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Article

PANDORA'S BOX ENTERS THE BATTER'S BOX: HOW THE TAX CUTS AND JOBS ACT'S UNINTENDED CONSEQUENCE PLACES MLB, AND ALL NORTH AMERICAN LEAGUES, IN TAX CHAOS

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I. INTRODUCTION

In the most recent collective bargaining agreement between Major League Baseball ("MLB") and the Major League Baseball Players Association ("MLBPA"), the word "tax" appears 114 times. Some of these references pertain to MLB's competitive balance tax.[1] First implemented in 2003 in lieu of a salary cap, the competitive balance tax is a three-tiered penalty assessed annually on teams with payroll exceeding a specified amount, or the "base tax threshold."[2] The assessment increases for each consecutive year the team exceeds the threshold, up to a maximum penalty of fifty percent of the excess.[3] In addition, MLB imposes a surcharge on each $20 million increment by which the team exceeds the threshold, up to an excess of $40 million.[4] These additional surcharges can drive the total assessment up to ninety-five percent of the excess.[5]

The New York Yankees are well acquainted with the competitive balance tax, having paid it for fifteen consecutive years since its inception in 2003.[6] They finally avoided it in 2018, however, even after acquiring the remaining term of a $325 million contract with reigning National League Most Valuable Player Giancarlo Stanton from the Miami Marlins on December 11, 2017.[7] In exchange for Stanton, the Yankees traded second baseman Starlin Castro and a

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1. 2017–2021 Basic Agreement, *available at* http://www.mlbplayers.com/pdf9/5450407.pdf [https://perma.cc/LJ8T-U46A] (last visited Mar. 22, 2019).

2. The base tax threshold was increased under the 2017–2021 Collective Bargaining Agreement to $195 million for 2017, $197 million for 2018, $206 million for 2019, $208 million for 2020, and $210 million for 2021. *See id.* at 107.

3. *See id.* at 108.

4. *See id.* at 108–09.

5. *See id.* at 110.

6. *See Yankees Set to Avoid Luxury Tax; Red Sox, Nationals Only Teams over Threshold*, ESPN (Sept. 13, 2018, 6:06 AM), https://abcnews.go.com/Sports/yankees-set-avoid-luxury-tax-red-sox-nationals/story?id=57790844 [https://perma.cc/7KWK-D22W?type=image]. In spite of the hefty penalties, a number of MLB teams exceeded the $195 million threshold in 2017 and paid a total of $61.15 million for this so-called "luxury tax." *See Luxury Tax Payments* by Major League Baseball Teams from 2003 to 2018 (in Million U.S. Dollars)*, STATISTA, https://www.statista.com/statistics/207455/year-by-year-luxury-tax-payments-in-major-league-baseball/ [https://perma.cc/65KP-7ZDT] (last visited Mar. 22, 2019). The Los Angeles Dodgers alone owed $36.2 million; 2017 marked the fourth consecutive year that the team owed the highest assessment in the league, bringing its five-year total to nearly $150 million. *See Dodgers Hit with $36.2 Million Luxury Tax, Yankees with $15.7 Million*, NBC SPORTS (Dec. 19, 2017, 6:39 PM), https://mlb.nbcsports.com/2017/12/19/dodgers-hit-with-36-2-million-luxury-tax-yankees-with-15-7-million/ [https://perma.cc/AJA3-XL7G].

7. *See id.*; *see also* Clark Spencer, *It's Official, Stanton Is Now a Yankee*, MIAMI HERALD (Dec. 11, 2017, 6:24 PM), http://www.miamiherald.com/sports/mlb/miami-marlins/article189137539.html [https://perma.cc/8TNA-GJTR].

pair of minor league players, pitcher Jorge Guzman and infielder Jose Devers.[8]

Meanwhile, Congress was fast at work enacting sweeping changes to the federal tax laws.[9] On December 22, 2017, just eleven days after the Yankees acquired Stanton, Congress enacted the Tax Cuts and Jobs Act, which has been referred to as "the most significant overhaul to the U.S. tax code in thirty years."[10] The changes included a permanently reduced rate of twenty-one percent for corporate taxes as well as a temporary reduction of personal income tax rates.[11] Little could the Yankees have known—in fact, little did Congress realize—that one of the changes under the new tax law has far greater consequences for professional sports than any league salary cap or the competitive balance tax.[12] For the first time in over fifty years, the gains realized on professional sports trades are no longer tax-exempt.

Recognizing that the calculation of gain and loss on these transactions is complex and fraught with uncertainty, the IRS issued safe harbor rules applicable to trades entered into by professional sports teams after April 10, 2019.[13] At the team's election, the rules also apply to trades that were transacted in an open taxable year.[14] However, specific requirements must be met for transactions to fall within the scope of the safe harbor rules.[15] Therefore, any trades transacted on or before April 10, 2019 that were already reported for federal income tax purposes are fully taxable, as are those trades

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8. *See id.*

9. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2054 (2017) (codified as amended in scattered sections of the Internal Revenue Code).

10. Damian Paletta and Jeff Stein, *Sweeping Tax Overhaul Clears Congress*, WASH. POST (Dec. 20, 2017), https://www.washingtonpost.com/business/economy/gop-tax-bill-passes-congress-as-trump-prepares-to-sign-it-into-law/2017/12/20/0ba2fd98-e597-11e7-9ec2-518810e7d44d_story.html?utm_term=.904b0284b596 [https://perma.cc/SZZ4-XE7E].

11. *See id.*

12. The tax bill was rushed through Congress in only two months, and some of the changes, including a potential tax on professional sports trades, were likely unforeseen. "Republicans say they weren't trying to hamstring sports teams: The change in the like-kind provision, Senate staff members said, was simply an attempt to broaden the United States tax base." Jim Tankersley, *A Curveball from the New Tax Law: It Makes Baseball Trades Harder*, N.Y. TIMES (Mar. 19, 2017), https://www.nytimes.com/2018/03/19/us/politics/baseball-tax-law-.html [https://perma.cc/8868-DNZR].

13. *See* Rev. Proc., 2019-18, 2019-18 I.R.B. 1077. For a discussion of the safe harbor rules, see *infra* notes 155–171 and accompanying text.

14. *See id.*

15. *See id.* at § 3. For a discussion of the specific requirements, see *infra* notes 162–165 and accompanying text.

which are deemed out of scope because the safe harbor requirements are not satisfied.

This Article explores many of the uncertainties created by the new federal tax framework by examining some key issues unique to the business of sports. Section II examines the specific change to Internal Revenue Code ("IRC") Section 1031 that affects professional sports trades.[16] Section III looks at MLB's unique standing in the business world since securing a rare antitrust exemption almost a century ago that it has maintained, more or less, through legislative and judicial acquiescence.[17] Section IV examines Section 1031 like-kind exchanges, why such transactions were initially tax-exempt, the IRS's somewhat surprising proclamation that MLB trades qualify as 1031 exchanges,[18] and how the IRS may have turned a blind eye to enforcing Section 1031's technical rules and reporting requirements for professional sports trades. Section IV also outlines the new tax law, how it potentially impacts all major league sports, and some of the complexities involved.[19] Section V takes a practical look at valuation and how it poses a particular challenge in enforcing the new tax law.[20] Finally, Section VI outlines the safe harbor rules issued by the IRS for the calculation of gain or loss on professional sports trades.[21]

II. UNCHARTERED WATERS: A NEW GAINS TAX ON PROFESSIONAL SPORTS TRADES

Along with many other changes, the new tax law drastically reduces the scope of IRC Section 1031 that applied largely to manufacturers and farmers—and, as it turns out, major league sports—and allowed them to swap certain "like-kind" assets without recognizing gain or loss.[22] Under the new law, only the exchange of cer-

16. For a discussion of the specific changes to I.R.C. § 1031 that impact professional sports, see *infra* notes 22–31 and accompanying text.

17. For a discussion of MLB's anti-trust exemption and how it has been maintained even through challenges in the federal judicial system, see *infra* notes 32–73 and accompanying text.

18. *See* Rev. Rul. 67-380, 1967-2 C.B. 291.

19. For a discussion of the history of I.R.C. section 1031 and its impact on trades in the major sports leagues, including MLB, see *infra* notes 70–121 and accompanying text.

20. For a practical discussion of valuation and the challenge it poses in enforcing the new tax law, see *infra* notes 126–153 and accompanying text.

21. For a discussion of the safe harbor rules, see *infra* notes 155-71 and accompanying text.

22. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2123–2124 (2017) (amending I.R.C. § 1031 (2008)). Section 1031 applied to the exchange of certain like-kind assets used in a trade or business or held for investment. *See*

tain types of real estate remains tax exempt. This change was projected to raise $30.5 billion in tax revenue over the next decade.[23] The unintended consequence of this change is that trades like the one involving Giancarlo Stanton are now taxable, giving rise to new complexities in the world of professional sports.

Specifically, unless a team can invoke the safe harbor rules prescribed by the IRS, it will have to determine the fair market value of each player's contract at the time of the exchange before calculating the gain or loss on each of the players traded.[24] This is easier said than done. A player's fair market value is not necessarily the same as the remaining cost of his current contract; one significant factor is the player's prior season performance.[25] For example, if a player's performance greatly improves from one year to the next, his market value might exceed the value he signed for originally. In addition, valuations can differ depending on the method used and other various factors unique to the league in question.[26] Trading a player who was originally acquired in a 1031 exchange adds another layer of complexity.[27]

In any case, a gains tax poses a potentially significant added expense. Consider, for example, the sheer magnitude of Stanton's $325 million contract and the fact that every $1 million of gain taxed at the twenty-one percent corporate rate yields an additional $210,000 tax liability. Consider also that in 2017 alone, MLB saw approximately 375 players traded in ninety-nine separate like-kind

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I.R.C. §1031(a) (2008) (amended 2017). Under the previous version of I.R.C. § 1031, gain was recognized in a like-kind exchange only to the extent that "boot" (cash and other non-like-kind property) was received in the exchange. *See id.* §1031(a)–(b). This was also the rule articulated for professional sports trades. *See* Rev. Rul. 67-380, 1967-2 C.B. 291.

23. *See* 131 Stat. at 2123–2124; *see also* STAFF OF JOINT COMMITTEE ON TAXATION, 115TH CONG., ESTIMATED REVENUE EFFECTS OF THE "TAX CUTS AND JOBS ACT," AS PASSED BY THE SENATE ON DECEMBER 2, 2017, FISCAL YEARS 2018–2027, JCX-63-17, 7 l.C(7) (2017), *available at* https://www.jct.gov/publications.html?func=startdown &id=5047.

24. For a discussion of valuation of player contracts, *see* IRS, *Sports Franchises, Market Segment Specialization Program,* Training 3123-005 (8–99), TPDS No. 839831, at 12-1–12-5, *available at* http://www.unclefed.com/SurviveIRS/MSSP/sport.pdf. [https://perma.cc/YV3U-QYXH] (providing IRS guidance on examination of sports franchises).

25. *See, e.g., id.*, at 12-4; *see also* Tankersley, *supra* note 12.

26. For further discussion of different valuation methods, see *infra* notes 126–153 and accompanying text.

27. For a full discussion of 1031 exchange transactions, see *infra* notes 74–125 and accompanying text.

exchanges, while a total of 330 trades were transacted among the four major North American sports leagues.[28]

On the other hand, it was somewhat doubtful that teams would adhere to the reporting requirements and that the new tax would be fully enforced. This doubt was grounded in reality. Simply put, MLB is adept at minimizing government regulation. The League has maintained a rare antitrust exemption since 1922 and, quite possibly, an implicit exemption from the technical rules and annual reporting requirements for like-kind exchanges under Section 1031.[29] MLB is a $9.46 billion industry that has paid millions of dollars in lobbying expenses over the years.[30] When asked about the League's position on the new tax, MLB's chief legal officer Daniel R. Halem stated: "This is a change we hope was inadvertent, and we're going to lobby hard to get it corrected."[31] If the past, beginning with baseball's antitrust exemption almost 100 years ago, was any indication, MLB's chances of success were not to be underestimated.

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28. *See MLBTR Transaction Tracker*, MLB TRADE RUMORS, https://www.mlbtraderumors.com/transactiontracker [https://perma.cc/3Q4E-8PEW] (last visited Mar. 22, 2019) (allowing users to search for and display all MLB trades made in 2017); *NFL Transactions*, SPORTRAC, https://www.spotrac.com/nfl/transactions/2017/trade/ [https://perma.cc/5MMM-6HFR] (last visited Mar. 22, 2019) (listing all National Football League trades in 2017); *NHL Transactions*, SPORTRAC, https://www.spotrac.com/nhl/transactions/2017/trade/ [https://perma.cc/Z6PA-ZNKH] (last visited Mar. 22, 2019) (listing all National Hockey League trades in 2017); *NBA Transactions*, SPORTRAC, https://www.spotrac.com/nba/transactions/2017/all/trade/ [https://perma.cc/T96E-JZ37] (last visited Mar. 22, 2019) (listing all National Basketball Association trades in 2017).

29. *See generally* Fed. Baseball Club of Balt., Inc. v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200 (1922). An IRS audit guide does address gain and loss on professional sports trades under I.R.C. § 1031, including the recognition of gain up to the value of any cash and other non-like-kind property received in the exchange; *Sports Franchises, Market Segment Specialization Program, supra* note 24. The audit guide is consistent with Revenue Ruling 67-380, 1967-2 C.B. 291. However, it is unclear to what extent professional sports teams have complied with the reporting requirements under I.R.C. § 1031 or to what extent the IRS has enforced the tax.

30. *See Major League Baseball Total League Revenue from 2001 to 2017 (in Billion U.S. Dollars)**, STATISTA, https://www.statista.com/statistics/193466/total-league-revenue-of-the-mlb-since-2005/ (last visited Nov. 8, 2018). MLB paid $1.32 million to lobbyists in 2016 and again in 2017. It paid an additional $660,000, in 2018, as of August 28 that year. *See Major League Baseball Commissioner's Ofc: Summary*, CTR. FOR RESPONSIVE POL., https://www.opensecrets.org/lobby/clientsum.php?id=D000022093&year=2018 [https://perma.cc/CVB2-LVS5] (last visited Nov. 8, 2018).

31. Tankersley, *supra* note 12.

III. BASEBALL'S RARE ANTITRUST EXEMPTION: "AMERICA'S FAVORITE PASTIME" HITS A HOMERUN

The first antitrust law was enacted in 1890 and was "aimed at preserving free and unfettered competition as the rule of trade."[32] Known as the Sherman Act, the act outlaws "every contract, combination, or conspiracy in restraint of trade," and any "monopolization, attempted monopolization, or conspiracy or combination to monopolize."[33] Ultimately, antitrust laws are designed to protect consumers by preventing businesses from gaining unrestrained market power and ensuring they compete fairly.[34] Yet, MLB—a $9.46 billion industry with thirty teams averaging $315.3 million in revenue and thirty-six players projected to earn over $21 million in 2017—has enjoyed a rare antitrust exemption for nearly a century. This extraordinary feat dates back to a United States Supreme Court decision written by Justice Oliver Wendell Holmes in 1922.[35] The exemption has since survived a series of challenges, including two appeals that were rejected by the Court as recently as June 2018.[36]

A. *Federal Baseball*

The Federal League of Baseball folded in 1915 after its second season of play when five of its eight clubs joined the so-called "Peace Agreement" with the other two major leagues.[37] Under the agreement, club owners received cash settlements or ownership shares in major league franchises.[38] The owners of the Baltimore Terrapins, however, were excluded from the agreement, standing

32. *Guide to Antitrust Laws*, FED. TRADE COMM'N (last visited Mar. 22, 2019) (quoting N. Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1968)), https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws [https://perma.cc/2DUC-ERDP].

33. *Id.*

34. *See* RODNEY D. FORT, SPORTS ECONOMICS, 425 (2d ed. 2006).

35. *See Major League Baseball Total League Revenue from 2001 to 2017 (in Billion U.S. Dollars)**, STATISTA, https://www.statista.com/statistics/193466/total-league-revenue-of-the-mlb-since-2005/ (last visited Nov. 8, 2018); *see also The Highest-Paid Players on Every MLB Team*, BUS. INSIDER (Sept. 4, 2017, 4:08 PM), https://www.businessinsider.com/mlb-highest-paid-players-every-team-2017-7 [https://perma.cc/LH9Y-CPMU]; *see generally* Fed. Baseball Club of Balt., Inc. v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200 (1922).

36. *See* Right Field Rooftops, LLC v. Chic. Cubs Baseball Club, LLC, 870 F.3d 682, *cert. denied* 138 S. Ct. 2621 (2018); Wyckoff v. Office of Comm'r of Baseball, 705 F. App'x 26, *cert. denied* 138 S. Ct. 2621 (2018).

37. *See* BRAD SNYDER, A WELL-PAID SLAVE: CURT FLOOD'S FIGHT FOR FREE AGENCY IN PROFESSIONAL SPORTS, 20 (2007).

38. *See id.*

firm in their demands for a major league club in Baltimore.[39] They ultimately sued alleging that a reserve clause limiting free agency, along with other monopolistic practices, was invoked to destroy the Federal League.[40] It was then that the United States Supreme Court began deregulating baseball.

On May 29, 1922, Justice Oliver Wendell Holmes issued a decision on behalf of a unanimous Court in favor of what was then known as the National League of Professional Baseball Clubs.[41] He reasoned that the owners of the Baltimore Terrapins were not entitled to damages under the Sherman Act because professional baseball did not constitute interstate commerce and, therefore, was not subject to federal regulation.[42] Following Holmes's opinion, the issue did not resurface for another twenty-five years.

Beginning in 1948, however, there were several challenges to MLB's exemption. The first was brought by Danny Gardella, a 1946 wartime replacement player for the New York Giants who turned down the team's contract proposal for the 1947 season.[43] MLB subsequently banned him and seventeen other players for five years after they signed with the Mexican League and played a season there.[44] After a disappointing decision in the United States District Court for the Southern District of New York in which Judge Henry W. Goddard held it was outside the court's jurisdiction to overturn the exemption afforded to MLB by the United States Supreme Court in *Federal Baseball Club of Baltimore, Inc.*,[45] Gardella filed an

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39. *See id.*

40. *See id.*

41. *See Fed. Baseball*, 259 U.S. at 208–09.

42. *Id.* (providing how Holmes stated that "[t]he business is giving exhibitions of baseball, which are purely state affairs" and that the transportation of people across state lines to view those exhibitions was purely incidental and "not enough to change the character of the business").

43. *See* Ed Edmonds, Over Forty Years in the On-Deck Circle: Congress and the Baseball Antitrust Exemption, 19 T. MARSHALL L. REV. 627, 632–34 (1994), *available at* https://scholarship.law.nd.edu/law_faculty_scholarship/470/ [https://perma.cc/T4CU-8RGS]; *see also* LEE LOWENFISH, THE IMPERFECT DIAMOND: A HISTORY OF BASEBALL'S LABOR WARS 162–63 (rev. ed. 1991).

44. *See id.*

45. Goddard stated the following:

> Notwithstanding that there seems to me to be a clear trend towards a broader conception of what constitutes interstate commerce than formerly in view of the expanding and changing conditions since the decision in the Federal Baseball Club case, I feel that as the Circuit Court of Appeals of this Circuit regards Federal Base Ball Club v. National League as authority, this court must do so.

Gardella v. Chandler, 79 F. Supp. 260, 263 (S.D.N.Y. 1948).

appeal in the United States Court of Appeals for the Second Circuit.[46]

On February 9, 1949, a three-judge panel ruled 2-1 that Gardella's case held enough merit to warrant a trial.[47] However, on October 8, 1949, the World Series between the Dodgers and the Yankees eclipsed what would have otherwise been headline news: Gardella's case settled out of court one month before the trial was slated to begin.[48] Gardella later admitted to receiving a cash settlement of more than $60,000, which he split with his lawyer.[49] For MLB, it was a small price to pay to avert the very real threat Gardella posed to the League's antitrust exemption.

The issue at stake in the Gardella case—whether the tides had changed and *Federal Baseball* should be overturned—prompted some members of Congress to examine the issue more closely.[50] As early as April 1949, Congressmen A.S. "Syd" Herlong of Florida and Wilbur Mills of Arkansas introduced a bill that would create a legislative exemption and legalize the reserve clause limiting free agency.[51] At least sixty bills concerning baseball's exemption were introduced over the next two decades, but no legislative action was taken.[52]

In May 1951, Democratic Congressman Emanuel Celler of Brooklyn proclaimed: "If baseball is illegal, then we must prosecute

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46. *See generally* Gardella v. Chandler, 172 F.2d 402 (2d Cir. 1949).

47. *See id.* The three-judge panel included Judge Harrie Brigham Chase, who was in the minority in considering Holmes's *Federal Baseball* decision binding, and Judges Jerome Frank and Learned Hand, both of whom voted in favor of granting Gardella a trial. *Id.* In so ruling, Frank noted the following:

> I reach that conclusion somewhat hesitantly. For, while the Supreme Court has never explicitly overruled the Federal Baseball Club case, it has overruled the precedents upon which that decision was based; and the concept of commerce has changed enough in the last two decades so that, if that case were before the Supreme Court de novo, it seems very likely that the Court would decide the other way. This court cannot, of course, tell the Supreme Court that it was once wrong. But "one should not wait for formal retraction in the face of changes plainly foreshadowed;" this court's duty is "to divine, as best it can, what would be the event of the appeal in the case before it . . . Legal doctrines, as first enunciated, often prove to be inadequate under the impact of ensuing experience in their practical application. And when a lower court perceives a pronounced new doctrinal trend in Supreme Court decisions, it is its duty, cautiously to be sure, to follow not to resist it."

Id. at 409 n.1 (internal citations omitted).

48. *See* LEE LOWENFISH, *supra* note 43, at 167.

49. *See id.*

50. *See id.* at 164.

51. *See id.*

52. *See id.*

the owners or change the law."[53] He opened an investigation several months later.[54] By that time, eight separate actions had been brought against various representatives of organized baseball seeking treble damages totaling several millions of dollars, as provided for under the Clayton Act for federal antitrust violations.[55] However, after interviewing several key members of the baseball community, the Subcommittee on the Study of Monopoly Power recommended no legislative action, deferring to the courts.[56]

B. *Toolson*

It would not take long for the courts to weigh in on baseball's antitrust exemption. This time, the case involved George Earl Toolson, a player who pitched only 138 games in the minors.[57] After the Yankees demoted him in 1950 to their Class A affiliate in Binghamton, New York, he refused to report for duty and was consequently placed on the ineligible list.[58] He then sued the Yankees, alleging that his ineligibility status was an illegal restraint of trade.[59] However, both the District Court for the Southern District of California and the Ninth Circuit Court of Appeals ruled against him, citing *Federal Baseball*.[60] The United States Supreme Court then granted *certiorari,* and his case was argued in October 1953 together with two other cases challenging the exemption.[61]

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53. *See id.* at 174.

54. *See id.*

55. *See* H.R. REP. NO. 82-2002 (1952); *see also* Clayton Antitrust Act, Pub. L. No. 63-212, 38 Stat. 730, 730-40 (1914) (codified at 15 U.S.C. §§ 12–27, 15(a)).

56. H.R. REP. NO. 82-2002. Members of the baseball community who were interviewed by the committee included MLB commissioner Ford Frick, Chicago Cubs president Philip Wrigley, former New York Yankees owner Lehland "Larry" MacPhail, Boston Red Sox manager Lou Boudreau, and Brooklyn Dodgers short stop Pee Wee Reese. In addition, the committee sent questionnaires to a random selection of baseball writers.

57. *See George Toolson*, BASEBALL REFERENCE, https://www.baseball-reference.com/register/player.fcgi?id=toolso001geo [https://perma.cc/5ZMU-QHA5] (last visited Mar. 22, 2019) (providing Toolson's career statistics, spanning seasons from 1942 through 1950).

58. *See George Toolson: Biographical Information*, BASEBALL REFERENCE, https://www.baseball-reference.com/bullpen/George_Toolson [https://perma.cc/EE48-2FNQ] (last updated Oct. 28, 2010, 2:55 AM) ("He moved to California and sued the Yankees . . . claiming he had been effectively banned from baseball.").

59. *See* Toolson v. N.Y. Yankees, Inc., 101 F. Supp. 93 (S.D. Cal. 1951), *aff'd* 200 F.2d 198 (9th Cir. 1952).

60. *See id.*

61. *See* Toolson v. N.Y. Yankees, Inc., 345 U.S. 963 (1953) ("Petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit granted and case transferred to the summary docket.").

On November 9, 1953, in a 7-2 decision, the Court upheld the lower court's ruling.[62] However, it did not rely on *Federal Baseball.* Instead, it based its decision on what amounted to Congressional acquiescence. Although it was well within Congress's power to overturn existing case law, the Court reasoned, it had not done so in over thirty years, signaling its endorsement of MLB's exemption.[63] Toolson's pivotal action was thus the second case in which the United States Supreme Court held that MLB was exempt from existing antitrust legislation.

Soon after rendering the *Toolson* decision, the Court muddled the issue further. It determined, in subsequent cases, that baseball's antitrust exemption did not extend to other professional sports, meaning as long as Congress acquiesced in the MLB exemption, the Court's current interpretation should be adhered to, but only as it related to baseball.[64] Congress responded by proposing an exemption for the national football, hockey, and basketball leagues, but the proposal failed to make it past the Subcommittee on Antitrust and Monopoly in 1958.[65]

C. *Flood*

Curt Flood, a centerfielder who played twelve seasons for the St. Louis Cardinals, brought yet another challenge to baseball's antitrust exemption before the United States Supreme Court in 1972.[66] During his time in St. Louis, Flood won three World Series

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62. *See generally* Toolson v. N.Y. Yankees, Inc., 346 U.S. 356 (1953).

63. *See id.* at 357 ("Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation.").

64. *See* Radovich v. Nat'l Football League, 352 U.S. 445, 452 (1957) ("It seems that this language would have made it clear that the Court intended to isolate these cases by limiting them to baseball, but since Toolson and Federal Baseball are still cited as controlling authority in antitrust actions involving other fields of business, we now specifically limit the rule there established to the facts there involved, i.e., the business of organized professional baseball."). The majority conceded that, in all probability, it would deny baseball its antitrust exemption if the issue were heard *de novo*, but that the Court was bound by existing case law in the absence of legislative action.

65. *See Sports Antitrust Bill*, CQ ALMANAC 1958, 14th ed., 10-318-10-320. Washington, DC: Congressional Quarterly (1959), *available at* https://library.cqpress.com/cqalmanac/document.php?id=cqal58-1341776 [https://perma.cc/4YUJ-47NZ] ("The House Judiciary Committee early in 1958 gave its approval to a measure making antitrust laws applicable to professional sports, but the House overruled its Committee by amending the bill to exempt most activities of professional baseball, basketball, football and hockey from such regulation. The Senate did not act on either proposal.").

66. *See generally* Flood v. Kuhn, 407 U.S. 258 (1972).

titles and seven Gold Glove Awards and served as the team co-captain from 1965 to 1969.[67] He was traded to the Philadelphia Phillies in the 1969 offseason and subsequently sued MLB and the Commissioner's office for invoking the reserve clause, which denied him the right to contract with another major league team.[68]

On June 19, 1972, the Court upheld MLB's exemption, ruling that the longstanding inconsistency between baseball and other professional sports was an issue for the legislature to address rather than the courts.[69] Yet it was another sixteen years before Congress took action and passed the "Curt Flood Act of 1998," extending the same rights to baseball players under federal antitrust law that are afforded to other professional athletes.[70] The act did not change existing antitrust law in any other context or with respect to any other person or entity.[71]

The antitrust exemption was a surprising windfall for baseball that has survived a series of challenges spanning an entire century. This includes two recent petitions dismissed by the United States Supreme Court in June 2018.[72] It is remarkable that the federal government released its grip on such a vast and powerful empire. However, it did so not just under federal antitrust law, but also under federal tax law until 2017, affording MLB an exemption under IRC Section 1031.[73] This new exemption pertains to a gains tax on professional sports trades.

IV. SECTION 1031 LIKE-KIND EXCHANGES: AMERICA'S FAVORITE PASTIME HITS ANOTHER HOMERUN

The Revenue Act of 1921[74] enacted the earliest tax-deferred exchange provision in the United States.[75] In stark contrast to later versions of the law, it allowed investors to defer their gains and

67. *See id.* at 264.

68. *See id.* at 265.

69. *See id.* at 267–68.

70. *See* Curt Flood Act of 1998, Pub. L. No. 105-297, 112 Stat. 2824, 2824–2826 (1998) (codified at 15 U.S.C. § 26).

71. *See id.* at 2824.

72. *See* Right Field Rooftops, LLC v. Chic. Cubs Baseball Club, LLC, 870 F.3d 682, *cert. denied* 138 S. Ct. 2621 (2018); Wyckoff v. Office of Comm'r of Baseball, 705 F. App'x 26, *cert. denied* 138 S. Ct. 2621 (2018).

73. *See* Rev. Rul. 67-380, 1967-2 C.B. 291.

74. Revenue Act of 1921, Pub. L. No. 67-98, 42 Stat. 227, 230 (1921) (originally codified at I.R.C. § 202(c)).

75. *See History of Section 1031 of the Internal Revenue Code*, EXETER 1031 EXCHANGE, http://www.exeter1031.com/History_Section_1031.aspx [https://perma.cc/B2WG-BUD3] (last visited Mar. 22, 2019).

losses on the exchange of securities and other property that did not have a readily realizable market value.[76] It also allowed gains and losses to be deferred on the exchange of like-kind properties held for investment or for productive use in a trade or business.[77]

One of the purposes of the original law was the administrative convenience it afforded.[78] In order to determine gain or loss on the disposition of property, a property must be assigned its fair market value.[79] However, this can prove difficult when dealing with property not having a "readily realizable or ascertainable value such as property in a two-party swap."[80] By deferring the gain or loss on such exchanges, the difficult task of assigning fair market value was eliminated. This issue is relevant to the high-profile "swaps" of player contracts today, and it may explain the position taken by MLB's chief legal officer, Daniel R. Halem, who stated: "'There is no fair-market value of a baseball player. There isn't[.]'"[81]

Yet, just three years after the law's enactment, Congress amended it to remove any reference to property not having a "readily realizable market value."[82] It reasoned:

> The provision is so indefinite that it cannot be applied with accuracy or with consistency. It appears best to provide generally that gain or loss is recognized from all exchanges, and then *except specifically and in definite terms those cases of exchanges in which it is not desired to tax the gain or allow the loss.* This results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result.[83]

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76. *See id.*

77. *See Legislative History of IRC Section 1031*, FED. OF EXCHANGE ACCOMMODATORS, http://www.1031taxreform.com/1031history/#references [https://perma.cc/2XVQ-C8EP] (last visited Mar. 22, 2019).

78. *See id.* (discussing how original purpose of "administrative convenience" was "designed to avoid the cost and complication of assigning value, and therefore gain or loss, to property that did not have readily realizable or ascertainable value such as property in a two-party swap").

79. To calculate the gain or loss on property that is sold or exchange, the taxpayer must determine the "amount realized" in the transaction. *See* I.R.C. § 1001(a) (2017). The "amount realized" is the amount of cash plus the fair market value of other property the taxpayer received. *See id.* § 1001(b).

80. *Legislative History of IRC Section 1031*, *supra* note 77.

81. Tankersley, *supra* note 12.

82. Act of March 4, 1923, Pub. L. No. 67-546, 42 Stat. 1560, 1560–61 (1923).

83. *Legislative History of IRC Section 1031*, *supra* note 77 (emphasis added), *citing* H.R. Rep. No. 68-179, at 13 (1924), *reprinted in* 1939-1 C.B. 241, 251.

A. Major League Baseball Trades Qualify as 1031 Exchanges

It was another forty-three years before the IRS articulated a formal tax exemption for baseball trades under Section 1031.[84] In 1967, the IRS issued Revenue Ruling 67-380, stating its position that MLB player trades qualify as like-kind exchanges.[85] This position was later extended to other professional sports, including the National Football League, National Hockey League, and National Basketball Association.[86] The 1967 ruling was another huge windfall for baseball and, like the federal antitrust exemption, one MLB is prepared to "lobby hard" for in the wake of the 2017 changes to the federal tax laws.[87]

The reason given for the exemption was that trading a player for a player in baseball is no different from trading a bus that is held for productive use in a trade or business for a like-kind bus.[88] However, the ruling glossed over the fact that baseball clubs do not technically trade players as people. Rather, they trade the rights to enforce the players' contracts. That presents an issue. Section 1031 excluded certain property from like-kind exchange treatment,[89] including "choses in action."[90] A "chose in action" describes all of the personal rights to property that can be claimed or enforced exclusively through legal action, as opposed to taking possession.[91] Simply put, a chose in action includes the rights to enforce a contract.[92] As such, the right to enforce a player's contract qualifies as a chose in action and is disqualified from Section 1031 like-kind exchange treatment.

Nevertheless, the IRS took the position more than fifty years ago that MLB trades did, in fact, qualify as like-kind exchanges and were thus tax-exempt under Section 1031. The IRS articulated the same rule for baseball trades that applied to other Section 1031

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84. *See* Rev. Rul. 67-38, 1967-1 C.B. 9. The exemption was later extended to other professional sports. *See, e.g.*, Rev. Rul. 71-137, 1971-1 C.B. 104.

85. *See* Rev. Rul. 67-380, 1967-2 C.B. 291.

86. *See* Rev. Rul. 71-137.

87. *See* Tankersley, *supra* note 12.

88. *See* Rev. Rul. 67-380.

89. *See* I.R.C. § 1031(a)(2) (2008) (amended 2017).

90. *See id.* at § 1031(a)(2)(F).

91. *See* Torkington v. Magee, [1902] 2 K.B. 427, 430 (Eng.).

92. If a party fails to perform its obligation under a contract, the injured party can enforce his rights or seek damages only by suing the party in breach. *See* W.S. Holdsworth, *The History of the Treatment of "Choses" in Action by the Common Law*, 33 HARV. L. REV. 997, 997 (1920).

exchanges.[93] The revenue ruling was issued at a time when player trades were relatively simple. Clubs typically traded one player's contract for another, and no gain was recognized.[94] But player trades have become much more complex, involving significant sums of cash and other non-like-kind properties (referred to as "boot"),[95] which only increases the potential for gain to be recognized in a 1031 exchange.[96]

B. The Basics of a Section 1031 Transaction

Two of the most basic tenets of tax law are: 1) gain or loss is realized any time an asset is sold, exchanged, or otherwise disposed of; and 2) unless specifically excluded by law, the full amount of gain or loss is recognized immediately for tax purposes.[97] In this context, the term "realized" means that there was an event triggering a gain or loss, while the term "recognized" means that the gain or loss is of consequence in calculating taxes due. This is true whether the asset is an automobile, vacant land, business equipment, or—in the case of a professional sports team—a player's contract.[98]

For example, consider the Giancarlo Stanton trade between the Marlins and the Yankees in December 2017, which is depicted in Exhibit 1.

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93. *See* Rev. Rul. 67-380. Specifically, if the transaction resulted in a gain, the taxpayer would recognize the gain only up to the value of "boot" (cash and other non-like-kind property) received; but if the transaction resulted in a loss, the taxpayer would recognize none of its loss. These rules were consistent with those articulated in the I.R.C. *See* I.R.C. § 1031(a)–(c) (2008) (amended 2017).

94. *See* Rev. Rul. 67-380; *see also* I.R.C. § 1031(a) (2008) (amended 2017).

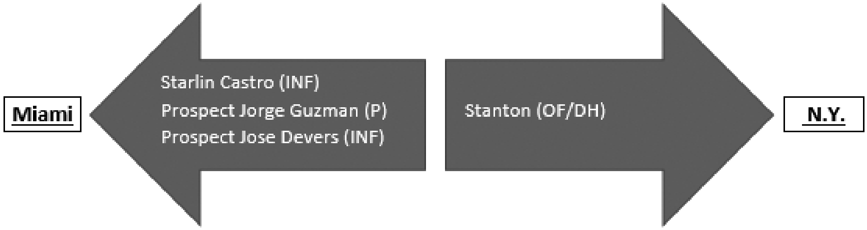
95. Boot also includes the excess value received by a franchise when the amount of liability that is discharged on a player's contract exceeds the liability it assumes on a replacement player's contract. *See generally Sports Franchises, Market Segment Specialization Program*, *supra* note 24. For example, suppose Franchise A owes $400,000 salary on Strong Player's contract, but exchanges the contract for Fast Player's contract and assumes liability for the remaining $300,000 salary owed to Fast; Franchise A receives $100,000 of boot, the net decrease in its liabilities. *See id.* at 12-5. A "potential emerging issue" identified by the IRS in 1999 was future draft picks and existing player contracts not constituting like-kind properties under I.R.C. § 1031. *See id.* at 12-7.

96. *See* Rev. Rul. 67-380; *see also* I.R.C. § 1031(a)–(b) (2017).

97. *See* I.R.C. § 1001(a)–(c) (2017). There are notable exclusions, particularly for individuals. *See, e.g.*, *id.* § 165(c).

98. *See Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-1–12-7.

EXHIBIT 1: PLAYER CONTRACTS TRADED BETWEEN THE MIAMI MARLINS AND THE NEW YORK YANKEES[99]



How much gain or loss did the team realize when it traded Stanton's contract? And of that amount, how much should have been recognized? The first step in making this determination is to calculate the "amount realized," which is the amount of cash plus the fair market value of other assets the Marlins received in the exchange.[100] Significantly, the amount of cash the Marlins received is deemed to include the amount of any liability that the team was discharged. This discharge of liability would have included the remaining amount it owed on Stanton's contract at the time of the trade that was assumed by the Yankees.[101] However, the amount is offset, in turn, by the amount of liability the Marlins assumed when they acquired Castro's, Devers's, and Guzman's contracts.[102] The Marlins' "amount realized" is depicted in Exhibit 2.

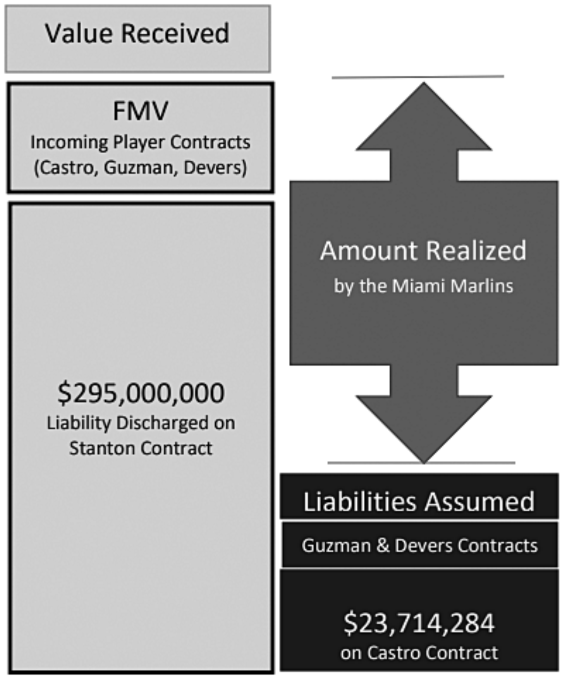
99. "INF" refers to infielder; "P" refers to pitcher; "OF" refers to outfielder; and "DH" refers to designated hitter. The Marlins decided to trade their Most Valuable Player, Giancarlo Stanton, in a desperate move to save on payroll costs. As a result, they agreed to trade Stanton on terms that required the Yankees to assume only $265,000,000 of the $295,000,000 balance still owed on his contract. That left the Marlins on the hook for the remaining $30,000,000, provided that Stanton does not exercise his opt-out clause after 2020. *See Giancarlo Stanton*, SPORTRAC, https://www.spotrac.com/mlb/new-york-yankees/giancarlo-stanton-6864/ [https://perma.cc/PQ3A-NYEW] (last visited Mar. 22, 2019); *see also* Ben Diamond et al., *Transaction Analysis: Jeter's First Fire Sale Gifts Stanton to Yankees*, BASEBALL PROSPECTUS (Dec. 11, 2017), https://www.baseballprospectus.com/news/article/36373/transaction-analysis-jeters-first-fire-sale-gifts-stanton-yankees/ [https://perma.cc/L64W-HKMP?type=image] (discussing how Marlins should have received much more value from Yankees in trade of Stanton than they actually received).

100. *See* I.R.C. § 1001(b) (2017) ("The amount realized from the sale or other disposition of the property shall be the sum of any money received plus the fair market value of the property (other than money) received.").

101. *See* 26 C.F.R. § 1.1001-2(a)(1) (1980) ("Except as provided in paragraph (a)(2) and (3) of this section, the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition."); *see also Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

102. *See* 26 C.F.R. § 1.1001-2(a)(3) ("In the case of a liability incurred by reason of the acquisition of the property, this section does not apply to the extent that such liability was not taken into account in determining the transferor's basis for

EXHIBIT 2: AMOUNT REALIZED ON STANTON'S CONTRACT



The next step in determining the gain or loss realized by the Marlins is to calculate the difference between: 1) the amount realized; and 2) the adjusted basis in Stanton's contract at the time of the trade.[103] The adjusted basis is the original cost of the contract less the deductions allowed for amortization and/or depreciation.[104]

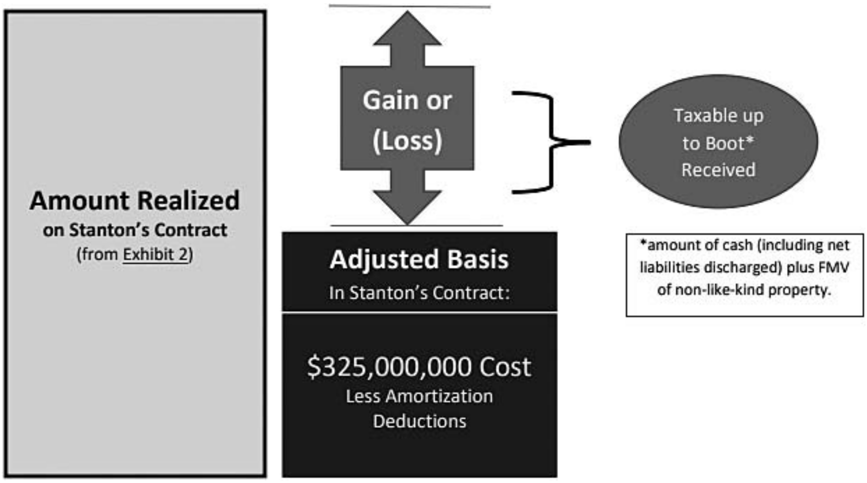
A potential gain or loss on Stanton's contract is depicted in Exhibit 3:

such property."); *see also Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

103. *See* I.R.C. § 1001(a) (1993). The result is a gain when the amount realized is larger than adjusted basis. Otherwise, it is a loss.

104. *See* I.R.C. §§ 1011 (1969), 1012 (2014), and 1016 (2018). I.R.C. § 1011 defines "adjusted basis" as the basis determined under § 1012 (which is cost) or other applicable provision, adjusted under § 1016. Had the Marlins originally acquired Stanton in a §1031 exchange, the basis in his contract would have been determined under § 1031(d) as opposed to § 1012. *See* I.R.C. § 1031(d) (2008) (amended 2017).

EXHIBIT 3: DETERMINING THE MARLINS TAXABLE GAIN



If the above transaction results in a gain, it is generally recognized and is thus taxable.[105] A loss, on the other hand, is generally deductible.[106] Section 1031 provides an exception to these rules by deferring the recognition of gain or loss on certain assets that are disposed of in a qualifying like-kind exchange.[107]

Under prior law, Section 1031 applied generally to the exchange of like-kind properties held for investment or productive use in a trade or business.[108] Thus, the exchange of a truck for a truck or a machine for a machine, so long as they were of like-kind or like-class, could qualify under Section 1031.[109] The regulations allowed real estate exchanges to qualify more broadly so that real estate held for productive use in a trade or business, such as land and a warehouse, could be swapped for investment property, such as vacant land.[110]

In a 1031 exchange, the taxpayer normally recognizes gain only up to the amount of cash (which is deemed to include the net liabilities the taxpayer is discharged) plus the fair market value of

105. *See* I.R.C. § 1001(c).

106. *See id.* There are notable exclusions and limitations, however, particularly for individuals. *See, e.g.*, *id.* § 165(c).

107. *See id.* § 1031(a)–(c) (2017).

108. *See* I.R.C. § 1031(a) (2008) (amended 2017).

109. *See* 26 C.F.R. §§1.1031(a)-1(c) (1991), 1.031(a)-2 (2005). Little to no guidance is provided for determining what qualifies as like-kind or like-class.

110. *See* §1.1031(a)-1(c).

any non-like-kind property received, as illustrated in Exhibit 3.[111] In addition, loss is not recognized in a 1031 exchange.[112]

While the IRC refers to Section 1031 as a tax "non-recognition" provision (i.e. a non-taxable event), it is actually a tax deferral provision. If and when the like-kind replacement property is disposed of in a subsequent sale or non-like-kind exchange, the taxpayer recognizes the gain or loss realized but not recognized in the original 1031 transaction.[113] This is accomplished through Section 1031(d), which provides a special rule for determining the taxpayer's basis in the replacement property.[114] Applying this rule to the Giancarlo Stanton trade, the Marlins' total basis in its replacement property—its contracts with Jorge Guzman, Jose Devers, and Starlin Castro—is the same as its adjusted basis in Stanton's contract: 1) decreased by any cash the franchise received and any liabilities it was discharged; and 2) increased by any liabilities it assumed and any gain it recognized. The rule then provides a method for allocating basis when the taxpayer receives multiple replacement properties, including property that is non-like-kind.[115] In that case, the basis is allocated first to the non-like-kind property received, up to its fair market value.[116] Any excess is then allocated to the like-kind properties.[117] Because the Marlins received only like-kind properties in the Giancarlo Stanton trade, its total basis in the replacement property would be allocated pro-rata to each of the newly acquired contracts with Guzman, Devers, and Castro.

Normally, there are strict reporting requirements for Section 1031 exchanges. The taxpayer must complete Form 8824 and file it with the income tax return for the year during which the exchange took place.[118] The form requires the taxpayer to provide the date

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111. *See* I.R.C. § 1031(a)–(b) (2017); *see also* 26 C.F.R § 1.1001-2(a)(1); 26 C.F.R. §1.1031(a)-1(c); *Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

112. *See* I.R.C. § 1031(c) (2017). Loss is deferred until the property is disposed of in a subsequent non-1031 exchange.

113. This is true, provided no other exclusions apply.

114. *See* I.R.C. §1031(d) (2017); *see also Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-5.

115. *See* I.R.C. § 1031(d) (2017) (providing rules for determining basis).

116. *See id.*

117. *See id.*

118. *See generally* IRS FORM 8824: LIKE-KIND EXCHANGES (2018), *available at* https://www.irs.gov/pub/irs-pdf/f8824.pdf [https://perma.cc/KMZ5-NBWJ]; INSTRUCTIONS FOR FORM 8824 (2018), *available at* https://www.irs.gov/instructions/i8824 [https://perma.cc/G4Y9-98ME].

of transfer.[119] It also requires the taxpayer to provide the dates the replacement property was: 1) identified by written notice to another party; and 2) actually received by the taxpayer.[120] Finally, the taxpayer is required to show its calculations for the gain or loss realized, the amount of gain recognized, and the basis in the replacement property received.[121]

C. The 2017 Tax Law Changes: Changing the Landscape of Section 1031—and Opening Pandora's Box on Professional Sports Trades

On July 31, 2017, thirty-nine MLB players were swapped on the day of the trade deadline. In three of those exchanges, the Los Angeles Dodgers' front office acquired Yu Darvish and two other pitchers to bolster its pitching staff prior to the playoffs, all in hopes of ending a twenty-nine-year championship drought.[122] Meanwhile, front office officials from other teams across the league evaluated nearly every aspect of their ball clubs to make what was, in their estimation, the right move. No matter how much analysis was undertaken, however, one thing was certain: teams gave little thought to the potential tax consequences of these like-kind exchanges. The sweeping tax law changes that Congress enacted in just the last few days of 2017, however, could have profoundly affected the way teams thought about these deadline deals.

The question that becomes even more apparent since passage of the Tax Cuts and Jobs Act is the extent to which various sports franchises have been reporting their Section 1031 exchanges and the basis in the contracts they have acquired.[123] This is important for tracking purposes. If this information was not reported, or was reported inaccurately, it would prove difficult, if not impossible, to accurately determine basis when the contract was later traded. However, this question has been eclipsed by yet another complexity that quickly became apparent under the new tax laws: the IRS needed to provide guidance on an appropriate valuation method

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119. *See* IRS FORM 8824: LIKE-KIND EXCHANGES, *supra* note 118, at Part I, line 4.

120. *See id.* at Part I, lines 5–6. This is due to strict timing requirements within which the transaction must be completed in order to qualify for like-kind exchange treatment. *See* I.R.C. §1031(a)(3) (2017).

121. *See* IRS FORM 8824: LIKE-KIND EXCHANGES, *supra* note 118 at Part III.

122. *See* Ken Gurnick, *Dodgers Get Yu, Relief, Dazzle at Deadline*, MLB.COM (July 31, 2017), https://www.mlb.com/news/dodgers-trade-for-yu-darvish-bolster-bullpen/c-245570576 [https://perma.cc/53D6-9BP3?type=image].

123. *See* IRS FORM 8824: LIKE-KIND EXCHANGES, *supra* 118; *see also* INSTRUCTIONS FOR FORM 8824, *supra* note 114.

for determining the amount realized in a professional sports trade and thus the gain or loss realized.[124] The method would have to reflect current market conditions and be applied across the various leagues.[125] Although important, issuing such guidance would have been a massive undertaking for the IRS, especially given the little time it had to implement all the changes under the new tax law. Ultimately, valuation was too complex an issue for the agency to tackle without clear confirmation from Congress that a tax on professional sports trades would be fully enforced.

V. THE COMPLEXITIES OF VALUATION: PLAYER CONTRACTS

In his book, *Diamond Dollars: The Economics of Winning in Baseball*, author Vince Gennaro observes, "At a time when sabermetric tools can diagnose a player's performance better than an MRI can detect a rotator cuff tear, measuring the dollar value of a player seems to have lagged far behind on the analytical priority list."[126]

He goes on to describe two fundamentally different approaches in determining the value of a professional athlete: 1) the cost or market-based valuation approach; and 2) the marginal revenue approach.[127]

A. Cost or Market-Based Valuations

The cost approach calculates the going rate for a certain level of performance by comparing players' salary levels and their performance levels.[128] When applied exclusively to a free agent market, in which player movement is unrestricted and salaries are not suppressed by MLB's reserve clause, this approach lends itself to a market-based valuation.[129]

For example, the Philadelphia Phillies announced in December 2017 that the club agreed to a three-year, $60 million contract with free agent Carlos Santana.[130] This provides a market-based val-

124. *See* I.R.C. § 1001(a)–(b) (2017).

125. This includes, for instance, a player's prior season performance. *See Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

126. VINCE GENNARO, DIAMOND DOLLARS: THE ECONOMICS OF WINNING IN BASEBALL, 69 (2013).

127. *See id.*

128. *See id.*

129. *See id.* at 70. The reserve clause is set forth in the Collective Bargaining Agreement with MLB Players Association. *See* 2017–2021 BASIC AGREEMENT, *supra* note 1, at art. XX.

130. *See* Steve Adams, *Phillies Sign Carlos Santana*, MLB TRADE RUMORS (Dec. 20, 2017, 8:03 AM), https://www.mlbtraderumors.com/2017/12/phillies-agree-to-terms-with-carlos-santana.html [https://perma.cc/FK3T-HR77].

uation for talent of his magnitude.[131] Like a bond, however, it is only natural that Santana's value will fluctuate over time given changes in his performance level and the price he will command in an open market. It is critically important, then, to recalculate his market value annually over the term of his contract. This approach yields an up-to-date market-based valuation.

This method may seem the simplest approach to valuing player contracts, but it raises a litany of issues. For example, there could be a wide salary range for different players who are currently at the same performance level. This may be the case because players signed multi-year contracts at different times and at dramatically different compensation levels.[132] It is also potentially difficult to determine, with some accuracy, an athlete's expected future performance level and thus his value to the team and what the open market would pay for that value.

1. *Expected Future Performance Levels*

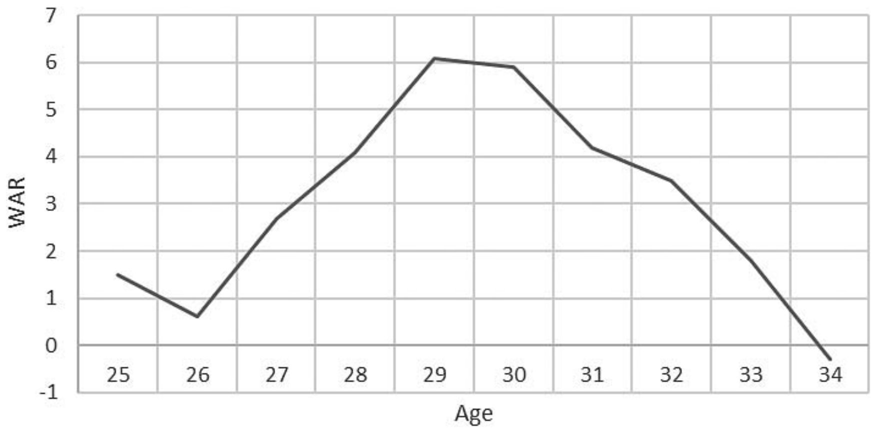
In nearly every other type of exchange, the assets that are traded lose value over time. With baseball players, however, their performance level, and thus their market value, will wax and then wane over the course of their careers. Take Kevin Youkilis, for example, who played eleven seasons in MLB. Exhibit 5 illustrates his performance in terms of wins above replacement ("WAR") in relation to his age. WAR is a common performance metric used in baseball that estimates the number of additional wins a player contributes to his team.[133]

131. It would be fair to assess Santana's fair market value as equal to the amount of his contract, which was based on the current market of free agent baseball players at that time.

132. *See* VINCE GENNARO, *supra* note 126, at 70.

133. *See Kevin Youkilis*, BASEBALL REFERENCE, https://www.baseball-reference.com/players/y/youklke01.shtml [https://perma.cc/EA7T-JTNF] (last visited Mar. 22, 2019). Specifically, WAR indicates the number of additional wins attributable to a player that his team would not have achieved had he been replaced with a player expected to win only a baseline minimum number of games. *See Wins Above Replacement (WAR)*, MLB.COM, http://m.mlb.com/glossary/advanced-stats/wins-above-replacement [https://perma.cc/QD4A-RTU7] (last visited Mar. 22, 2019).

EXHIBIT 5: KEVIN YOUKILIS PERFORMANCE VERSUS AGE



It is evident in Exhibit 5 that Youkilis's performance generally improved until age twenty-nine and then steadily declined after age thirty. Although not every player's career follows as nearly a perfect trajectory as Youkilis's, most are relatively close. Rather than lose value over time, athletes can be expected to yield increasing levels of performance, and thus value, during the first half of their careers.

An important issue, then, is determining, with some accuracy, a player's expected future performance. This can be accomplished by developing an aging curve, or function, based on a set of historically comparable players. There are many different methods to construct the curve, ranging from simple to complex, which generally result in a quadratic-like graph, similar to the one shown in Exhibit 5.[134]

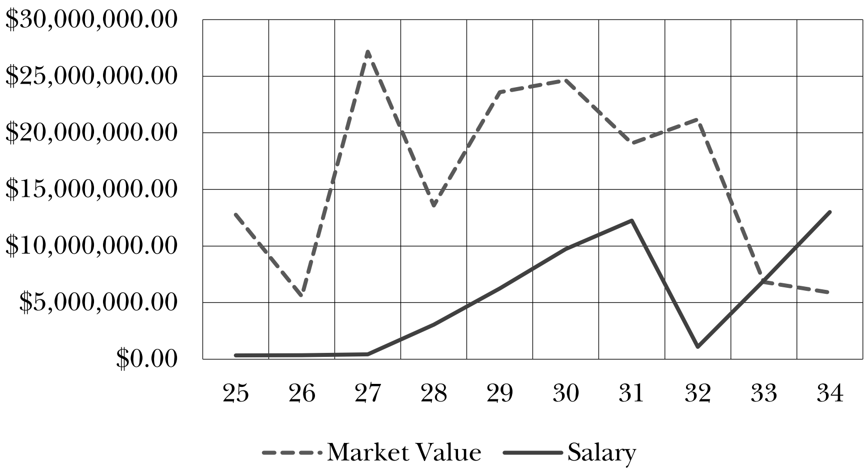
134. The standard form of a quadratic equation is $y = ax^2 + bx + c$, where a is not 0. Two of the simpler methods for determining future performance levels are Tom Tango's Marcel the Monkey model and the delta method. *See Marcel 2012*, TANGOTIGER, http://www.tangotiger.net/marcel/ [https://perma.cc/W2N7-5RH7] (last visited Mar, 22, 2019); *see also* Neil Weinberg, *The Beginner's Guide to Aging Curves*, FANGRAPHS (Dec. 10, 2015), https://www.fangraphs.com/library/the-beginners-guide-to-aging-curves/ [https://perma.cc/ZES4-NAWX] ("Simply put, the aging curve represents the average improvement or decline expected based on the player's age."). The Steamer projection model is widely considered the most accurate projection model for the subsequent season. *See Steamer*, MLB.COM, http://m.mlb.com/glossary/projection-systems/steamer [https://perma.cc/P4Q4-T2FL] (last visited Mar. 22, 2019); *see also* Jared Cross et al., *About*, STEAMER PROJECTIONS, http://steamerprojections.com/blog/about-2/ [https://perma.cc/6SH7-SLA6] (last visited Mar. 22, 2019). The authors' preferred method is an adjusted second-degree polynomial regression constructed using historical comparable players. With the increase in technology and computing power, more complex projection models have become prevalent. Projection mod-

Because there is a wide range of methods available for constructing an aging function, there is a wide range of projections of a player's future performance levels. Thus, the function used by clubs across the league would have to be standardized to yield reliable and consistent results. Once a player's future performance levels are projected, the next issue is determining what the open market would pay.

2. *What Would the Open Market Pay?*

Although cost and market-based valuations stem from similar philosophies, they usually yield different results. To illustrate the potential differences, Exhibit 6 compares the cost and market-based valuations for Kevin Youkilis over the span of his eleven-season career:

EXHIBIT 6: KEVIN YOUKILIS: COST VS. MARKET-BASED VALUATIONS



In Exhibit 6, Youkilis's market value is plotted against his age. His market value each year was determined by calculating the average cost per WAR for a third baseman and then multiplying that cost by his own level of performance. Exhibit 6 also shows his annual salary, or cost valuation, over that same span of time. Except for his very last season in MLB, Youkilis's high productivity yielded surplus value to his team. In other words, his market-based valuation exceeded his cost valuation by a very wide margin for nearly ten years. Simply put, his salary represented a very deep discount.

els relying heavily on machine learning techniques are likely to increase the accuracy of projection models in the near future.

In fact, baseball's reserve clause has a significant impact on cost valuation.[135] In enacting this clause, MLB created a system that restricts player movement and deliberately suppresses contract values. For this reason, cost valuation for players who are subject to the reserve clause will generally yield a lower result than market-based valuation, which reflects what the open market would pay in the absence of such restrictions. Notably, in examining the validity of MLB's reserve clause under federal antitrust law in *Flood*, the United States Supreme Court did not expound on the effect of the reserve clause on contract costs. Instead, upon an extensive review of prior case law and after noting that various Congressional bills relating to the reserve clause and MLB's antitrust exemption had stopped short of enactment, the Court concluded,

> We repeat for this case what was said in Toolson:
>
> "Without re-examination of the underlying issues, the [judgment] below [is] affirmed on the authority of Federal Baseball Club of Baltimore v. National League of Professional Baseball Clubs, supra, so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws."
>
> And what the Court said in Federal Baseball in 1922 and what it said in Toolson in 1953, we say again here in 1972: the remedy, if any is indicated, is for congressional, and not judicial, action.[136]

Four years after the ruling in *Flood,* however, the MLBPA and MLB negotiated the 1976 Collective Bargaining Agreement and, for the first time, limited the application of the reserve clause to a player's first six years of service.[137] During these first six years, players are unable to negotiate with any teams other than their own.[138] In other words, players have no way of obtaining a salary that reflects their true market value. This is a critically important issue. If a tax is to be assessed on the net gain realized by a team in a profes-

135. *See generally* Flood v. Kuhn, 407 U.S. 258 (1972).

136. *Id.* at 285 (internal citations omitted).

137. *See id.*; *see also* 2017–2021 BASIC AGREEMENT, *supra* note 1, at art. XX. Under a new pact reached on July 12, 1976, players could also demand trade after five years. *See MLBPA History: The 1970's*, MLBPA (Aug. 31, 2016), http://www.mlbplayers.com/ViewArticle.dbml?DB_OEM_ID=34000&ATCLID=211157624 [https://perma.cc/37AR-XMVU].

138. *See* 2017–2021 BASIC AGREEMENT, *supra* note 1, at art. XX.

sional sports trade, it is the fair market value of the incoming player (*i.e.* in the absence of such restrictions, what the open market would pay for the player's services at the time of the trade) that is relevant.[139] Therefore, the potential effects of the reserve clause must be taken into account in arriving at a proper valuation. Otherwise, teams would be sorely underestimating the value of player contracts when negotiating trades and when determining the resulting tax consequences, including the amount realized, the gain or loss realized and recognized, and the basis of the incoming players' contracts. The term of the contract and a standardized rate of inflation are also critically important in determining the contract's present value.

B. The Marginal Revenue Approach

The marginal revenue approach is yet another valuation method and is based on the principle that teams should pay players for the value they provide.[140] This can be translated into value based on the team's overall performance. A "Win-Curve" model, which shows the relationships between wins and attendance and between attendance and revenue, can be used to derive the player's impact on attendance and, ultimately, his monetary worth.[141] The model's creator emphasizes, however, that a player's value does not end with performance; one must also consider a player's "marquee value," which refers to his off-field star power, or "gate appeal."[142] By evaluating a player's economic impact, it reflects more closely what a team would pay in an open market for the value he contributes.[143]

The marginal revenue approach solves some of the issues associated with the cost or market-based approaches.[144] For instance, it is not tied to cost and therefore avoids the problem of salary compression under MLB's reserve clause.[145] However, there are still

139. To calculate the gain or loss on a player trade, the taxpayer must determine the "amount realized" in the transaction. *See* I.R.C. § 1001(a) (1993). The "amount realized" is the amount of cash (including net liabilities discharged) plus the fair market value of other property that the taxpayer received in the trade. *See* I.R.C. § 1001(b); and 26 C.F.R. § 1.1001-2(a)(1), (3) (1980). This includes the value of replacement player contracts. *See Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

140. *See* VINCE GENNARO, *supra* note 126, at 72–87.

141. *See id.*

142. *See id.* at 93.

143. *See id.*

144. *See id.* at 72–87.

145. *See id.*

too many issues that render it impractical as a valuation method for professional sports trades.[146] Determining a player's gate appeal, impact on attendance, and associated "marquee value" are just some of the complexities.[147] It also raises some of the same issues as the cost or market-based approaches, such as having to project the players' expected future performance levels. The prospective team's future performance expectations must also be projected to determine the player's potential value to the team.[148]

In addition, a player's value under the marginal revenue approach will depend largely on whether the player is going to a team in a small or large market. A star player headed to the Yankees will likely generate more revenue and thus yield a higher value than he would for the Cincinnati Reds, based on the relative size of those markets. It is interesting to note that MLB implemented the competitive balance tax as a financial disincentive for teams that generate higher revenues in the major markets and can thus afford to sign all the best players at higher salaries from actually doing so.[149] There is tension, then, between the marginal revenue approach, in which a player's value generally increases when he signs on to play in one of the larger markets, and MLB's philosophy that the best talent should *not* be limited to large-market teams.

Because the player's value is tied to team revenue, adopting this method means that standardizing valuation and financial metrics across teams becomes critically important. One possible solution is to standardize valuation and financial metrics across each of the various leagues. However, this adds additional layers of complexity. For starters, financial information pertaining to individual franchises is not publicly available. With the exception of the Green Bay Packers, sports teams are not publicly traded companies and are subject only to their league's standards, not those set by the Federal Trade Commission or the Securities and Exchange Commission. In addition, franchises are not subject to separate audits ensuring league compliance. To develop standardized metrics, rules would have to be implemented to ensure access to the appropriate information and compliance among the various sports leagues. This would be a huge undertaking for the IRS.

146. *See id.*

147. *See id.*

148. *See id.*

149. *See* Luis Delgado, *Explaining the Luxury Tax in Major League Baseball*, SPORTING CHARTS (Mar. 3, 2015), https://www.sportingcharts.com/articles/mlb/explaining-the-luxury-tax-in-major-league-baseball.aspx.

C. Assessing FMV of Player Contracts: The Stark Reality

Cost, market-based, and marginal revenue valuations are general approaches to assessing the fair market value of player contracts. In adopting any one of these approaches, practitioners have developed numerous methods and proprietary models. They factor in a number of different variables and rely heavily on the multitude of data available to project the value of a player based on quality as well as both past and future performance.

The IRS has, at times, glossed over the complexity of assessing these values. The IRS provides an example in an examination training manual for the calculation of gain or loss on the exchange of player contracts, and it presupposes that the sport franchises simply "agree" as to the fair market values of the contracts they are trading.[150] But is it standard practice for both teams to state an explicit, agreed-upon value? A number of accountants have been recommending this practice in the last year to avoid IRS scrutiny, suggesting that disparate values raise obvious questions and thus the possibility of an audit.[151] However, the parties must essentially agree to use the same valuation methods, variables, models, and data. This is not as simple as it sounds.

In addition, it is unreasonable to assume that teams will agree to place the very same monetary values on players' contracts. While teams may agree to trade two players, the contract values that are being exchanged are not necessarily of equal dollar value to both teams, which may be operating under wholly different circumstances and in different sized markets, and may have different needs motivating the trade. Take, for instance, the Giancarlo Stanton trade. Although he was the National League's Most Valuable Player, the Marlins agreed to trade him to the Yankees for cash, second baseman Starlin Castro, and two minor league players in a desperate move to save on payroll costs.[152] The Marlins' motivation to unload his contract was certainly different from that of the Yankees' to secure it, and thus the monetary value of the trade to the Marlins may be very different from its value to the Yankees.

In fact, in a memorandum concerning the examination of sports franchise acquisitions, the IRS acknowledged that "disagree-

150. *See Sports Franchises, Market Segment Specialization Program*, *supra* note 24, at 12-4.

151. *See, e.g.*, Harvey Bezozi, *Tax Reform's Impact on Professional Sports*, WEALTHMANAGEMENT.COM (Apr. 30, 2018), https://www.wealthmanagement.com/high-net-worth/tax-reform-s-impact-professional-sports [https://perma.cc/5Z5U-VG2N].

152. *See supra* note 99 and accompanying text.

ment exists concerning an appropriate methodology for the valuation of player contracts" and that significant time and resources are incurred by the agency to retain experts and to resolve significant disputes.[153] The memorandum serves as a "directive" that "reflects a management decision to balance resources and workload priorities" in the conduct of these examinations.[154] There is no reason to believe that the valuation of player contracts to determine gain or loss in a professional sports trade would be any less contentious, and the need for further guidance and a simplified method for determining gain or loss was clear.

VI. REVENUE PROCEDURE 2019-18: SAFE HARBOR RULES

Before launching into the safe harbor rules for calculating gain or loss on a professional sports trade, Revenue Procedure 2019-18 acknowledges the many factors that contribute to the complexity of valuing player contracts.[155] These factors include not only player performance, the cost of player development, the number of years before the player becomes a free agent, and the impact of any injuries, but also the changing needs of the team and other teams, the player's effect on fan attendance, and the size of the team's market.[156] These factors, it acknowledges, can cause wide fluctuations in the value of a player's contract not only during the term of the contract but also over the course of a single season.[157] Finally, unlike other assets traded in an open market, player contracts are traded within a specific league and thus in a market that is small and private.[158] The Revenue Procedure further acknowledges that the exact value that a team may place on a player's contract is highly subjective.[159] Specifically, the Revenue Procedure states:

> As a result, although each team may believe it is receiving something of equal or greater value to what it is giving up in a trade . . . in light of its particular circumstances and priorities at the time, it is unusually difficult to assign an

153. *See Examination of Sports Franchise Acquisitions*, IRS, https://www.irs.gov/businesses/examination-of-sports-franchise-acquisitions [https://perma.cc/4JBQ-2VR5] (last updated Nov. 29, 2018).

154. *See id.*

155. *See* Rev. Proc. 2019-18, 2019-18 I.R.B. 1077 § 2.02.

156. *See id.* at § 2.02(1).

157. *See id.*

158. *See id.*

159. *See id.*

> objective monetary value to. . . personnel contracts or drafts picks.[160]

It is for this reason, and "to avoid highly subjective, complex, lengthy, and expensive disputes between professional sports teams and the IRS," that the safe harbor rules were issued.[161]

Revenue Procedure 2019-18 goes on to establish that trades of player contracts and draft picks fall within the scope of the safe harbor provisions if specific requirements are met.[162] First, all parties to a trade that are subject to United States federal income tax must follow the safe harbor rules for purposes of reporting the trade on their federal income tax returns.[163] In addition, each party must transfer and receive a player's contract or a draft pick, and the trade cannot include any other asset except for cash.[164] Finally, the specific player contract or draft pick must not qualify as an amortizable section 197 intangible, and the parties' financial statements cannot reflect any assets or liabilities resulting from the trade other than cash.[165]

For qualifying transactions, the safe harbor provisions simplify the rules for purposes of calculating gain and loss.[166] The contract value of a player's contract or draft pick is treated as $0, and thus the amount realized by a team in a qualifying trade is limited to the amount of cash it receives.[167] If a team receives no cash, its amount realized is zero.[168] For any team paying cash as part of a trade, its basis in the player contract or draft pick it receives is limited to the amount of such cash paid out.[169] If a team pays no cash, its basis in its newly acquired player contract or draft pick is zero also.[170] Finally, gain or loss on a player's contract or a draft pick is calculated as the team's amount realized less its unrecovered basis in such contract or draft pick.[171] By eliminating the fair market value of players' contracts from the determination of amount realized and basis,

160. *Id.* at § 2.02(2).
161. *Id.* at § 2.02(3).
162. *See id.* at § 3.
163. *See id.* at § 3.01.
164. *See id.* at § 3.02.
165. *See id.* at § 3.03–.04.
166. *See id.* at § 4.
167. *See id.* at §§ 4.01, 4.02(2).
168. *See id.* at § 4.02(2).
169. *See id.* at § 4.02(3).
170. *See id.*
171. *See id.* at § 4.02(1), (5).

the rules simplify the process significantly for calculating gains and losses on player trades.

VII. CONCLUSION

The 2017 tax law changes[172] drastically limited the scope of IRC Section 1031.[173] In doing so, it opened Pandora's Box for the professional sports industry: for the first time in over fifty years, sports trades became fully-taxable exchanges. However, well over a year passed and there were still no answers to some critically important questions. Would Congress enact a legislative exemption for professional sports trades? If not, would the IRS enforce the new law? How would the law be enforced? What guidance would the agency issue? Or would professional sports escape enforcement as a result of government inaction—the same means by which MLB has successfully maintained a rare federal antitrust exemption for the past century?

Ultimately, Congress kept silent on the issue (publicly at least) and deferred to the Treasury Department to issue appropriate guidance as to how the law would be interpreted and administered. Such guidance was necessary to properly assess the value of player contracts in a consistent manner and to determine gain or loss on professional sports trades. This, however, was a monumental task, and the IRS took the middle road, issuing safe harbor rules that allow player contracts in qualifying trades to be assessed a fair market value of zero. The rules also provide a simplified method for determining gain and loss.

In the midst of all of the uncertainty in the past year, one thing was certain: professional sports trades are unique from other business transactions. They have grown increasingly complex over the decades, and there is no single method that will resolve all of the issues arising with valuation. In addition, major league athletes make up only a small portion of the assets that are traded in professional sports. It is very common to see major league player contracts traded for prospects (players who have not yet reached the major leagues and thus have no known value) or draft picks (enabling the team to exercise the right to draft a player, whose value might be estimated but is still very speculative). What valuation method, or methods, should be used for these assets? These issues had to be addressed if a gains tax was to be fully enforced on profes-

172. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2054 (2017) (codified as amended in scattered sections of the Internal Revenue Code).
173. *See id.* at 2123–24.

sional sports trades, and the safe harbor rules are a valiant attempt to simplify the process in a way that is not only consistent, but also transparent. For those trades that do not fall within the scope of the safe harbor provisions, valuation and the calculation of gain or loss may still prove highly contentious, but at least the volume of such trades should be significantly reduced. In any case, the gains tax and the safe harbor provisions may largely influence the way teams think about these trades and how they ultimately structure the deals.