The Selig Case and Amortization of Player Contracts: Baseball Continues Its Winning Ways

S. Barksdale Penick
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By S. Barksdale Penick*

I

Introduction

A recent federal district court opinion has added another chapter to the continuing story of professional baseball's success in the courtroom. In *Selig v. United States*, a part owner of the Milwaukee Brewers baseball team received an extremely favorable tax result, a result best explained by the court's forthright adoption of a policy decision favoring baseball.²

To some degree, all professional sports receive special treatment under the law,³ but baseball has been treated even better than other professional sports. In tort law, for example, owners of baseball teams have been sued many times over the years for injuries to spectators caused by foul balls or broken bats.⁴ With few exceptions, baseball owners have escaped liability, usually by asserting an assumption of risk defense.⁵ By contrast, courts have split where hockey owners have been sued for injuries to spectators.⁶

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2. See infra text accompanying note 118.
5. Id. at 32. The introduction of comparative negligence may erode the basis for denying recovery to a spectator. See Akins v. Glens Falls City School Dist., 53 N.Y.2d 325, 424 N.E.2d 531, 441 N.Y.S.2d 644 (1981), where the Court of Appeals of New York noted the New York cases barring recovery by a spectator on the grounds of assumption of risk, and concluded that under comparative negligence a baseball owner might be found liable. Id. at 331.
The most famous example of baseball's special treatment is its unique antitrust exemption. The Supreme Court has consistently held that baseball is not subject to the Sherman Act. The Court's initial rationale for this conclusion was that baseball was not "commerce" within the meaning of the Sherman Act. In later cases the Court rested its decision on stare decisis. The 1972 Flood decision has been described as a "catechism of the virtues of organized baseball." The Selig opinion voices similar approval of the national sport: "Baseball is good for Americans (who can argue with this).

The Selig dispute essentially involved a single issue—the proper allocation of cost to player contracts purchased with a sports franchise. Because player contracts are amortizable assets, the allocation of cost to player contracts has significant tax implications for owners of teams. Put simply, the higher the allocation to player contracts, the greater the ensuing amortization deductions.

The Selig opinion is the third in a line of cases involving allocations to player contracts. In two earlier cases, Laird v. United States, dealing with the Atlanta Falcons football team, and First Northwest Industries of America, Inc. v. Commissioner, dealing with the Seattle SuperSonics basketball team, the team owners attempted to allocate about ninety percent of their respective purchase prices to player contracts. The Laird court reduced the taxpayer's allocation to thirty-six percent, while the First Northwest court reduced the allocation to twenty-nine percent. In Selig, the court allowed an allocation of ninety-five percent to player contracts, about three times the level permitted in the earlier cases. The government has

12. See infra text accompanying notes 23-32.
16. First Northwest, 70 T.C. at 856.
17. Selig, 565 F. Supp. at 543. The total price was $10.8 million. The $10.2 million allocation was equal to 95%.
appealed the case to the Seventh Circuit, but at least at the
district court level, baseball continues to enjoy greater court-
room success than other professional sports.

This note begins by reviewing sports amortization practices
and the two earlier cases. It then considers the facts, holding
and rationale of the Selig case. This note then argues that the
cost allocation to player contracts in Selig is not supported
by the evidence and concludes that, on appeal, the allocation
should be overturned.

II
The Use of Sports Teams as Tax Shelters

As background to the Selig case, it is necessary to discuss
why the amortization of player contracts has important tax
consequences for purchasers of sports teams.

A professional sports franchise consists of a number of
rights and assets sold together as a package. Veteran player
contracts are one of the assets transferred when an established
sports team is sold; the player roster is simply included in the
package. When an expansion franchise is sold, however, no
such ongoing roster exists. To make new teams more competi-
tive, an expansion purchaser is normally allowed to select vet-
eran players from the rosters of established teams in the
league. Thus, in the sale of either an existing or an expansion
team, the new owner acquires the rights to the services of vet-
eran athletes. Other rights and assets acquired with a sports

19. Id.
21. Traditionally, ownership of a player's contract gave the team the exclusive
right to the athlete's services throughout his career. This was accomplished either
through the use of the reserve clause, which gave the team an indefinitely renewable
option, or by the application of compensation procedures for a team whose player was
signed by another team. See Zaritsky, supra note 3, at 691-92. In a series of cases in
the 1930's, the IRS argued that because of the reserve clause, baseball contracts had
more than a one year useful life, and therefore part of the cost of the contract should
be capitalized. The courts were not persuaded and allowed club owners to deduct the
contract cost. Commissioner v. Chicago Nat'l League Ball Club, 74 F.2d 1010 (7th Cir.
1935); Helvering v. Kansas City Am. Ass'n Baseball Co., 75 F.2d 600 (8th Cir.
1935); Commissioner v. Pittsburgh Athletic Co., 72 F.2d 883 (3rd Cir. 1934). The IRS conceded
the issue for a number of years; however, in 1967 the IRS changed its position and
issued a revenue ruling taking notice of the reserve clause and the effective lifetime
this change of position by the IRS came just before the rise of free agency and the
franchise may include television rights, local monopoly on the league's product, college draft rights, the right to share in future expansion benefits, radio rights, a share of the league's goodwill, and sports equipment.\footnote{22} Most of these rights are intangible rights that may last indefinitely.\footnote{23} Only player contracts and sports equipment necessarily diminish in value with the passage of time; bats and balls wear out and players get older. Because of this deterioration, the cost of acquiring sports equipment and player contracts may be deducted from gross income over the useful life of each asset.\footnote{24} These deductions are termed "depreciation" for tangible assets such as sports equipment, and "amortization" for intangible assets such as player contracts.\footnote{25} The group of non-amortizable intangibles that makes up the rest of the package is often referred to collectively as the "franchise assets," or sometimes simply as the "franchise."\footnote{26}

A purchaser must allocate the price for the entire team among the various assets purchased to reflect the cost of each item.\footnote{27} Whatever portion of the price is allocated to depreciable or amortizable assets may be written off as deductions.\footnote{28} Tangible assets, such as sports equipment, are depreciable but comprise only a small part of the overall value of a team.\footnote{29} By contrast, player contracts are among a team's most valuable assets.\footnote{30} Because player contracts are the only significant amor-

\begin{footnotes}
\footnote{22}{See generally Zaritsky, supra note 3, at 694-95; see also text accompanying notes 122-24.}
\footnote{23}{See Weill, Depreciation of Player Contracts—The Government is Ahead at the Half, 53 Taxes 581, 584-87 (1975).}
\footnote{24}{An asset such as goodwill may decline over time, but if it does, it will be for reasons other than the passage of time.}
\footnote{25}{I.R.C. § 167(a) provides that there shall be allowed as a deduction a reasonable allowance for the exhaustion, wear and tear of property used in the taxpayer's trade or business. Congress has since enacted I.R.C. § 168, which alters the rules for depreciation of tangible personal property, but this would not affect the treatment of an intangible asset such as player contracts. See J. Freeland, S. Lind & R. Stephens, Fundamentals of Federal Income Taxation 732 (4th ed. 1982).}
\footnote{27}{See Note, Sports Franchising, supra note 18, at 321.}
\footnote{28}{See supra note 24.}
\footnote{30}{Id. at 2973.}
\end{footnotes}
Amortization of player contracts has been a flexible tax sheltering tool, in part because of the nature of the asset. Purchasers make their own determinations as to the allocations for player contracts, subject to a test of reasonableness. Because the value of such human assets is difficult to measure objectively, it is possible to inflate the allocation to player contracts without arousing too much attention.

Purchasers also make their own estimates of the useful life of the asset, the period over which deductions are taken. The useful life of a group of player contracts is equated with the estimated average playing careers of the athletes, another figure difficult to measure precisely. Estimates of average playing careers have usually ranged from three to six years, although one estimate was as short as eighteen months, thereby allowing a quick write-off.

Purchasers, therefore, have a measure of control over both the total amount to be amortized and the period of amortization which allows them to structure the transaction within reasonable bounds to meet particular needs. The benefit from the deductions thus can be predicted accurately before purchasing a team and does not depend on the success of the team on the field or at the gate.

Until the passage of the Tax Reform Act of 1976, the advantages to owners of sports teams were even greater. While it is in the purchaser's interest to have a high allocation to player contracts, the seller's interest is best served by a low allocation.

31. See id. at 2976; see also Zaritsky, supra note 3, at 688.
32. Zaritsky, supra note 3, at 688.
33. Note, Sports Franchising, supra note 18, at 323.
34. See House Report, supra note 29, at 2977.
35. Note, Sports Franchising, supra note 18, at 324.
37. See Note, Sports Franchising, supra note 18, at 324.
to avoid recapture provisions that might force the seller to recognize part of the gain from the sale of the team as ordinary income rather than as capital gain.\textsuperscript{40} Despite their opposing interests, the buyer and seller of a team, before 1977, were not required to agree upon a single allocation for use by both—each could provide his own allocation as long as it was reasonable.\textsuperscript{41} Naturally, buyers routinely allocated far more to player contracts than did sellers.\textsuperscript{42}

Since there were no effective restraints on allocations to player contracts, it became standard practice to allocate most of the cost of the team to player contracts.\textsuperscript{43} For example, between 1966 and 1974 the National Basketball Association added nine expansion teams. Each purchaser allocated about ninety percent of the cost of the team to player contracts.\textsuperscript{44} The tax treatment of professional sports owners before 1976 was so beneficial that it has been characterized as a "state of grace within the tax laws."\textsuperscript{45} These benefits have been credited with fueling the tremendous expansion of professional sports in the 1960's and early 1970's.\textsuperscript{46} The tax laws have also been criticized as having encouraged instability in franchise ownership.\textsuperscript{47} Whatever the exact effects of amortization of player contracts, there is little doubt that sports teams were prone to abusive tax shelter practices under pre-1976 law.

III

The Tax Reform Act of 1976

Attention began to focus on sports tax practices in 1974 when

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  \item \textsuperscript{40} Horvitz & Hoffman, \textit{New Tax Developments in the Syndication of Sports Franchises}, 54 \textit{TAXES} 175, 177 (1976). Sellers might have been forced to recognize as ordinary income the portion of the gain on the sale of a franchise attributable to player contracts whose bases had been depreciated below the amount realized on the sale of the contracts. I.R.C. § 1245(a)(4)(A). This problem would only arise where the seller of a team still had players on the team left over from his original purchase. \textit{See generally House Report, supra} note 29, at 2976-77.
  \item Zaritsky, \textit{supra} note 3, at 689.
  \item See \textit{House Report, supra} note 29, at 2976.
  \item See \textit{id. at} 2974.
  \item \textit{First Northwest}, 70 T.C. at 832. For a detailed account of how one owner was able to use these tax strategies to his financial benefit, see \textit{Note, The Professional Sports Team as a Tax Shelter—A Case Study: The Utah Stars}, 1974 \textit{Utah L. Rev.} 556 [hereinafter referred to as \textit{Note, Utah Stars}].
  \item Zaritsky, \textit{supra} note 3, at 679.
  \item See \textit{id. at} 679 n.2. See also \textit{Note, Sports Franchising, supra} note 18, at 321.
  \item \textit{See Note, Utah Stars, supra} note 44, at 569. See also \textit{Note, Sports Franchising, supra} note 18, at 329.
\end{itemize}
the Laird case was tried. Several law review articles appeared detailing the amortization benefits available to purchasers of sports teams.\textsuperscript{48} The House Ways and Means Committee considered some tax curbs on the sports industry in 1974, but they were never reported out of committee.\textsuperscript{49} Later, the issue arose in preparation for the Tax Reform Act (TRA) of 1976. One of the main purposes of this statute was to restrict abusive tax shelters,\textsuperscript{50} and by this time, Congress was persuaded that constraints on sports teams were necessary. It enacted three provisions specifically applicable to sports teams: (1) the creation of a rebuttable presumption that no more than fifty percent of the cost of a team was properly allocable to player contracts;\textsuperscript{51} (2) a requirement that purchaser and seller use consistent allocations;\textsuperscript{52} and (3) a special depreciation recapture provision for sports teams.\textsuperscript{53} The final report of the House Select Committee on Professional Sports stated that the “new tax provisions applicable to professional sports will surely be effective in reducing tax shelter abuses to the extent they have occurred.”\textsuperscript{54} One commentator on the sports provisions felt that they were more than corrective: “1976 marked a dramatic alteration in the taxation of professional sports teams. Owners of professional teams now find themselves forced from a state of grace within the tax laws that had helped promote the incredibly rapid growth of the sports industry.”\textsuperscript{55}

The sports provisions of the TRA of 1976 were intended and expected to significantly alter the amortization of player contracts. However, all three cases, Laird, First Northwest and Selig, arose from transactions in taxable years prior to 1976. The corrective measures passed by Congress would have only prospective application, so it was up to the IRS to attack allocations made under prior law.

\textsuperscript{48} Note, Utah Stars, supra note 44, was the first article dealing with the subject.
\textsuperscript{50} House Report, supra note 29, at 2903.
\textsuperscript{51} I.R.C. § 1056(d).
\textsuperscript{52} I.R.C. § 1056(a).
\textsuperscript{53} I.R.C. § 1245(a) (4). See Wiesner, supra note 49, at 91-93.
\textsuperscript{54} SELECT COMMITTEE ON PROFESSIONAL SPORTS, INQUIRY INTO PROFESSIONAL SPORTS: FINAL REPORT, H.R. REP. NO. 1786, 94th Cong., 2d Sess. 107 (1977) [hereinafter cited as FINAL REPORT].
\textsuperscript{55} Zaritsky, supra note 3, at 679.
IV

Laird

Laird v. United States, the first case to address the amortization of player contracts, grew out of the formation of the Atlanta Falcons football team in 1965. E. Cody Laird was a member of the 'Five Smiths,' the group of investors that purchased the franchise from the National Football League (NFL) and its member teams for $8,500,000. The NFL and the Five Smiths agreed to structure the deal as the purchase of forty-two veteran players from the existing NFL teams for $8,450,000, which in effect allocated nearly one hundred percent of the purchase price to player contracts. On his tax return, Laird reduced the allocation to player contracts to ninety-one percent ($7.7 million) to account for an allocation to interest.

Pursuant to an audit, the Internal Revenue Service reduced the allocation to player contracts to $1.05 million, approximately twelve percent of the cost of the franchise. The other eighty-eight percent of the cost of the franchise was found by the IRS to comprise non-amortizable franchise rights. Laird sued for a refund in the District Court of Northern Georgia. The trial was held in 1974, and was accompanied by widespread publicity. In 1974, the IRS placed all cases involving this issue “in suspense,” ordering agents not to close such cases until Laird was concluded. The IRS accumulated over 130 cases in suspense, pending resolution of this case. A lawyer for the Justice Department stated that the government wished to demonstrate in Laird that it would “no longer accept the arbitrary valuations placed on player contracts for depreciation purposes.”

At the trial, the government went further than merely arguing for a low allocation and tried to demonstrate why it should
not have to accept any allocation at all to player contracts. If it had been successful, this argument would have eliminated all amortization deductions for the Five Smiths. The government argued that an accurate allocation was not possible among the assets of a sports franchise, that a sports team was a bundle of related assets whose values were too closely tied to one another to allow accurate allocation. This line of reasoning, otherwise known as the “mass asset theory,” had been sporadically applied in a number of different areas without much success. The Fifth Circuit had considered the mass asset theory in 1973, and after reviewing the cases that supposedly had applied the theory, it determined that in most of these cases the taxpayers had actually failed to carry their evidentiary burdens.

The government’s choice of the bundle of rights/mass asset theory as its chief argument in Laird seems surprising since any appeal would be to the Fifth Circuit, which had so recently criticized the theory. Furthermore, the earlier cases purporting to apply the mass asset theory had involved much smaller amounts of money than the millions of dollars in potential taxes at stake in Laird. This added financial incentive made it certain that Laird would avoid an evidentiary failure, if it was at all possible. Perhaps the government took an unlikely gamble with the mass asset theory because, if it had been successful, it would have taught the owners a lesson and provided a strong bargaining chip in settling the cases held in suspense.

The government supported the mass asset theory by offering evidence of projected values for all the assets acquired by the Five Smiths, including some rather vague assets such as a share of the NFL’s goodwill and the local monopoly on the league’s product. When added together, these projected values totalled about twice as much as the Five Smiths had paid. The government’s point was that the values of the assets in a

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67. Id.
68. For a list of cases dealing with the mass asset theory, see Comment, supra note 25, at 833-34.
69. Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240, 1249-50 (5th Cir. 1973). The case involved the sale of a newspaper; the government alleged that the list of subscribers constituted a mass asset.
70. For example, Boe v. Commissioner, 35 T.C. 720 (1961), was a mass asset case where the amount in dispute was approximately $30,000. Id.
71. See Laird v. United States, 556 F.2d 1224, 1232 n.13 (5th Cir. 1977).
72. See id. at 1232.
team exist only in the context of each other, and therefore cannot be found to have a separable value.\textsuperscript{73} The district court was not persuaded that an accurate allocation to player contracts was impossible, and accordingly rejected the bundle of rights/mass asset theory.\textsuperscript{74}

As an alternative, the government also presented expert testimony by an economist who estimated the value of the contracts at about $1.4 million.\textsuperscript{75} This evidence was later described by the appellate court as "thoroughly unpersuasive."\textsuperscript{76}

Laird then presented two NFL executives who testified as to the fair market value of the contracts. One estimated $6.8 million, and the other $7.3 million.\textsuperscript{77} On this basis, Laird contended that the $7.7 million allocation was reasonable.\textsuperscript{78} The court, however, found that Laird's allocation was simply too high and did not "reflect economic reality."\textsuperscript{79}

While the court decided that an accurate allocation was possible, it rejected the estimated worth of the contracts offered by the parties, and therefore had to establish the allocation on its own. The court noted that no allocation had been made by the Five Smiths to rights under the existing national television contract, which the court found to deserve an allocation of $4.3 million, the present value of amounts due the Falcons over four years under the then-existing national television contract.\textsuperscript{80} The court then subtracted the $4.3 million from the total amount in dispute, $7.7 million, leaving a remainder of $3.4 million.\textsuperscript{81} The court characterized the remainder as the total amount available for allocation to player contracts.\textsuperscript{82} The court eventually accepted a compromise allocation of $3 million offered by Laird some months after the trial.\textsuperscript{83} The Five Smiths were therefore eligible to write off about thirty-five percent of the cost of the team in amortization deductions.

Laird appealed to the Fifth Circuit on another issue,\textsuperscript{84} and

\textsuperscript{73} Id.
\textsuperscript{74} Laird, 391 F. Supp. at 670.
\textsuperscript{75} Laird v. United States, 556 F.2d at 1238 n.22.
\textsuperscript{76} Id.
\textsuperscript{77} Laird, 391 F. Supp. at 666.
\textsuperscript{78} See id.
\textsuperscript{79} Id. at 669.
\textsuperscript{80} Id. at 664.
\textsuperscript{81} Id. at 664-65.
\textsuperscript{82} Id.
\textsuperscript{83} Id. at 667.
\textsuperscript{84} Laird appealed on the ground that the cost of acquiring television rights should
the government cross-appealed, arguing that (1) the mass asset theory should be applied, and (2) the trial court's allocation was unsupported by the evidence. The court predictably rejected the mass asset theory. The government supported its second point by attacking the "subtraction method" employed by the district court and arguing that in subtracting the value of the television rights from the total amount in dispute, and allocating most of the remainder to player contracts, the court had not accounted for the values of any other rights acquired by the Five Smiths.

In support of its position, the government pointed to its projected value of the entire package of rights, and argued that where such a projection totals more than was paid, the lower court should be required to make findings as to the value of each right acquired. The assumption was that such findings would necessarily reduce the amount allocable to player contracts. This scarcely seems to have been a practical suggestion, for the lower court would have been required to make specific findings as to the value of such nebulous assets as a local NFL monopoly or a share of the NFL's goodwill.

The Fifth Circuit agreed that the subtraction method used by the lower court had been improper, but held that this did not necessarily invalidate the allocation. The court stated:

The fact that the valuation method adopted by the district court arrived at what was, in essence, a compromise ... in no way diminishes the validity of that valuation. The district court was called upon to measure the worth of men, not machinery, a task of no small proportions. In a situation like the one at bar, arriving at a compromise figure was an acceptable valuation solution.

The appellate court was not willing to reject the trial court's allocation merely because of the possibility of overallocation, holding that valuation of every right was not required by the Treasury regulations.

While the government had failed in its attempt to preclude

be considered amortizable. The Fifth Circuit affirmed the district court's rejection of this contention. Laird v. United States, 556 F.2d at 1235.

85. Id. at 1231-35.
86. Id. at 1241.
87. Id.
88. Id. at 1242.
89. Id.
90. Id.
entirely amortization of player contracts, it was regarded as the victor in the *Laird* case. This decision was viewed as a step toward clamping down on tax abuse in the sports industry. The widespread publicity that accompanied the *Laird* case has been credited with having prompted Congress to include the sports provisions in the TRA of 1976. Furthermore, this publicity meant that owners could no longer safely assume their allocations to player contracts would go unnoticed.

**V**

*First Northwest*

The second major case dealing with the amortization of player contracts, *First Northwest Industries of America, Inc. v. Commissioner,* arose from the 1967 formation of the Seattle SuperSonics basketball team. A group of investors purchased the expansion franchise for $1.75 million, and allocated $1.6 million to player contracts, about ninety-one percent of the total price. The IRS reduced the allocation to $450,000, and the taxpayer filed suit in the Tax Court.

Despite the rejection of the mass asset theory in *Laird*, the government again asserted that theory in *First Northwest.* The IRS had some grounds for hoping for better success in *First Northwest*, as the trial was in the Tax Court and any appeal was to the Ninth Circuit, both of which had previously approved the mass asset theory. The trial was held after the enactment of the TRA of 1976, although, as noted above, the case concerned transactions arising under previous law. While it may have been technically plausible to contend that amortization of player contracts should be disallowed, this contention is clearly not consonant with the Congressional intent of the law. The legislative history of the TRA of 1976 shows that Congress considered amortization of player contracts permissible.

91. See Weill, *supra* note 22, at 582-84.
93. 70 T.C. 817 (1978).
94. *Id.* at 822.
95. *Id.* at 844.
96. Tomlinson v. Commissioner, 58 T.C. 570 (1972); Credit Bureau of Erie, Inc. v. Commissioner, 94 T.C. 726 (1970); Boe v. Commissioner, 35 T.C. 720 (1961), *aff'd*, 307 F.2d 339 (9th Cir. 1962). The cases all involved the sale of an ongoing business where one of the assets transferred was a list of customers. The government successfully argued in these cases that such a list was a mass asset. See *Comment, supra* note 25, at 829.
under pre-1976 law. The Fifth Circuit had taken note of the TRA of 1976 in Laird, and the Tax Court mentioned the statute in First Northwest. Thus it was not surprising that the Tax Court found the mass asset theory inapplicable to sports teams, and thereby laid to rest the government's efforts to prevent amortization of player contracts.

As an alternative to the mass asset theory, the government presented expert testimony by an economist who estimated the value of the contracts at $60,000. As a further alternative, the government requested that in any event the allocation by the court should not exceed the $450,000 figure reached on audit by the IRS.

The taxpayer did not try to support his original allocation of $1.6 million at trial, a tacit concession that this previous allocation of ninety-one percent was unreasonable. The taxpayer presented testimony from three basketball executives: two estimated the value of the players at $850,000, and one estimated the value at $875,000.

The court was thus offered a variety of suggestions as to the proper allocation, but as in Laird, was not satisfied with any of them. As for the government witness who had testified to a $60,000 allocation, the court stated that "[w]ith all due respect to the witness as an economist, we find that bottom line figure ridiculous. We disregard it entirely." The taxpayer's witnesses were more credible, but apparently not entirely con-
vinging, as the court found their allocations too high.\footnote{Id.}

The Tax Court, like the district court in \textit{Laird}, having dismissed the allocations made by the parties, was forced to provide its own allocation. The court announced its finding as follows:

Clearly, we are presented with a difficult task, but, after careful study of a record consisting of 1,700 pages of testimony and over two hundred exhibits, we hold that it amply and reasonably supports a finding that of the $1.75 million purchase price a fair market value of $500,000 is allocable to expansion player rights.\footnote{Id. at 856 (footnote omitted).}

The court did not detail its exact method of reaching the $500,000 figure. It is clear the court considered the value of at least two other rights in making its decision—television rights and rights to share in proceeds of future expansion which was already planned at the time.\footnote{Id. at 860-66.} The court did not provide actual values for these rights; apparently they were weighed into the final compromise.

After \textit{Laird} and \textit{First Northwest}, the law concerning amortization of player contracts seemed fairly well settled in most regards. The government had clearly failed with the mass asset theory. Not surprisingly, sports industry executives were more convincing than economists at estimating the value of player contracts. Each case allowed about one third of the total cost of the franchise to be allocated to player contracts. While the cases reached consistent results, it is perhaps most significant that they were unable to articulate a satisfactory method of allocating value to player contracts.\footnote{The government's reliance in both \textit{Laird} and \textit{First Northwest} on the mass asset theory may be partly to blame for the failure to develop a reliable method of allocating cost to player contracts. By focusing its energies on the attempt to persuade the court that an accurate allocation was not possible, the government failed to address sufficiently the question of how such an allocation should be made if allowed by the court.}

A period of laxity towards sports tax practices had been followed by a move to increase scrutiny and tighten the rules of the game;\footnote{See supra text accompanying note 55.} after \textit{First Northwest} it appeared that an equilibrium had been reached. The controversy over amortization of player contracts died down and law review interest in the issue
waned. No cases were reported on the subject from 1978 until 1983, when the Selig opinion appeared.

VI

Selig

Selig v. United States\^[112] involved the formation of the Milwaukee Brewers. The story of the Brewers perhaps begins with the transfer of the Boston Braves to Milwaukee in 1953, giving Milwaukee a major league baseball team for the first time since before the turn of the century.\^[113] The Braves were extremely popular from the start in Milwaukee, and even more so when they won the National League pennant in 1957 and 1958. Yet while the team was popular, the Braves did not make money in Milwaukee, and against the wishes of many local sports fans, the Braves moved in 1965 to Atlanta.\^[114]

Bud Selig had been a shareholder of the Braves in Milwaukee, and when the team left, he set about trying to bring baseball back to Milwaukee.\^[115] Selig formed the Milwaukee Brewers organization in 1965. The group applied for American League membership in 1966 and 1967, and for National League membership in 1966, 1967 and 1968. The group also tried to purchase existing teams, and had nearly obtained the Chicago White Sox in 1969 when the deal fell through. Later in 1969, the Milwaukee group reached an agreement to buy the Seattle Pilots, a struggling team that had entered the American League two years before. The deal was delayed when other American League owners refused to approve the transfer, but the league owners capitulated when the Pilots filed for bankruptcy and a court ordered the sale of the team.\^[116] The team has played in Milwaukee since that time, and in 1983, the Brewers won the American League pennant and brought the World Series back to Milwaukee.

Meanwhile, the IRS challenged the allocation to player con-

\^[111] Of the ten articles cited in this note, eight appeared between 1974-1978, and only two after that period.
\^[113] Milwaukee had a National League team for a single season, 1878, when it finished in last place. BASEBALL ENCYCLOPEDIA 110 (J. Reichler ed. 1982).
\^[114] Selig, 565 F. Supp. at 530.
\^[115] Id.
\^[116] Id. at 530-32.
tracts made by Bud Selig in connection with the purchase of the team. Selig filed suit in the federal district court, and the case came to trial in Milwaukee shortly after the World Series. Whether or not the court was influenced by the recent success and popularity of the Brewers, the opinion straightforwardly voiced an approving and paternalistic attitude toward baseball:

Baseball is good for Americans (who can argue with this), but from a business standpoint, much to my surprise, professional baseball generally is unprofitable. Recognizing that baseball is good for Americans, the courts and Congress have helped professional clubs by taxing them as businesses and by historically exempting professional baseball from the antitrust laws. 

The court did not view the Justice Department quite so favorably. The court stated, "Throughout this case the Government has intimated that there exists in organized baseball a conspiracy to deprive the government of its taxes."

Perhaps by then, the steam had simply gone out of the move to restrict sports tax practices; whatever the reason, the court did not view the case as an effort to curb tax abuse. The court noted that "each side operated on premises inapposite to the other's case." The court seemed to have found the two approaches irreconcilable, and made an initial policy decision in favor of baseball. The tone of the entire opinion reflected this pro-baseball attitude.

Before discussing the arguments and evidence offered at trial, the court surveyed the three markets in which player contracts are bought and sold: the club market, the player market, and the free agent market. The club market includes only those sales of player contracts that accompany the sale of a franchise, the type of sale involved in Selig. The player market consists of transactions between clubs—the trading, buying, and selling of players. The player market was the exclusive market, other than franchise sales, until the recent rise of free agency. In the free agent market, clubs compete to purchase the contract of a player no longer bound to any one

117. Id. at 525.
118. Id. at 528.
119. Id. at 527.
120. Id. at 526.
121. Id. at 530.
122. Id. at 529.
The court cautioned that because these three markets had different characteristics, evidence of transactions in one market might not be relevant to transactions in another.\textsuperscript{124}

The court then turned to the theories offered by the parties. The group including Selig had purchased the Seattle franchise for $10.8 million, and allocated $10.2 million to player contracts, about ninety-four percent of the price.\textsuperscript{125} In addition to Seattle's major league roster, the Brewers received over one hundred minor league players, for a total of 149 players transferred.\textsuperscript{126}

At the trial, Selig showed that the $10.2 million allocation had been based on four appraisals of the players which were made shortly after the 1970 purchase.\textsuperscript{127} The appraisals had been made by four men with considerable baseball experience and were based on personal observations, scouting reports, statistics and conversations with baseball executives. In making their valuations, the appraisers did not know what amount had been allocated by the club owners to player contracts, but they did know that $10.8 million had been the total price of the team.\textsuperscript{128} As the court noted, it was common knowledge in the baseball industry in 1970 that purchasers of teams allocated most of the price to player contracts.\textsuperscript{129} Since the valuations were made by baseball executives who understood the significance of allocations to player contracts, it is not surprising that all of the valuations totalled about $10 million.\textsuperscript{130} After having raised the issue of potential bias, the court dismissed it by concluding that the appraisals were trustworthy and supportive of the $10.2 million.\textsuperscript{131}

As further support, the taxpayer offered evidence of the cost of developing a major league ballplayer through the minor leagues. At the time of the purchase of the Brewers, major league teams spent between $1 million and $1.4 million yearly on their minor league systems.\textsuperscript{132} On the average, a team

\textsuperscript{123} Id. at 529-30.
\textsuperscript{124} Id. at 528-29.
\textsuperscript{125} Id. at 525.
\textsuperscript{126} Id. at 532.
\textsuperscript{127} Id.
\textsuperscript{128} Id. at 534.
\textsuperscript{129} Id.
\textsuperscript{130} Of the four valuations, two were about $10.3 million, and two were about $9.7 million. Id. at 532.
\textsuperscript{131} Id. at 534.
\textsuperscript{132} Id.
moved two to four players per year from the minors to the majors.\textsuperscript{133} Dividing the overall cost to a team by the number of players it developed through the minor league system resulted in a rough figure of $350,000 per player. When multiplied by the number of players on a major league roster (twenty-five) this comparison yields a figure of $8.7 million for the cost of a roster of major league players.\textsuperscript{134} Using this analysis, the taxpayer contended that an overall allocation to player contracts of $10.2 million is reasonable because of the minor league players also transferred.\textsuperscript{135}

The relevance of this evidence seems questionable, for it assumes there is a logical connection between the cost of supporting a minor league team and the price paid by Selig for the player contracts. Any such logical connection is tenuous at best. Nonetheless, the court found this line of reasoning credible and supportive of the taxpayer’s allocation.\textsuperscript{136}

The taxpayer further supported his $10.2 million allocation by (1) showing that the team carried insurance on the players worth $11.3 million;\textsuperscript{137} (2) arguing that because the Milwaukee metropolitan area was a poor prospect for financial success, franchise rights other than player contracts had little value;\textsuperscript{138} and (3) offering evidence of transactions in the free agent market which supported a high valuation of player contracts.\textsuperscript{139} The court commented favorably on all three points.\textsuperscript{140}

The court then turned to the government’s case in a section of the opinion titled “The Government’s Evaluations of the Player Contracts are Unreliable and Irrelevant.”\textsuperscript{141} The government presented two expert witnesses in an attempt to counter Selig’s allocation. One witness, Dewey Soriano, who had been president of the Seattle organization, testified to an allocation of an estimated $3.2 million.\textsuperscript{142} The court noted that this allocation, unlike the taxpayer’s, was “made twelve years after the fact and [was] based primarily on memory.”\textsuperscript{143} The

\begin{enumerate}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id. at 534-35.}
\item \textit{Id.}
\item \textit{Id. at 535.}
\item \textit{Id. at 535-36.}
\item \textit{Id. at 536.}
\item \textit{Id. at 534-36.}
\item \textit{Id. at 536.}
\item \textit{Id. at 541.}
\item \textit{Id.}
\end{enumerate}
court also noted that in the negotiations for the sale of the Seattle team, Soriano had characterized Seattle's players as quite valuable.\textsuperscript{144} Because of this inconsistency, the court found Soriano's testimony unreliable.\textsuperscript{145} The government's other expert witness, Richard Walsh, had been general manager of the California Angels from 1968 to 1971.\textsuperscript{146} Walsh's allocation, also made twelve years after the fact, was based primarily upon a review of player statistics.\textsuperscript{147} The court criticized Walsh for using data from player market transactions to arrive at his allocation for the club market transaction and declined to give his testimony much weight.\textsuperscript{148}

The government also presented several theories based on economic analyses. One of these theories was the "going concern" argument, according to which the entire investment in the Brewers could not be considered a business investment.\textsuperscript{149} Rather, the franchise was an investment with both pleasure and business motives, much as one might purchase a small airplane for both business and pleasure.\textsuperscript{150} In a situation involving mixed investment motives, only that portion attributable to business motives may be eligible for amortization.\textsuperscript{151} The government's economist, Dr. Roger Noll, tried to show that the return that would be received on the investment was not enough to justify, on business grounds, an investment of $10.8 million.\textsuperscript{152}

With the going concern argument, the government was attempting to challenge the court's assumption that Selig's investment was purely a business investment. However, the court was unwilling to alter its initial assumptions:

Purchasing a major league baseball club is not a wise investment from the standpoint of rate of return on investment, but it is nevertheless still a business investment. For the reasons stated in my discussion of the assumptions that underlie this decision this Court cannot allocate part of the $10.8 million investment in the Brewers to business motives.\textsuperscript{153}

\begin{thebibliography}{9}
\bibitem{144} Id.
\bibitem{145} Id.
\bibitem{146} Id. at 541-42.
\bibitem{147} Id. at 542.
\bibitem{148} Id.
\bibitem{149} Id. at 536-37.
\bibitem{150} Cf. Sharp v. United States, 199 F. Supp. 743, (D. Del. 1961), aff'd, 303 F.2d 783 (3rd Cir. 1962) (dealing with the gain on the sale of an airplane used for both business and pleasure).
\bibitem{151} Id. at 744.
\bibitem{152} Selig, 565 F. Supp. at 536-37.
\end{thebibliography}
purchase price to the emotional aspects of the purchase. 153

The government also developed two economic models for determining the worth of player contracts. One of these, an income sensitivity analysis, measured the value of the player contracts by determining the portion of team revenue affected by the quality of team play. 154 The court found the allocation produced by this method to be arbitrary and not necessarily relevant to the case. 155

The second economic model was a regression analysis which produced an equation to predict market value based on information such as the player's statistics, age, and salary level. 156 Based on this method, Dr. Noll testified that one could be ninety-eight percent certain that the true value of the player contracts was between $.5 million and $1.5 million. 157 The court, however, was one hundred percent sure that the regression analysis could not be trusted. 158 The court found fault with both the data base and the method used to derive the equation. 159 The court also criticized Dr. Noll for failing to distinguish transactions in the player market from those in the club market, saying the two were "totally different market[s]." 160

The government further attempted to discredit some of the allocations to specific players by showing that some players who had been assigned high values were released shortly thereafter. 161 The court answered this argument by stating that the release of a player in the player market has nothing to do with his value in the club market. 162 The court stated that "[t]he government's argument totally confuses the two markets." 163 Yet, surely there is some correlation between values in the two markets; if a player has a low enough value in the player market to be released, then he cannot have a high value in the club market. In the opinion, the court faulted the gov-

153. Id. at 537.
154. Id. at 541.
155. Id.
156. Id. at 537-40.
157. Id. at 539.
158. Id. at 541.
159. Id. at 539-41.
160. Id. at 539.
161. Id. at 533.
162. Id. at 534.
163. Id.
ernment three times for failing to distinguish the player market from the club market. Earlier, by contrast, the court had considered free agent market evidence offered by the taxpayer, and had commented favorably on it. The court was thus quick to point out any potential flaw in the government's arguments, on grounds of relevance, bias or credibility, while approving of all the taxpayer's theories, even the logically unpersuasive comparison to minor league costs. In essence, the court seemed predisposed to reject the government's position.

The court concluded that Selig had demonstrated that the player contracts had a fair market value of $10.2 million. The court then applied what it termed "generally accepted accounting principles" which called for allocations to be made to assets to reflect their fair market value.

Other than player contracts, the only asset valued by the court was sports equipment, which was given an allocation of $100,000. The court thus allocated $10.2 million to player contracts and $100,000 to sports equipment, leaving a $500,000 remainder to account for the other franchise rights. This allocation by "generally accepted accounting principles" is equivalent to the subtraction method that was disapproved of by the Fifth Circuit in Laird. The flaw in this method lies in the distinct possibility that some valuable rights may not be given sufficient consideration. Among the franchise assets were television rights. Data attached in the appendix to the case shows that the Brewers received local television revenues of $600,000 in 1970 and 1971, and combined local and national revenues of $1.3 million in the years 1972-1975. The sums generated by television rights suggest that this asset alone was worth more than the $500,000 remainder. The Laird court had specifically accounted for television rights. The Selig court should have done the same.

The allocation of $10.2 million allowed by the court does not

164. See supra text accompanying notes 148, 160 & 163.
165. See supra text accompanying note 140.
166. Selig, 565 F. Supp. at 543.
167. Id. at 526-27.
168. Id. at 532.
169. Id. at 543.
170. See supra text accompanying notes 80-82.
171. Selig, 565 F. Supp. at 545.
172. See supra text accompanying notes 80-82.
make economic sense. The court attempted to rationalize the result:

It is economically impossible to separate the value of the franchise from the value of the player contracts for, in fact, one is valueless without the other . . . . Although it is a legal fiction that one can allocate part of the purchase price of a baseball club to the franchise and part to the player contracts in an economically sensible manner, it is the law that we have to allocate . . . . Once it is accepted that the allocation of the price among the assets is the law, then we are relieved of trying to explain it in rational economic terms and can proceed to test the reasonableness of the allocation in terms of generally accepted accounting principles and legal requirements. This process is necessarily arbitrary from an economic standpoint . . . .

The court's reasoning had begun with certain assumptions about the nature and status of professional sports. Judge Reynolds wrote, "[A]t the outset I will set forth the assumptions (i.e. conclusions of law) that underlie my decision and which pretty much determine the outcome of the case . . . ." When these assumptions led to an illogical result, the court explained the result on the basis of those same assumptions. This circular reasoning provides a weak explanation for the illogical result.

VII
Comparison

In comparing Selig with Laird and First Northwest, the most significant and obvious difference is that the Selig court allowed ninety-five percent of the purchase price to be allocated to player contracts, a percentage about three times the level permitted in the earlier cases.

It might be argued that the facts and circumstances of the Selig case are sufficiently distinguishable from the earlier cases to justify the higher allocation. It is true that the Selig group purchased an established team instead of the expansion franchises involved in the earlier cases. However, the Seattle team had been established for only two years, and its performance on the field had been dismal. If the value of a group of

174. Id. at 526.
175. See supra note 17.
players is related to their ability and performance, the team purchased by the Selig group was not much more valuable than an expansion team.

The Brewers also came with over one hundred minor league players, which unquestionably added some value to the overall purchase of players. Yet, if we accept the court’s assumption that the purpose of a minor league system is to develop two to four major league players per year, then the minor league players should have added to the value of the major league roster by fractions, not multiples. The only other noticeable factual difference is that the Selig case involved baseball while the earlier cases dealt with football and basketball. However, there was no evidence in Selig suggesting that baseball players comprise a higher percentage of their team’s value than is the case in other sports. It is also true that the taxpayer in Selig improved on earlier cases by using expert allocations that had been made years before the case, thereby strengthening their credibility. However, these differences do not appear significant enough to explain the very different result.

In Selig, as in the earlier cases, the government was unable to present persuasive arguments at trial. The government’s economic theories, from the mass asset argument to the regression analysis, met with little success. The government’s attempts at making independent appraisals of the player contracts fared no better; government allocations in the three cases were described in turn as “thoroughly unpersuasive,”176 “ridiculous,”177 and “unreliable and irrelevant.”178

As noted above, all three cases dealing with this issue have concerned events in taxable years before the passage of the Tax Reform Act of 1976. Perhaps the government will be able to present a more effective case when the newer provisions become applicable. However, the presumption that no more than fifty percent of the cost of a team is allocable to player contracts is a rebuttable one, and the result in Selig demonstrates the ability of expert witnesses to support high allocations. Since an owner of a sports team will inevitably have access to better experts than the government,179 the fifty percent presumption may not measurably strengthen the government’s

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176. Laird v. United States, 556 F.2d at 1238 n.22.
177. First Northwest, 70 T.C. at 854.
179. The most persuasive experts in the cases discussed herein have been execu-
The Selig case thus suggests the possibility that the corrective provisions enacted by Congress may not be effective at reducing allocations to player contracts.

VIII
Conclusion

The Selig opinion emphasized that when dealing with player contracts, the allocation process is necessarily arbitrary. The cases support this position, for no accurate method of allocating cost to player contracts has been found. However, the fact that the process may be arbitrary does not mean it must be one-sided. Laird and First Northwest are both best explained as compromises between the competing positions, while Selig in no way demonstrates such a compromise.

The Laird and First Northwest cases, along with the Tax Reform Act of 1976, were part of a general tightening of the tax treatment of sports teams in the mid-1970's. Perhaps the pendulum has swung back, and amortization of player contracts will be seen as a subsidy to the sports industry rather than as a tax sheltering device. However, the policy favoring baseball was taken too far by the district court in Selig. The appeal in Selig will turn on policy questions. The Selig decision should be overturned unless the Seventh Circuit agrees with the district court that baseball is so good for Americans that common sense is not required in the taxation of the sport.

180. The effect of the 50% presumption may be minimal, for the government always enjoys a presumption in its favor in tax cases. See, e.g., United States v. Prince, 348 F.2d 746, 748 (2d Cir. 1965). The presumption's main effect will be to serve as a warning that allocations over 50% may be challenged. See Wiesner, supra note 49, at 92.
181. See supra text accompanying note 173.
182. The Selig court certainly considered tax subsidies appropriate for baseball. See 565 F. Supp. at 928.