTIZABLE INTANGIBLE ASSET (NOT INCLUDING ANY MEDIA RIGHTS): In applying the compliance measure, agents will use a discount rate of 5.5% per annum. The discount rate will be applied to the stream of amortization deductions claimed (and to be claimed) assuming that the deductions are allowable at the close of each calendar year. The present value factor may be determined via the use of the attached present value table (see Attachment A – Present Value Table). The table has two columns, one showing useful life and the other the corresponding present value factor for that life. The table states an asset's useful life in quarter-year increments. The present value factor for each amortizable asset is determined by matching the asset's useful life to the useful life on the table (to the nearest quarter-year increment), and using the corresponding present value factor shown on the table.

Step Three - CALCULATE THE PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO THE AMORTIZABLE INTANGIBLE ASSETS (NOT INCLUDING ANY MEDIA RIGHTS) INDIVIDUALLY AND AS A GROUP: This is computed by multiplying the percentage calculated in Step One by the factor determined in Step Two for each asset individually. Add the results for each amortizable asset together to calculate the present value recovery percentage for the group as a whole.

Step Four - DETERMINE IF AN ADJUSTMENT TO BASES OF THE AMORTIZABLE INTANGIBLE ASSET (NOT INCLUDING ANY MEDIA RIGHTS) IS REQUIRED. IF REQUIRED, CALCULATE THE GROSS STEP DOWN OF BASES NECESSARY TO ACHIEVE A GROUP PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO THE AMORTIZABLE INTANGIBLE ASSETS THAT DOES NOT EXCEED THE COMPLIANCE MEASURE PERCENTAGE AND ALLOCATE THAT GROSS STEP-DOWN TO EACH OF THE AMORTIZABLE INTANGIBLE ASSETS: To determine whether an adjustment to basis is required, compare the resulting group present value percentage achieved in Step Three to the compliance measure percentage. If the group present value percentage achieved in Step Three is greater than the 60% maximum compliance measure, the bases of the amortizable intangible assets must be reduced by an amount that will achieve a group present value percentage that does not exceed the compliance measure percentage. Conversely, if the group present value percentage achieved in Step Three is less than the 60% maximum compliance measure, no adjustment to the bases of the amortizable intangible assets would be warranted.

The following calculations are required to determine the basis reduction amounts.

1. The present value difference calculated in Step Four must be converted to its face amount to determine the full adjustment to the purchase price allocations (and bases) of amortizable intangible assets.

2. The face amount calculated in (1) above is allocated pro-rata among the amortizable intangible assets.

Step Five - REALLOCATE THE GROSS BASES REDUCTION AMOUNT AMONG THE REMAINING INTANGIBLE ASSETS: Once the step-down of the bases of amortizable assets has been completed, a corresponding step-up in the bases of the remaining (non-amortizable) intangible assets, including media rights, must be made. The allocation of the gross step-up will not require a revaluation of the remaining intangible assets. Generally, as noted above, the remaining intangibles will represent about 30% of the value of all intangibles. Media rights will generally account for about 20% (about 10% to current and 10% to future rights) of the purchase price for all intangibles. Franchise and other non-amortizable franchise rights will generally account for about 10% of the intangibles. These percentages will be used as a base for an allocation process to determine the bases step-up.

General Allocation Process: Agents generally will allocate the step-up to three groups of assets: (1) current media rights, (2) future media rights, and (3) franchise and other non-amortizable assets. Within each group, the allocation will be made pro-rata among the distinct assets within the group. The step-up will initially be allocated equally to each of the three groups up to an amount (taking into account any existing purchase price allocation) that does not exceed 10% of the total purchase price of all intangibles. When the existing purchase price allocation to a group is at or exceeds 10%, or when the step-up (together with any existing purchase price allocation) allocated to a group reaches the 10% mark, no additional step-up will be allocated to that group at that time. The allocation will then be made to any remaining group (up to the 10 % mark) until such time as all three groups have reached the 10% mark. When all three groups have reached the 10% mark, the step-up will be allocated in a manner so as to result (to the greatest extent possible) in three groups with the same percentage share of the total purchase price allocable to all intangibles. In accomplishing this step, any remaining unallocated step-up will initially be allocated equally among the groups up to (but not exceeding) the percentage that is the highest percentage of total intangibles allocable to any group. When, if at all, all three groups have reached the highest percentage of total intangibles, any remaining unallocated step-up will be allocated equally among the three groups. In the overall allocation process, the purchase price ultimately allocated to a group may ultimately be less than or greater than the 10% average generally seen for a group.

With one exception, the starting point in performing the allocation will be the purchase price allocation as reported (whether by original or amended return) by the taxpayer. In any initial instance in which franchise exceeds 10% of the total purchase price of all intangibles and future media rights are less than that 10% mark, the excess of franchise over the10% mark will be reallocated to future media rights (even in cases in which the taxpayer does not initially value future media rights) up to, but not exceeding, 10%. Thus, if both future media and franchise exceed 10%, there will be no reallocation between franchise and future media rights. Similarly, if franchise is 10% or less, there will be no reallocation between franchise and future media rights. In no event will there be a reallocation of reported purchase price for franchise or future media rights to current media rights (whether or not valued by the taxpayer). Agents should not reallocate the reported purchase price among the reported non-amortizable assets except as otherwise noted in this paragraph.

EXAMPLES

EXAMPLE 1

B, in an asset acquisition, acquired the assets of sports franchise S for $200 million. B allocated $180 million of the purchase to intangible assets. Of the $180 million allocated to intangible assets, B allocated $38 million to non-amortizable assets (including $15 million to future media rights and $23 million to franchise and all other non-amortizable assets and league membership rights), and $142 million to intangible assets for which B claimed amortization deductions. Of the $142 million, B allocated $15 million to current media rights (as represented by the current TV and radio contracts), and $127 million to player contracts and all other amortizable assets as follows:

Assets	*Original Allocation*	*Useful Life*
Player Contracts	$115,000,000	3.29 years
Season Ticket Holder List	$ 4,000,000	21 years
Concession Agreement	$ 3,000,000	5.5 years
Sponsorship Agreements	$ 2,500,000	2.5 years
Luxury Suite Contracts	$ 2,500,000	2 years
National TV Contracts	$ 12,500,000	4 years
Local TV Contacts	$ 2,000,000	3 years
Local Radio Contracts	$ 500,000	3 years
Group Total	$142,000,000	

Step One – CALCULATE THE PERCENTAGE OF TOTAL INTANGIBLE ASSETS ALLOCATED TO EACH AMORTIZABLE INTANGIBLE ASSET (NOT INCLUDING ANY MEDIA RIGHTS) AND THE GROUP TOTAL.

Assets	*Original Allocation*	*Computation*	*Percentage of Intangibles*
Player Contracts	$115,000,000	$115,000,000/$180,000,000	63.89%
Season Ticket Holder List	$ 4,000,000	$ 4,000,000/$180,000,000	2.22%
Concession Agreement	$ 3,000,000	$ 3,000,000/$180,000,000	1.67%
Sponsorship Agreements	$ 2,500,000	$ 2,500,000/$180,000,000	1.39%
Luxury Suite Contracts	$ 2,500,000	$ 2,500,000/$180,000,000	1.39%
Group Total	$127,000,000		**70.56**%

Note: The taxpayer's allocation to current media contracts will not be taken into account in the calculation of the present value of the recovery of the cost allocable to the amortizable intangible assets. Examiners are not to allow as a deduction any amortization claimed by the taxpayer for current media contracts.

Step Two - DETERMINE THE PRESENT VALUE (PV) FACTOR FOR EACH AMORTIZABLE INTANGIBLE ASSET (NOT INCLUDING ANY MEDIA RIGHTS) (SEE ATTACHMENT A).

Assets	*Useful Life*	*PV Factor*
Player Contracts	3.29 years	89.3%
Season Ticket Holder List	21 years	58.5%
Concession Agreement	5.5 years	84.3%
Sponsorship Agreements	2.5 years	91.1%
Luxury Suite Contracts	2 years	92.3%

Step Three - CALCULATE THE PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO EACH AMORTIZABLE INTANGIBLE ASSET (NOT INCLUDING ANY MEDIA RIGHTS) AND THE GROUP TOTAL.

Assets	*Percentage of Total Intangibles*	*PV Factor*	*Computation*	*Present Value %*
Player Contracts	63.89%	89.3%	(63.89%)*(89.3%)	57.05%
Season Ticket Holder List	2.22%	58.5%	(2.22%)*(58.5%)	1.30%
Concession Agreement	1.67%	84.3%	(1.67%)*(84.3%)	1.41%
Sponsorship Agreements	1.39%	91.1%	(1.39%)*(91.1%)	1.27%
Luxury Suite Contracts	1.39%	92.3%	(1.39%)*(92.3%)	1.28%
Group Total	**70.56**%			**62.31%**

Step Four – DETERMINE IF AN ADJUSTMENT TO THE BASES OF THE AMORTIZABLE INTANGIBLE ASSETS (NOT INCLUDING ANY MEDIA RIGHTS) IS REQUIRED. IF REQUIRED, CALCULATE THE GROSS STEP DOWN OF BASES NECESSARY TO ACHIEVE A GROUP PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO THE AMORTIZABLE INTANGIBLES ASSETS THAT DOES NOT EXCEED THE COMPLIANCE MEASURE PERCENTAGE AND ALLOCATE THAT GROSS STEP-DOWN TO EACH OF THE AMORTIZABLE INTANGIBLE ASSETS.

1. An adjustment to the bases of the amortizable intangible assets is warranted in this example as the 62.31% present value percentage of the recovery of the cost allocable to the amortizable assets exceeds the compliance measure percentage (60%) by 2.31%.

2. Calculate the amount by which the total bases of the amortizable intangible assets are to be stepped down.

$127,000,000 - ($127,000,000 * (60%/62.31%)[1]) = $4,708,233

3. Calculate the stepped down bases of the amortizable intangible assets and, to ensure that the 60% compliance measure was applied properly, calculate the revised present value percentage of the recovery of cost allocable to the amortizable assets.

[1] The ratio of the compliance measure percentage to the taxpayer's present value percentage of the recovery of cost allocable to amortizable assets.

Assets	*Original Allocation*	*Step Down Computation*	*Revised Allocation*
Player Contracts	$115,000,000	$115,000,000 - (($115,000,000/$127,000,000)*$4,708,233)	$110,736,640
Season Ticket Holder List	$ 4,000,000	$4,000,000 - (($4,000,000/$127,000,000)*$4,708,233)	$ 3,851,709
Concession Agreement	$ 3,000,000	$3,000,000 - (($3,000,000/$127,000,000)*$4,708,233)	$ 2,888,782
Sponsorship Agreements	$ 2,500,000	$2.500,000 - (($2.500,000/$127,000,000)*$4,708,233)	$ 2,407,318
Luxury Suite Contracts	$ 2,500,000	$2.500,000 - (($2.500,000/$127,000,000)*$4,708,233)	$ 2,407,318
Group Total	$127,000,000		$122,291,767

The revised present value percentage of the recovery of the cost allocable to each of the amortizable assets and as a group is computed as follows:

Assets	*Revised Allocation*	*Revised % of Total Intangibles*	*PV Factor*	*Revised Present Value %*
Player Contracts	$110,736,640	61.52%	89.3%	54.94%
Season Ticket Holder List	$ 3,851,709	2.14%	58.5%	1.25%
Concession Agreement	$ 2,888,782	1.60%	84.3%	1.35%
Sponsorship Agreements	$ 2,407,318	1.34%	91.1%	1.22%
Luxury Suite Contracts	$ 2,407,318	1.34%	92.3%	1.24%
Group Total	$122,291,767			60.00%

The $4,708,233 will be reallocated (as determined below) among the remaining intangible assets (current media rights, future media rights and franchise, etc.). These remaining intangible assets, as a group, will represent $57,708,233 of the $180,000,000 allocable to total intangible assets.

$180,000,000 - $122,291,767 = $57,708,233

or

$53,000,000 (amount taxpayer originally allocated to remaining intangibles) (180,000,000 – 127,000,000) + $4,708,233 = $57,708,233

Step Five - REALLOCATE THE GROSS BASES REDUCTION OF THE AMORTIZABLE INTANGIBLES SO AS TO STEP UP THE BASES OF THE REMAINING INTANGIBLE ASSETS.

The following computations are required to allocate the $4,708,233 step down computed in Step 3:

1. CALCULATE THE PERCENTAGE OF TOTAL INTANGIBLE ASSETS TO BE REALLOCATED.

The $4,708,233 is 2.616% of total intangible assets ($4,708,233/$180,000,000).

2. Calculate each remaining intangible asset's percentage of total intangible assets.

Assets	*Original Allocation*	*Computation*	*Percentage of Total Intangibles*
National TV Contracts Current	$12,500,000	$12,500,000/$180,000,000	6.94%
Local TV Contracts Current	$ 2,000,000	$ 2,000,000/$180,000,000	1.11%
Local Radio Contracts Current	$ 500,000	$ 500,000/$180,000,000	0.28%
Subtotal Current Media Rights			**8.33%**
Future Media Rights	$15,000,000	$15,000,000/$180,000,000	8.33%
Franchise and Other Non-Amortizable Intangible Assets	$23,000,000	$23,000,000/$180,000,000	12.78%

3. CATEGORIZE THE REMAINING ASSETS INTO THREE GROUPS: (1) CURRENT MEDIA RIGHTS, (2) FUTURE MEDIA RIGHTS, AND (3) FRANCHISE AND OTHER NON-AMORTIZABLE ASSETS.

   The groups' respective percentage of total intangible assets is as follows:

   Current Media = 8.33%
   Future Media = 8.33%
   Franchise, etc. = 12.78%

   a. Because franchise exceeds 10%, and future media rights is less than 10%, allocate the excess of franchise over 10% to future media rights up to, but not exceeding 10%. Thus, 1.67% of franchise value will be allocated to future media rights to bring that value up to 10%. As a result of this re-allocation, the starting place for the bases step up is 11.11% (12.78% - 1.67%) for franchise, etc., and 10% (8.33% + 1.67%) for future media rights.

   b. Because both franchise and future media are at or above the 10% mark, the step-up will first be allocated exclusively to current media rights to bring that group up to 10%. Current media rights will be increased initially (as a percentage of total intangibles) by 1.67%, the amount necessary to bring that group up to the 10% mark. As a result of this re-allocation:

      Current Media = 10.00% (8.33% + 1.67%)
      Future Media = 10.00%
      Franchise, etc. = 11.11%

   c. Following these initial reallocations, the three groups are at or above 10%. At this stage, the remaining step-up of .95% (2.616-1.67%) will be allocated in a manner so as to achieve to the greatest extent possible three equal groups of the highest percentage of purchase price allocable to total intangibles. The highest percentage allocable to total intangibles is 11.11%, the amount allocable to franchise, etc. Since current and future media rights are below 11.11%, the remaining .95% step-up will be allocated equally to each of those two groups so as to bring each group up to 11.11%. An equal allocation will exhaust the remaining step-up and result in .475% of step-up to both current and future media. The final step-up allocation to the three groups of assets as a percentage of total intangible assets both individually and as a group is as follows:

Current Media Rights:	10.475% (8.33% + 1.67% + .475%).
Future Media Rights:	10.475% (8.33% + 1.67% +.475%).
Franchise, etc.:	<u>11.11</u>%. (12.78% - 1.67%)
Group Total	32.06%

4. DETERMINE THE GROSS STEP-UP (IF ANY) FOR EACH GROUP AND DISTRIBUTE PRO RATA THAT STEP-UP TO EACH DISTINCT INTANGIBLE ASSET WITHIN EACH GROUP.

The gross step-up amount for a group is the portion of the $57,708,233 (the amount to be allocated to remaining intangible assets (*i.e.*, current and future media rights and franchise, etc., as a group) from Step 4, above) to be allocated to the group, less the amount originally allocated to the group. The portion of the $57,708,233 to be allocated to a group is the product of the $57,708,233 and the ratio of the percentage of total intangible assets for the group to the percentage of total intangible assets for the remaining intangible assets.

a. Current Media Rights Gross Step-up Amount is $3,855,076. This amount is calculated by subtracting from the portion of the $57,708,076 to be allocated to current media rights the original allocation to current media rights.

The portion of the $57,708,233 to be allocated to current media rights is $18,855,076, the product of (10.475%/32.06%)[2] * $57,708,233. The original allocation to current media rights was $15,000,000. Thus, the gross step-up amount of $3,855,076 is $18,855,076 minus $15,000,000.

[2] The ratio of the percentage of total intangible assets for current media rights to the percentage of total intangible assets for the remaining intangible assets.

Assets	*Original Allocation*	*Step-up Computation*	*Step-Up*	*Revised Allocation*
National TV Current	$12,500,000	$12,500,000 + ($3,855,076 * ($12,500,000/$15,000,000))	$3,212,563	$15,712,563
Local TV Current	$ 2,000,000	$2,000,000 + ($3,855,076 * ($2,000,000/$15,000,000))	$ 514,010	$ 2,514,010
Local Radio Current	$ 500,000	$500,000 + ($3,855,076 – ($3,212,563 + $514,010))	$ 128,503	$ 628,503
Group Total	$15,000,000			$18,855,076

b. Future Media Rights Gross Step-up Amount is $3,855,076. This amount is calculated by subtracting from the portion of the $57,708,076 to be allocated to future media rights the original allocation to future media rights.

The portion of the $57,708,233 to be allocated to future media rights is $18,855,076, the product of (10.475%/32.06%)[3] * $57,708,233. The original allocation to future media rights was $15,000,000. Thus, the gross step-up amount of $3,855,076 is $18,855,076 minus $15,000,000.

The $3,855,076 is made up of a $3,001,919 reallocation from franchise, etc. (as determined below) plus $853,157 of additional step-up (the difference between the $3,855,076 gross step-up amount and the $3,001,919 reallocation form franchise, etc.).

Assets	*Original Allocation*	*Step-up Computation*	*Revised Allocation*
Future Media Rights	$15,000,000	$15,000,000 + $3,001,919 + $853,157	$18,855,076
Group Total	$15,000,000		$18,855,076

c. Franchise, etc. amount is $19,998,081. The $19,998,081 is the portion of the $57,708,233 allocable to franchise, etc. ((11.11%/32.06%)[4] * $57,708,233). This amount reflects the reallocation from franchise, etc. to future media rights. The reallocation to future media rights is $3,001,919, the difference between the original allocation to franchise, etc. ($23,000,000) and the $19,998,081.

[3] The ratio of the percentage of total intangible assets for current media rights to the percentage of total intangible assets for the remaining intangible assets.

[4] The ratio of the percentage of total intangible assets for franchise, etc. to the percentage of total intangible assets for the remaining intangible assets.

Assets	*Original Allocation*	*Step-up Computation*	*Revised Allocation*
Franchise, etc.	$23,000,000	($23,000,000 - $3,001,919)	$19,998,081
Group Total	$23,000,000		$19,998,081

5. COMPARE THE ORIGINAL ALLOCATION TO THE REVISED ALLOCATION TO ENSURE THAT THE TOTAL AMOUNT OF INTANGIBLE ASSETS IS ACCOUNTED FOR.

The following table compares the original return allocation to the revised allocation made as a result of applying the compliance measure.

Assets	*Original Allocation*	*Revised Allocation*
Player Contracts	$115,000,000	$110,736,640
Season Ticket Holder List	$ 4,000,000	$ 3,851,709
Concession Agreement	$ 3,000,000	$ 2,888,782
Sponsorship Agreements	$ 2,500,000	$ 2,407,318
Luxury Suite Contracts	$ 2,500,000	$ 2,407,318
Group Total	$127,000,000	$122,291,767
National TV Current	$ 12,500,000	$ 15,712,563
Local TV Current	$ 2,000,000	$ 2,514,010
Local Radio Current	$ 500,000	$ 628,503
Group Total	$ 15,000,000	$ 18,855,076
Future Media Rights	$ 15,000,000	$ 18,855,076
Group Total	$ 15,000,000	$ 18,855,076
Franchise, etc.	$ 23,000,000	$ 19,998,081
Group Total	$ 23,000,000	$ 19,998,081
Total Intangible Assets	$180,000,000	$180,000,000

Closing Agreement

The closing agreement that would be prepared in Examination in this example would include the determination of the taxpayer's amortization deductions for all acquired amortizable intangible assets (not including any media rights) based on the revised allocation.

EXAMPLE 2

Y, in an asset acquisition, acquired the assets of sports franchise Z for $200 million. Y allocated $180 million of the purchase to intangible assets. Of the $180 million allocated to intangible assets, Y allocated $137 million to intangible assets for which Y claimed amortization deductions. Of the $137 million, Y allocated $15 million to current media rights (as represented by the current TV and radio contracts), and $122 million to player contracts and other amortizable assets as follows:

Assets	*Original Allocation*	*Useful Life*
Player Contracts	$110,000,000	3.29 years
Season Ticket Holder List	$ 4,000,000	21 years
Concession Agreement	$ 3,000,000	5.5 years
Sponsorship Agreements	$ 2,500,000	2.5 years
Luxury Suite Contracts	$ 2,500,000	2 years
National TV Contracts	$ 12,500,000	4 years
Local TV Contacts	$ 2,000,000	3 years
Local Radio Contracts	$ 500,000	3 years
Group Total	$137,000,000	

Step One – CALCULATE EACH AMORTIZABLE INTANGIBLE ASSET'S PERCENTAGE OF TOTAL INTANGIBLE ASSETS AND GROUP TOTAL

Assets	*Original Allocation*	*Computation*	*Percentage of total Intangibles*
Player Contracts	$110,000,000	$110,000,000/$180,000,000	61.11%
Season Ticket Holder List	$ 4,000,000	$ 4,000,000/$180,000,000	2.22%
Concession Agreement	$ 3,000,000	$ 3,000,000/$180,000,000	1.67%
Sponsorship Agreements	$ 2,500,000	$ 2,500,000/$180,000,000	1.39%
Luxury Suite Contracts	$ 2,500,000	$ 2,500,000/$180,000,000	1.39%
Group Total	$122,000,000		67.78%

Note: The taxpayer's allocation to the media contracts will not be taken into account in the calculation of the present value of the recovery of the cost allocable to the amortizable intangible assets. Examiners are not to allow as a deduction any amortization claimed by the taxpayer for current media contracts.

Step Two - DETERMINE THE PRESENT VALUE (PV) FACTOR FOR EACH AMORTIZABLE INTANGIBLE ASSET (SEE ATTACHMENT A).

Assets	*Useful Life*	*PV Factor*
Player Contracts	3.29 years	89.3%
Season Ticket Holder List	21 years	58.5%
Concession Agreement	5.5 years	84.3%
Sponsorship Agreements	2.5 years	91.1%
Luxury Suite Contracts	2 years	92.3%

Step Three - CALCULATE THE PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO THE AMORTIZABLE INTANGIBLE ASSETS INDIVIDUALLY AND AS A GROUP.

Assets	*Percentage of total Intangibles*	*PV Factor*	*Computation*	*Present Value %*
Player Contracts	61.11%	89.3%	(61.11%)*(89.3%)	54.57%
Season Ticket Holder List	2.22%	58.5%	(2.22%)*(58.5%)	1.30%
Concession Agreement	1.67%	84.3%	(1.67%)*(84.3%)	1.41%
Sponsorship Agreements	1.39%	91.1%	(1.39%)*(91.1%)	1.27%
Luxury Suite Contracts	1.39%	92.3%	(1.39%)*(92.3%)	1.28%
Totals	**67.78**%			**59.83%**

Step Four – DETERMINE IF AN ADJUSTMENT TO BASIS IS REQUIRED. IF REQUIRED, CALCULATE THE AMOUNT OF BASIS REDUCTION IN ORDER TO ACHIEVE A GROUP PRESENT VALUE PERCENTAGE OF THE RECOVERY OF THE COST ALLOCABLE TO THE AMORTIZABLE INTANGIBLES ASSETS THAT DOES NOT EXCEED THE COMPLIANCE MEASURE PERCENTAGE AND ALLOCATE THE BASIS REDUCTION TO EACH OF THE AMORTIZABLE INTANGIBLE ASSETS.

No adjustment to the bases of the amortizable intangible assets is warranted in this example as the present value percentage of the recovery of the cost allocable to amortizable intangible assets of 59.83% does not exceed the compliance measure percentage (60%).

Closing Agreement

The closing agreement that would be prepared in Examination in this example would include the determination of no change to the taxpayer’s amortization deductions for all acquired intangible assets (not including any media rights).

CONTACTS

If you have any questions, please contact Eric Kashdin, Sport Industry Technical Advisor, at 954-423-7325 (eric.kashdin@irs.gov) or Fred Lichtenberg, Sport Industry Technical Advisor, at 954-423-7056 (fred.lichtenberg@irs.gov).

Attachment

cc: Commissioner and Deputy Commissioner, LMSB
Director, Quality Assurance and Performance Management

ATTACHMENT A

Present Value Interest Factor Table

DISCOUNT RATE - 5.50%

USEFUL LIFE	PRESENT VALUE FACTOR
0.25	96.7%
0.50	96.1%
0.75	95.4%
1.00	94.8%
1.25	94.2%
1.50	93.5%
1.75	92.9%
2.00	92.3%
2.25	91.7%
2.50	91.1%
2.75	90.5%
3.00	89.9%
3.25	89.3%
3.50	88.8%
3.75	88.2%
4.00	87.6%
4.25	87.1%
4.50	86.5%
4.75	86.0%
5.00	85.4%
5.25	84.9%
5.50	84.3%
5.75	83.8%
6.00	83.3%
6.25	82.7%
6.50	82.2%
6.75	81.7%
7.00	81.2%
7.25	80.7%
7.50	80.2%
7.75	79.7%
8.00	79.2%
8.25	78.7%
8.50	78.2%
8.75	77.7%
9.00	77.2%
9.25	76.8%
9.50	76.3%
9.75	75.8%

USEFUL LIFE	PRESENT VALUE FACTOR
10.00	75.4%
10.25	74.9%
10.50	74.5%
10.75	74.0%
11.00	73.6%
11.25	73.1%
11.50	72.7%
11.75	72.3%
12.00	71.8%
12.25	71.4%
12.50	71.0%
12.75	70.5%
13.00	70.1%
13.25	69.7%
13.50	69.3%
13.75	68.9%
14.00	68.5%
14.25	68.1%
14.50	67.7%
14.75	67.3%
15.00	66.9%
15.25	66.5%
15.50	66.1%
15.75	65.8%
16.00	65.4%
16.25	65.0%
16.50	64.6%
16.75	64.3%
17.00	63.9%
17.25	63.5%
17.50	63.2%
17.75	62.8%
18.00	62.5%
18.25	62.1%
18.50	61.8%
18.75	61.4%
19.00	61.1%
19.25	60.8%
19.50	60.4%
19.75	60.1%
20.00	59.8%
20.25	59.4%
20.50	59.1%
20.75	58.8%
21.00	58.5%

USEFUL LIFE	PRESENT VALUE FACTOR
21.25	58.1%
21.50	57.8%
21.75	57.5%
22.00	57.2%
22.25	56.9%
22.50	56.6%
22.75	56.3%
23.00	56.0%
23.25	55.7%
23.50	55.4%
23.75	55.1%
24.00	54.8%
24.25	54.5%
24.50	54.2%
24.75	53.9%
25.00	53.7%
25.25	53.4%
25.50	53.1%
25.75	52.8%
26.00	52.5%
26.25	52.3%
26.50	52.0%
26.75	51.7%
27.00	51.5%
27.25	51.2%
27.50	51.0%
27.75	50.7%
28.00	50.4%
28.25	50.2%
28.50	49.9%
26.75	49.7%
29.00	49.4%
29.25	49.2%
29.50	48.9%
29.75	48.7%
30.00	48.4%
30.25	48.2%
30.50	48.0%
30.75	47.7%
31.00	47.5%
31.25	47.3%
31.50	47.0%
31.75	46.8%
32.00	46.6%
32.25	46.3%

USEFUL LIFE	PRESENT VALUE FACTOR
32.50	46.1%
32.75	45.9%
33.00	45.7%
33.25	45.5%
33.50	45.2%
33.75	45.0%
34.00	44.8%
34.25	44.6%
34.50	44.4%
34.75	44.2%
35.00	44.0%
35.25	43.8%
35.50	43.6%
35.75	43.4%
36.00	43.2%
36.25	43.0%
36.50	42.8%
36.75	42.6%
37.00	42.4%
37.25	42.2%
37.50	42.0%
37.75	41.8%
38.00	41.6%
38.25	41.4%
38.50	41.2%
38.75	41.0%
39.00	40.8%
39.25	40.7%
39.50	40.5%
39.75	40.3%
40.00	40.1%
40.25	39.9%
40.50	39.8%
40.75	39.6%
41.00	39.4%
41.25	39.2%
41.50	39.1%
41.75	38.9%
42.00	38.7%
42.25	38.6%
42.50	38.4%
42.75	38.2%
43.00	38.1%
43.25	37.9%
43.50	37.7%

USEFUL LIFE	PRESENT VALUE FACTOR
43.75	37.6%
44.00	37.4%
44.25	37.2%
44.50	37.1%
44.75	36.9%
45.00	36.8%
45.25	36.6%
45.50	36.5%
45.75	36.3%
46.00	36.2%
46.25	36.0%
46.50	35.9%
46.75	35.7%
47.00	35.6%
47.25	35.4%
47.50	35.3%
47.75	35.1%
48.00	35.0%
48.25	34.8%
48.50	34.7%
48.75	34.6%
49.00	34.4%
49.25	34.3%
49.50	34.1%
49.75	34.0%
50.00	33.9%