INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

February 06, 2004

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Third Party Contact: None
Index (UIL) No.: 1060.01-04
CASE-MIS No.: TAM-168289-03, CC:PSI:B06

Taxpayer's Name:
Taxpayer's Address:

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

LEGEND:

Taxpayer:

Party A:

Franchise B:

League C:

Year 1:

Date 2:

ISSUE(S):

Whether certain media rights, which are the rights to receive revenue from local and national broadcast of League C games through existing or future contracts, previously determined to be non-amortizable, are properly characterized as being “in the nature of

goodwill" and, thus, classified as a Class IV asset in accordance with Section 1.1060-1T(d) of the temporary Income Tax Regulations as in effect in Year 1?

CONCLUSION(S):

Because the non-amortizable media rights asset at issue herein possesses characteristics of the concept of goodwill, the non-amortizable media rights asset at issue herein is properly characterized as being "in the nature of goodwill" and, thus, is properly classified as a Class IV asset in accordance with section 1.1060-1T(d) as in effect in Year 1.

FACTS:

Taxpayer (a limited partnership) acquired a professional sports franchise of the League C in Year 1 from a third party. Specifically, the current partners of Taxpayer acquired the entire partnership interest of the prior partners of Party A, which held Franchise B. The change in ownership of over 50% of the partnership interests resulted in an § 708 termination of Party A. Following the termination, Party A contributed all of its assets and liabilities to the new partnership, Taxpayer, and the terminated partnership distributed interests in the new partnership to the purchasing partners. Since a § 754 election was in place, the basis of partnership assets was adjusted pursuant to §§ 743 and 755. Taxpayer allocated the purchase price to the individual assets using the provisions of § 1060, pursuant to § 755.

An accounting firm was retained by Taxpayer to value the acquired assets. Among the assets identified, valued, and determined to have a useful life are both the national television rights and local media (television and radio) rights.

The acquisition of a League C sports franchise admits the purchaser into membership of the League C in which the sports team competes. Membership in the League C carries with it substantial and valuable rights. One of the
rights of a franchisee is to share in League C-wide revenue sources, including national television contracts. This sharing is a perpetual right that exists for as long as the franchise exists. Individual franchises do not have the right to separately negotiate a national broadcast contract. The League C shares the national broadcast revenues among its franchise members. The home team retains local broadcast rights and the away team retains the right to broadcast the game back to its home territory except during playoff or championship matches. The national media contracts have renewal provisions providing for exclusive negotiation rights with respect to any further contract and if no agreement can be reached, League C may negotiate with others.

The franchisee has the right to negotiate local television and radio broadcast contracts. The current contracts have one year remaining, and have renewal language similar to the national television broadcast contracts.

On Date 2, a National Office Field Service Advice (FSA) was issued by the Office of Associate Chief Counsel (Passthroughs and Special Industries) concerning the subject transaction (FSA 200142007). The FSA determined that the media rights acquired in connection with the acquisition by Taxpayer of Franchise B in Year 1 are an asset separate and distinct from goodwill. The FSA also determined that the media rights asset is inherent in the franchise acquired and that such rights have an indeterminate useful life, co-extensive with the life of the franchise, and, thus, are not depreciable under section 167 of the Internal Revenue Code.

LAW AND ANALYSIS:

An intangible asset that would otherwise fall within the concept of goodwill is depreciable provided it has an ascertainable value and a limited useful life that can be determined with reasonable accuracy. Newark Morning Ledger Co. v. U.S., 507 U.S. 546 (1993).

With the purchase of Franchise B, Taxpayer acquired numerous assets, tangible and intangible. Most of the identified assets have an ascertainable value, but some, like the media rights at issue herein have been determined by the Internal Revenue Service to not possess a limited useful life that can be determined with reasonable accuracy.

Treasury regulations under section 1060 provide for the application of the residual method to allocate consideration among all assets of an acquired trade or business. As in effect in Year1, section 1.1060-1T(d) divided the acquired assets into the following four classes: Class I includes cash and cash equivalents; Class II generally includes certificates of deposits; Class III includes all assets (other than Class I, II, or IV assets), both tangible and intangible (whether or not depreciable, depletable or amortizable); and Class IV includes “intangible assets in the nature of goodwill and going concern value.” To the extent that the purchase price exceeds the value of the assets included in Classes I, II and III, the excess is allocated to assets included in Class IV, the residual class of assets. For purposes of section 1060, goodwill is not defined in the Code or regulations, as in effect in Year 1. Treasury and the Service have never defined the phrase “in the nature of” for purposes of these regulations.

New regulations under sections 338 and 1060 proposed in 1999 (REG-107069-97, 1999-2 C.B. 346) and subsequently adopted as final in January 2001 (TD 8940, 2001-1 C.B. 1016), eliminated the phrase “in the nature of” for the residual class of assets. The result was to narrow the scope of the class to only goodwill and going concern value for

years after the period here at issue. The preamble to the 1999 proposed regulations comments that the scope of the residual class (Class V as in effect prior to the 1999 proposed regulations) was narrowed because "many section 197 intangibles would have been characterized by the IRS as assets in the nature of goodwill and going concern value prior to the enactment of section 197, the current regulations provide somewhat ambiguous guidance as to the line between current Class IV and current Class V." 1999-2 C.B. 354. The preamble further noted that another clarification "recognizes that many section 197 assets would have been considered part of goodwill or going concern value at the time Congress enacted section 1060." 1999-2 C.B. at 357.

The reference to "assets" and the use of the phrase "in the nature of" in the description of Class IV in section 1.1060-1T(d)(2) indicates that Class IV includes goodwill and going concern value, and also other assets that can be separately identified and have the characteristic or characteristics of goodwill. The characteristics that define goodwill include an expectation of continued patronage, the excess of purchase price over the value of otherwise identifiable assets of a trade or business, and, for purposes of section 167, no determinable useful life. C.f., Union Bankers Insurance Co. v. Commissioner, 64 TC 807 (1975).

In Rev. Rul. 74-456 (1974-2 C.B.65), the Service concluded that, in general, customer intangibles are "in the nature of goodwill" because they represent the customer structure of a business, their value lasting until an indeterminate time in the future. This revenue ruling also reasoned that "in an unusual case" amortization is allowable for such assets, turning on a factual showing of the assets having (1) an ascertainable value separate and distinct from goodwill, and (2) a limited useful life, the duration of which can be ascertained with reasonable accuracy.

In the instant case, the media rights asset is akin to a customer intangible, has an ascertainable value, but not necessarily a value separate from continued patronage, and does not have a determinable useful life. Consequently, the media rights asset at issue herein possesses characteristics of the concept of goodwill. Accordingly, the non-amortizable media rights at issue herein is properly classified as a Class IV asset in accordance with section 1.1060-1T(d) as in effect in Year 1.

CAVEAT(S):

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