

## Planning A Defense As IRS Kicks Off Sports Losses Campaign

By **Sheri Dillon and Jennifer Breen** (February 12, 2024, 4:36 PM EST)

On Jan. 16, the Internal Revenue Service announced its sports industry losses campaign, which is designed to identify and initiate specialized, issue-based examinations of partnerships operating within the sports industry that report significant tax losses.[1]

This enforcement initiative is one of the latest in the IRS' compliance campaign program, in operation since 2017.

In initiating this campaign, the IRS has called foul, and is signaling to sports teams and their owners that it believes their tax losses are an area of significant noncompliance.

### Why the Focus on Sports Industry Partnerships

The sports industry losses campaign falls in line with IRS goals announced over the last year and is consistent with the objectives outlined in the April 2023 Inflation Reduction Act strategic operating plan and the Large Business and International Division's strategic goals for fiscal year 2024.[2]

Among other things, the Inflation Reduction Act plan proposed to use tens of billions of Inflation Reduction Act dollars to hire and train specialized compliance employees and to initiate examinations of high-income and high-wealth individuals, complex partnerships and large corporations.

The IRS' intention is to investigate whether taxpayers within these broad groups are in compliance with the applicable tax law and paying the taxes they owe.

As part of the implementation of its strategic operating plan, in September 2023, the IRS established a new pass-through organizations unit, housed within the LB&I, to focus on large or complex pass-through entities.

This new compliance campaign builds upon the IRS' ongoing efforts to increase scrutiny of pass-through entities.

In 2021, as part of its continued efforts to ramp up enforcement and deploy its limited resources, the IRS launched a large partnership compliance program focused on using data analytics to identify partnerships with the highest noncompliance risk.



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The program targeted partnerships with over \$10 million in assets and was intended to aid the IRS in data collection and training examination personnel.

The sports industry losses campaign announcement provides little detail about the extent and nature of the campaign-related examinations and does not indicate how many sports industry partnerships would be targeted.

Rather, consistent with other campaign announcements, the IRS provides a high-level description of the campaign's focus — to identify sports industry partnerships with significant losses and examine whether the income and deductions producing those losses were reported in compliance with the Internal Revenue Code.

Unlike other campaigns that are issue-focused or seek to address compliance with the preparation and filing requirements for certain tax forms, and are not unique to a specifically identified industry, the sports industry losses campaign is narrowly focused.

## **Observations and Considerations**

### ***The Perfect Storm***

For the sports industry, the IRS' creation of the sports industry losses campaign comes from a perfect storm for those in this industry, including:

- Criticisms that high-income taxpayers do not get audited at the same rate as low-income taxpayers;
- Significant funding that was recently given to the IRS for enforcement under the IRA;
- The IRS' seeming belief that wealthy taxpayers use pass-through entities to shield income to avoid paying taxes;
- The IRS' commitment to using its new resources to expand its large partnership compliance pilot program by using artificial intelligence to identify compliance risks and select returns for examination; and
- Scrutiny of sports team owners and their taxes in the media, including a 2021 ProPublica report titled "The Billionaire Playbook: How Sports Owners Use Their Teams to Avoid Millions in Taxes," which criticized team owners for purportedly paying a lower tax rate than players.

### ***Restoring Fairness***

The IRS may be acting on its promise to restore fairness in tax compliance by taking more shots at partnerships and high-wealth individuals, including sports team owners.

Consistent with its ongoing efforts to increase examinations of pass-through entities, at the end of 2023, the IRS had opened examinations of 75 of the largest partnerships in the U.S., encompassing a variety of industries, including hedge funds, real estate investment partnerships, publicly traded partnerships and large law firms. And some of those shots have scored.

On Jan. 12, the IRS reported that its ongoing enforcement push has raked in over \$500 million from wealthy taxpayers. With the sports industry losses campaign, the sports industry looks to be the next opponent in the IRS arena.

### ***BBA Audit Regime Considerations***

To implement this campaign, the IRS will use specialized, issue-based Bipartisan Budget Act partnership examinations.

Partnerships selected for examinations with taxable years beginning after Dec. 31, 2017, are generally subject to the centralized partnership audit regime enacted as part of the BBA.

Under the default rule of the BBA audit regime, the IRS has authority to determine, assess and collect tax on partnership underpayments at the partnership level.

Also, a single person — the partnership representative or a designated individual — has the exclusive authority to represent, negotiate and bind the partnership at all stages of a partnership proceeding subject to the BBA audit regime; and partners do not have a statutory right to receive notice or to participate in the partnership proceeding.

To be in the best position to play defense, partnerships and their partners will, at a minimum, need to know the rules.[3]

### ***Global High Wealth Program Considerations***

Beyond the BBA rules, sports team owners should be aware of the LB&I's historic global high wealth program. The global high wealth program was initiated in 2009, but the recent Inflation Reduction Act funding has given it new life.

Through the global high wealth program, the IRS looks at the complete financial picture of high-wealth individuals and the entities they control, in whatever form they take — e.g., partnerships, trusts, subchapter S corporations and C corporations.

### ***How to Prepare***

Because the best defense is a good offense, sports industry partnerships and their owners are encouraged to ensure they are ready for the possibility of an IRS examination.

To prepare for a BBA partnership or a global high wealth program examination, sports team partnerships and sports team owners should be proactive in developing an examination defense that

- Identifies the income and deduction items that are driving losses, which for a sports team can include, among other things: depreciation of an arena or other fixed assets, amortization of intangible assets such as brand and broadcasting rights, and interest on indebtedness;
- Evaluates whether allocated partnership losses are subject to limitations under the passive activity or at-risk limitations; and

- Includes contemporaneous documentation, explanations of the strengths and weaknesses of relevant tax return positions, and an evaluation of the accounting methods adopted for income and expense items for compliance with the Internal Revenue Code.

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[1] <https://www.irs.gov/businesses/corporations/irs-lbi-compliance-campaign-jan-16-2024>.

[2] <https://www.irs.gov/pub/irs-pdf/p3744.pdf>; <https://www.irs.gov/pub/irs-pdf/p5319.pdf>.

[3] For more information on the BBA, read our LawFlash: New Legislation Makes Sweeping Changes Impacting All Partnerships; <https://www.morganlewis.com/pubs/2015/11/new-legislation-makes-sweeping-changes-impacting-all-partnerships>.