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The opinions expressed here are solely the author's and do not reflect the opinion of the department or the FTB.

In this viewpoint, Tourian discusses the taxation of professional sports teams playing in California and argues that a statute enacted in response to a 1980s court opinion has created more problems in this area than it resolved.

In 1983 the California State Legislature enacted Revenue and Taxation Code section 25141 in response to *Boston Professional Hockey Association Inc. v. Franchise Tax Board* (*BPHA*),[1] an unpublished 1982 court of appeal decision. The goal was for other states to follow suit to create a set of rules to easily administer the taxation of professional athletic teams, in and outside California, while protecting California's economic interests. No other state followed California's lead, but section 25141 remains.

This article argues that California reacted poorly to *BPHA*. Section 25141 crystalized the application of the unitary concept and the apportionment of business income based on facts applicable in 1969 to an entire industry. By setting in stone legal principles based on the facts and circumstances of a bygone era, section 25141 accomplished the opposite of what the Legislature intended — a tax that is more difficult to administer and that hurts California's economic interests.

This article first examines section 25141's history. It then explains how the provision's legislative path created administrative problems while hurting California's economic interests. Specifically, section 25141 treats professional athletic teams differently based on team ownership structure; apportions a professional athletic team's business income differently based on how that income is earned; creates an apportionment scheme for California-based teams while not fully recognizing the unitary concept; and provides a maze of rules not uniformly administered among states.

## History of Section 25141

In California, a unitary business generally apportions its income under Revenue and Taxation Code sections 25120 through 25141.[2] Section 25141 generally provides that the business income of a professional athletic team's direct and indirect operations will be allocated to its base of operations.

[1] *Boston Professional Hockey Association Inc. v. Franchise Tax Board*, 2 Civ. No. 63444 (2d Dist. Ct. App. 1982).

[2] Cal. Rev. & Tax. Code section 25101.

California's Legislature enacted section 25141 in response to, and with the intent that it be read consistently with, *BPHA*.[3] The opinion addressed whether California could subject the Boston Bruins to California's franchise tax. In 1969 the Bruins played 89 games, with six games played in California. Under the National Hockey League's constitution, home teams kept 100 percent of their gate receipts. The Bruins also earned income from local and national telecasts, as well as local radio broadcasts. The Bruins' television rights were pooled with other NHL teams and sold as a package to television networks. The revenue the Bruins received did not depend on whether those games involved California teams.

The court of appeal concluded that the Bruins were not subject to California's franchise tax and reasoned that the Bruins' unitary business — in particular, income from gate receipts and telecasts — was not materially enhanced when the Bruins played in California. Further, the court recognized that there was no harm done to California based on the agreement between NHL teams. However, the court recognized that its decision was limited to the facts at issue and that changing technology could change its ruling.[4]

California subsequently enacted section 25141 with the intent to create a set of rules to easily administer tax from teams belonging to existing professional sports leagues. The premise was that revenue generated from taxing professional athletic teams from major athletic leagues would be immaterial if either an allocation or apportionment formula was uniformly administered based on the equal number of games played in and outside California.[5] Implicit in the Legislature's decision was that California would never materially enhance an out-of-state professional athletic team's unitary business to generate more income, in accordance with *BPHA*.

## Professional Athletic Teams

As revenue from professional athletics has skyrocketed, nontraditional leagues have entered the fray, usually in the form of several teams being owned by a single entity. First came the XFL, a professional American football league operating

[3] Section 3 of Stats. 1983, c. 961, states:

> It is the intent of the Legislature by this act to provide for the allocation and apportionment of the income of professional athletic teams in a manner consistent with the decision of the California Court of Appeal in the case of *Boston Professional Hockey Association, Inc. v. Franchise Tax Board*. The enactment of this act shall not be construed to mean, nor is any inference to be drawn, that the unitary concept as now applied is to be limited, revised, or modified in any manner. It is further the intent of the Legislature that this act shall not apply to, nor affect, the taxation of professional athletes.

The provisions of this act are limited to the allocation and apportionment of business income of professional athletic teams, and do not limit or affect the minimum tax imposed on professional athletic teams doing business in this state.

[4] *BPHA* states in footnote 5:

> Our decision relates only to the facts of this case. In the future, if the Board is able to establish that California's activities contribute materially to Boston's income because of better proof, or changing technology such as pay television etc., then the other issues raised by the parties will have to be dealt with.

[5] Senate Committee on Revenue and Taxation on S.B. 601 (1983-1984 Reg. Sess.), at 2-3, states:

> The professional sport leagues supporting SB 601 contend that a 100 percent rule works to the advantage of the state and the taxpayer in the unique circumstances in which they do business. They recognize that a 100 percent rule would probably not work in any other situation with which they are familiar. The reason 100 percent reporting works in professional sports is that in no other industry are the in-state activities of non-California taxpayers matched so precisely by the out-of-state activities of non-California taxpayers. Here, as everyone knows, each team normally plays an equal number of games at home and away. This income attributed to activities in California can be fully reflected either by splitting reporting between visiting and home teams to reach 100 percent, or by requiring the home team to report all 100 percent itself. SB 601 proposes the latter approach for the reasons already set forth and for the benefits which will accrue as set forth below.
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> To accomplish those benefits, new Section 25141 of the Revenue and Taxation Code will provide that the business income of a professional athletic team will be determined by allocating all property, payroll and sales factors to the state in which it has its base of operations. This will have the effect of apportioning all of the net income of a team to its home state.

as a single entity that was a joint venture between NBC and World Wrestling Entertainment Inc.[6] Next came the BIG3 League — a three-on-three basketball league owned and operated by O'Shea Jackson,[7] also known as Ice Cube. Whether those nontraditional leagues are a sound business venture is a debate for another day. What is clear, however, is that section 25141 does not apply to them because their ownership structures consist of a single entity, even when all other operational aspects between traditional and nontraditional leagues are substantially similar.

Section 25141(a) defines a professional athletic team as a team that employs at least five athletes playing for it in public contests, has an aggregate of 40,000 people attending its games during the tax year, and has a minimum gross income of $100,000.[8] A professional athletic team must also be part of a league with at least five entities engaged in the operation of an athletic team.[9] An entity means an individual, corporation, association, partnership, limited liability company, estate, trust, or any combination thereof.[10]

The requirement that a team be part of a league with at least five separate entities operating teams creates disparate treatment with leagues owned and operated by a single entity, even with multiple team representations. The BIG3 League would not fall under section 25141's purview because its operations are run by a single entity. The assumption is that the BIG3 League was not created with section 25141 in mind, but because of potential sports revenue. Nor did California's Legislature anticipate that a founding member of the hip-hop group N.W.A. would create a sports league.

## Buckets of Business Income

Section 25141 adds an extra layer of tax administration by requiring a professional athletic team to bifurcate its business income between its operations as an athletic team and all other business income. When section 25141 was enacted, a professional athletic team's business income consisted of income generated only through competition. However, as sports have become big business, teams, as well as leagues, have diversified their income streams. For instance, the National Football League set up a venture capital fund to diversify its business operations. The NFL venture capital fund invested in Blue Star Sports, a rapidly growing technology company that creates and supports organizational youth sports software.[11] The assumption is that other sports leagues will also diversify their income streams, as leagues generally copy one another.[12]

Section 25141(c) creates separate apportionment rules for a professional athletic team's business income. First, it allocates a team's business income from its direct and indirect operations. Any business income otherwise must be apportioned in accordance with sections 25120 through 25140.

In *Boston Professional Hockey Association v. Commissioner of Revenue*,[13] the Massachusetts Supreme Judicial Court provided guidance on what income comes from the direct operations of a professional athletic team. Specifically, for purposes of a cost-of-performance analysis, the court addressed where the following income-producing activities took place: the sale of tickets to Bruins games, licensing of local broadcast rights, licensing of national and international broadcast rights, licensing of Bruins logos and

[6] Tracy Ziemer, "Where Did XFL Go Wrong?" *ABC News* (Feb. 28, 2001). At the time of the XFL, World Wrestling Entertainment was known as the World Wrestling Federation.

[7] Nicholas Parco, "Ice Cube Announces BIG3 Basketball League for Former NBA Stars, Will Feature Allen Iverson as Player and Coach," *New York Daily News*, Jan. 11, 2017.

[8] Cal. Rev. & Tax. Code section 25141(a)(3).

[9] *Id.*

[10] Cal. Rev. & Tax. Code section 25141(a)(1).

[11] Joe Lemire, "NFL Invests in Youth Sports Platform Blue Star Sports," SportTechie (July 11, 2017).

[12] Mike Vorkunov, "NFL Is First Sports League to Start Venture Capital Arm, Looking for New Revenue Streams," NJ.com (May 25, 2013).

[13] *Boston Professional Hockey Association Inc. v. Commissioner of Revenue*, 443 Mass. 276 (2005).

trademarks, and the organization's limited partnership interest with the New England Sports Network (NESN).

The court ruled that the receipts from the sale of tickets and the licensing of local broadcast rights were assignable to Massachusetts because the costs associated with those revenue streams were directly associated with the Bruins' operations. Receipts from national and international broadcast rights and the partnership with NESN were assignable outside Massachusetts because the costs associated with those activities were not part of the Bruins' direct operations. Receipts from licensing intangibles were assignable outside Massachusetts because the licensees were not domiciled in the state.[14]

*BPHA* provides guidance on what income comes from the indirect operations of a professional athletic team. The Bruins initially argued that income from TV and radio should be treated the same as income from other intangibles (such as copyright royalties) and sourced under then-section 25136, which used a cost-of-performance method, rather than by the number of games it played in and outside California. The team said in its briefing at the administrative level that receipts from radio and TV would be the same regardless of whether it played in California.[15]

The California Court of Appeal agreed with the team's argument and ruled that income from TV revenue should be assigned to Massachusetts because those receipts concerned only the team's home territorial rights. The court ruled that it was income indirectly regarding the Bruins operations and that revenue stream was derived by pooling

[14] *Boston Professional Hockey Association*, 443 Mass. at 291, states:

> When a taxpayer licenses its intangible property rights to a licensee that does not have its commercial domicile in Massachusetts, a fair reading of the 1995 regulation places the burden on the commissioner, not the taxpayer, to demonstrate that a greater proportion of the actual use of the license occurred in or was "geographically associated with" Massachusetts, rather than any other one State. 830 Code Mass. Regs. section 63.38.1(9)(d)(3)(c)(i). Having not produced any evidence on this point, the commissioner's burden has not been met. Accordingly, the revenue BPHA earned from those licensing agreements is not apportionable to Massachusetts for purposes of G.L. c. 63, section 38. FN21
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> FN21. In a footnote in his brief, the commissioner argues that the board's overarching finding that the "income-producing activity" of BPHA is the "operation of [an] NHL franchise" in Massachusetts is sufficient to support the allocation of those licensing revenue to Massachusetts. Implicit in this argument is the suggestion that the specific regulations relating to the allocation of separately identifiable licensing revenue does not apply in those circumstances. We do not read the 1995 regulations to provide for such an exception.

[15] In a section of its brief in *Matter of the Appeal of Boston Professional Hockey Association Inc.* (79-SBE-094 (Nov. 18, 1975)) titled, "Receipts Factor — Other Income," the Bruins argued that:

> The proposed assessment allocates $24,648 of radio and TV income to California. This amount was arrived at by taking the total radio and TV income earned by the taxpayer and allocating 6/89 to California on the theory that the taxpayer played eighty-nine hockey games during the year of which six were played in California. This proposed allocation is unreasonable in that there is no necessary connection between the number of games played in California and the radio and TV income realized by the taxpayer. Under the proposed formula the allocation would be the same regardless of whether any of the games played in California were even broadcast or telecast. Radio and TV income should be treated in the same manner in which other income from intangibles (such as copyright royalties) is treated, to wit: taxable in the state of the taxpayer's commercial domicile under Section 25127 of the Revenue & Taxation Code. Alternatively, radio and TV income should be allocated under the statutory formula set forth in Section 25136 for allocation of receipts, in which case the radio and TV income would be allocated to the state where the bulk of the income-producing activity takes place.

broadcast rights with other league clubs and sold as a package to a network.[16]

Section 25141(c) codified *BPHA*'s decision that a professional athletic team's unitary business could never be enhanced by California's market and crystalized use of a cost-of-performance method for income generated by a professional athletic team's direct and indirect operations. Contrary to legislative intent, section 25141 created an extra layer of bureaucracy in which all other business income that a professional athletic team earns is subject to California's normal apportionment rules.

## Deemed Allocation

The court of appeal in *BPHA* was prescient when it recognized that technology would change the economics of sports.[17] Within the past 20 years, professional athletic team values have skyrocketed. In 2016 the average NFL team was worth $2.3 billion,[18] compared with $200 million in 1997.[19] Franchises from other leagues have also increased in value, though not as pronounced as NFL franchises.[20] The escalation of team values results from increased television revenue. Fans watch sports live, rather than recording events and fast-forwarding through ads. That allows networks to charge a premium for commercial time.[21] Last year, Americans collectively spent 31 billion hours watching sports on TV — a 40 percent increase from a decade ago.[22]

While the business of professional athletics has evolved, section 25141 has remained stuck in time, never recognizing that a California-based professional athletic team would cultivate its media rights beyond California's boundaries. Section 25141 deems that all business income from a professional athletic team's operations be allocated to where its territorial rights are based.[23] Section 25141's allocation provisions were modeled on the base of operation rules in section 25133.[24] That section defines base of operations to mean the place where power or control is exercised by a taxpayer.[25] Both *BPHA* and its sister case, *Appeal of Milwaukee Professional Sports and Services Inc.*,[26] recognized that an athletic team's overall direction generally comes from its home offices, while day-to-day direction and control of the team occurs where the team is playing.

As such, all receipts a California-based professional athletic team generates are assignable to California, even if the team's media rights extend beyond state lines.[27] For example, the San Jose Sharks' broadcast rights are in Northern California, Nevada, and Oregon.[28]

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[16] In *BPHA,* the court wrote:

> There was no proof, again only speculation, concerning the impact of California telecasts and radio broadcasts into Boston's income. *The evidence before the court was that such revenue represented compensation for the exclusive right of Boston under the NHL constitution to present competitive events in its sport within its home territory. Boston's television revenue was from a pool with other League clubs and sold as a package to the network. The receipts concern only home territorial rights. The Board in the stipulation admits the television and radio receipts are paid whether Boston plays any particular game in any particular state.* There were no network telecasts and broadcasts of the California games in the subject year. The California games were broadcast and televised by a local station. [Emphasis added.]

[17] *See BPHA*, *supra* note 4.

[18] Cork Gaines, "The 32 NFL Teams Are Worth as Much as Every MLB and NBA Team Combined," *Business Insider* (Sept. 15, 2016).

[19] Jessica Schaak, "A Comparison of Team Values in Professional Team Sports — 2 Year Update," Nat'l Sports Law Inst. of Marq. Univ. L. Sch. (2007).

[20] Gaines, *supra* note 18.

[21] Jason Belzer, "Thanks to Roger Goodell, NFL Revenues Projected to Surpass $13 Billion in 2016," *Forbes*, Feb. 29, 2016.

[22] Meg James, "The Rise of Sports TV Costs and Why Your Cable Bill Keeps Going Up," *Los Angeles Times*, Dec. 5, 2016.

[23] Cal. Rev. & Tax. Code section 25141(b) provides:

> For purposes of this chapter, a team shall be considered to have its operations based in the state or country in which the team derives its territorial rights under the rules of the league of which it is a member.

[24] Senate Committee on Revenue and Taxation, *supra* note 5, at 3:

> To accomplish these benefits, new Section 25141 of the Revenue and Taxation Code will provide that the business income of a professional athletic team will be determined by allocating all property, payroll and sales factors to the state in which it has its base of operations. This will have the effect of apportioning all of the net income of a team to its home state.

[25] Cal. Code regs. tit. 18, section 25133(c), states:

> The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power or control is exercised by the taxpayer.

[26] 79-SBE-093 (June 28, 1979).

[27] Cal. Rev. & Tax. Code section 25141(c)(3)(A).

[28] Andi D., "GRAPHIC: New NHL Divisions by TV Coverage Zone," Mile High Hockey blog, *SBNation*, Sept. 30, 2017.

Section 25141(c)(3)(A) precludes the Sharks from assigning a portion of its sales to Nevada or Oregon, even when its broadcast rights encompass those states. Such a rule runs contrary to established California jurisprudence recognizing that the management of exclusive territorial rights is an integral part of an athletic team's business.[29] It also ignores the reality that both Oregon and Nevada materially enhance the value of the Sharks.

## Quid Pro Quo?

Section 25141's provisions treat California-based professional athletic teams differently based on the schedules they play, and non-California-based professional athletic teams differently based on their home jurisdictions' taxation of California-based teams. This provision gives new meaning to the phrase "home-field advantage."

Section 25141(d) provides that California professional athletic teams can offset their allocable income owed to California by the amount of business income that is allocated or apportioned by another state or country.[30] Because no other state has enacted a provision similar to section 25141, California-based athletic teams offset their California income tax based on how other jurisdictions tax them. Thus, a California-based professional athletic team's travel schedule would not just affect its competitive abilities, but also its bottom line.

When section 25141 was enacted, the offset of business income by California teams was limited to jurisdictions where teams played. However, with the proliferation of states subjecting a taxpayer to a net income tax based on economic nexus and using market-based receipts to apportion income, California-based teams face an increasing tax bill from jurisdictions in which they were not traditionally subject to tax because they did not play there.

As for teams not based in California, section 25141(d)(2) creates an oddity because teams in the same league are taxed differently in California based on where each team is based. First, section 25141(d)(2) provides that the allocation principles found under section 25141 do not apply to any sports team in a jurisdiction that taxes a California team. Section 25141(d)(2) then provides that the team in the other jurisdiction will be taxed in the same manner that the California team was taxed in its jurisdiction.[31]

For example, the new Vegas Golden Knights and Chicago Blackhawks would be taxed differently in California based on how the Los Angeles Kings are taxed in Nevada and Illinois, respectively. Nevada does not have a corporate franchise tax. Although Illinois does have such a tax, it does not provide a reciprocal arrangement in a similar manner to section 25141 in apportioning the income of sports teams.

## Conclusion

Section 25141 serves as a warning for drafting legislation based on the contemporaneous facts surrounding an industry. Putting pen to paper to administer an industry based on today's facts and circumstances will only cause more problems as businesses evolve to meet their own client needs and react to the changing market conditions. Businesses do not stay stagnant so taxing jurisdictions can administer their taxes easily. Rather, it is legislation that needs to be flexible to collect and administer the correct amount of tax. ■

[29] *Appeal of New York Football Giants Inc.*, 77-SBE-014 (Feb. 3, 1977).

[30] Cal. Rev. & Tax. Code section 25141(d)(1).

[31] Cal. Rev. & Tax. Code section 25141(d)(2) provides:

This section shall not apply to any team in the same league that has its operations based in the other state or country, and the business income of any such team derived directly or indirectly from its operations as a professional athletic team shall be allocated or apportioned to this state in a manner consistent with the method of allocation or apportionment imposed by the other state or country on the business income of the team that has its operations based in this state.