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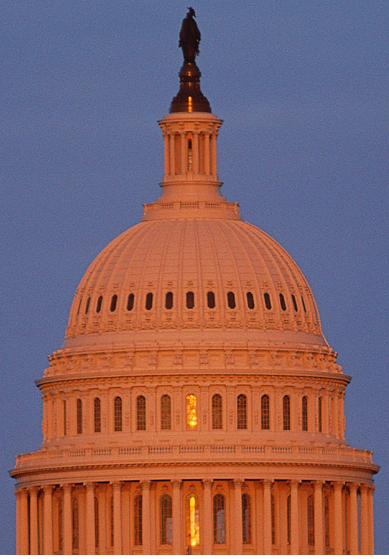

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U.S. Tax Court: Professional basketball franchise not allowed deduction for deferred compensation when amounts not paid to players

The U.S. Tax Court today issued a memorandum opinion in a case concerning a professional basketball organization's claim for a deduction of approximately $10.7 million with regard to deferred compensation liabilities.

The Tax Court held that the basketball franchise (a partnership) was not entitled to deduct the $10.7 million representing the deferred compensation liability because the deferred compensation amounts were not paid to the two basketball players in 2012 and were not includible in their gross income for 2012.

The case is: *Hoops LP v. Commissioner,* T.C. Memo 2022-9 (February 23, 2022). Read the court's **opinion** [PDF 144 KB]

Summary

A partnership in May 2000 acquired the Vancouver Grizzlies, a professional basketball franchise, and moved the team to Memphis, Tennessee, renaming the franchise the Memphis Grizzlies (a member of the NBA). The partnership owned and operated the Grizzlies from the date it acquired the franchise until it sold the franchise in 2012.

With the sale of the team in 2012, the buyer agreed to purchase substantially all of the franchise's assets and to assume substantially all of the liabilities and obligations of the partnership. One of the liabilities assumed was the $10.7 million—representing liabilities and obligations under certain binding agreements, which included NBA uniform player contracts for two of the professional basketball players.

The partnership did not claim an ordinary deduction of $10.7 million on its original Form 1065, "U.S. Return of Partnership Income," for the tax year ending December 31, 2012; did not reduce its amount realized on the sale by $10.7 million for the deferred compensation liability; and did not adjust its basis

in any property it owned as a result of the deferred compensation liability. Subsequently, the partnership filed an amended return on Form 1065X, and claimed an additional deduction of $10.7 million relating to the deferred compensation liability.

The IRS in March 2018 issued to the tax matters partner, a notice of final partnership administrative adjustment (FPAA) for the partnership's tax year ended December 31, 2012, disallowing the additional deduction claimed on the amended 2012 tax return relating to the deferred compensation liability. The tax matters partner filed a petition for readjustment of the partnership items in the FPAA.

The Tax Court today held that the partnership was not allowed to deduct deferred compensation until the tax year for which an amount attributable to the compensation is includible in the employee's gross income. As the court observed, the parties agreed that the partnership had not paid any amounts owed to the two players with respect to the deferred compensation liability in 2012; therefore, no amounts were includible in their gross incomes as compensation. Instead, pursuant to section 404(a)(5), any deduction for an amount attributable to the compensation would be allowed when the amount was includible in the gross incomes of the two players.

Thus, the court sustained the IRS's determination to disallow the additional deduction of $10.7 million relating to the deferred compensation liability claimed on the amended 2012 tax return.

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