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TaxNewsFlash

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Seventh Circuit: Deduction for assumed deferred compensation liabilities not allowed when not paid; Tax Court affirmed

The U.S. Court of Appeals for the Seventh Circuit today affirmed a decision of the U.S. Tax Court holding that a professional basketball franchise (a partnership) was not entitled to deduct approximately $10.7 million representing deferred compensation liabilities in 2012 because the deferred compensation amounts were not paid to the players in 2012 and were not includible in the players' gross incomes for 2012.

The case is: *Hoops, LP v. Commissioner,* No. 22-2012 (7th Cir. August 9, 2023). Read the Seventh Circuit's decision [PDF 150 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. 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 of the partnership. Among the liabilities assumed were the $10.7 million deferred compensation liabilities under certain binding agreements with two 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 liabilities; and did not adjust its basis in any property it owned as a result of the deferred compensation liabilities. Subsequently, the partnership filed an amended return on Form 1065X, and claimed an additional deduction of $10.7 million relating to the deferred compensation liabilities.

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 liabilities. The tax matters partner filed a petition with the Tax Court for readjustment of the partnership items in the FPAA.

The Tax Court held that section 404(a)(5) barred the partnership from deducting the deferred compensation in the 2012 tax year because it did not pay the employees during that year. Read *TaxNewsFlash*

The Seventh Circuit today affirmed the Tax Court's decision, finding that section 404(a)(5) reflects Congress's intent to treat the deductibility of deferred-compensation salary plans differently than ordinary service expenses—and that this special treatment prevails over any general provisions otherwise applicable to liabilities assumed in asset sales.

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