P. D. B. Sports, Ltd. v. Commissioner, 109 T. C. 423 (1997)

Section 1056 of the Internal Revenue Code does not apply to the sale of a partnership interest in a sports franchise, and partnership basis adjustments under Subchapter K apply exclusively.

Summary

P. D. B. Sports, Ltd. , a partnership owning the Denver Broncos, faced a dispute over the amortizable basis of its player contracts following a change in ownership. The IRS argued that Section 1056, which limits the basis of player contracts in sports franchise sales, should apply. However, the Tax Court held that Section 1056 did not apply to the sale of partnership interests and that the partnership correctly used Subchapter K rules to adjust the basis of the contracts to their fair market value of $36,121,385, allowing for amortization deductions.

Facts

In 1984, Patrick Bowlen purchased a majority interest in P. D. B. Sports, Ltd. , a partnership owning the Denver Broncos. The partnership's basis in the player contracts before the sale was $6,510,555. After the sale, the partnership adjusted the basis to $36,121,385, the estimated fair market value, and began amortizing the contracts over five years. The IRS challenged the amortization, asserting that Section 1056 limited the basis to the original partnership basis plus any gain recognized by the seller.

Procedural History

The IRS issued notices of final partnership administrative adjustments for 1989 and 1990, disallowing amortization deductions. P. D. B. Sports, Ltd. petitioned the Tax Court, which held that Section 1056 did not apply to the sale of partnership interests and upheld the partnership's basis adjustment under Subchapter K.

Issue(s)

1. Whether Section 1056 of the Internal Revenue Code applies to the sale of a partnership interest in a sports franchise?
2. If Section 1056 does not apply, did P. D. B. Sports, Ltd. correctly compute the basis of its player contracts under Subchapter K?

Holding

1. No, because Section 1056 applies only to direct sales of sports franchises and not to indirect transfers through partnership interests.
2. Yes, because the partnership's valuation of $36,121,385 for the player contracts was within the range of estimates and supported by evidence, triggering the mandatory basis adjustment under Section 732(d).

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Court’s Reasoning

The Tax Court reasoned that Section 1056 was intended to address direct sales of sports franchises, not indirect transfers through partnership interests. The court rejected the IRS’s arguments that the partnership should be treated as an aggregate or that a deemed distribution and recontribution constituted a sale or exchange under Section 1056. The court also found that the partnership correctly applied Subchapter K rules, particularly Section 732(d), to adjust the basis of the player contracts to their fair market value, as the partnership’s valuation was conservative and within the range of estimates provided by other NFL teams.

Practical Implications

This decision clarifies that Section 1056 does not apply to partnership transactions involving sports franchises, allowing partnerships to use Subchapter K basis adjustment rules. Legal practitioners should consider this when structuring transactions involving sports franchises held in partnership form. The ruling also underscores the importance of conservative valuations in partnership asset adjustments to avoid challenges from the IRS. Subsequent cases involving similar transactions will likely rely on this decision to determine the applicability of Section 1056 and the use of Subchapter K provisions. This case may influence how sports franchises are bought and sold, particularly in the context of partnership interests, and how basis adjustments are calculated for tax purposes.

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