WINSTON & STRAWN LLP

BLOG

Taking Aim: IRS's Compliance Campaign Makes Sports Industry Target of Enforcement Measures

APRIL 9, 2024

The world of professional sports has seen its share of activity in recent weeks, with the new NFL league year and free-agency-signing period opening and the sights and sounds of MLB Opening Day filling the air in recent weeks. Lest we forget February's Super Bowl LVIII overtime thriller, crowning a new football dynasty with the Kansas City Chief's third Super Bowl title in five years.

Not to be outdone, the Internal Revenue Service (IRS) has dipped its toe into the world of sports, announcing a newly minted compliance campaign aimed specifically at partnerships operating in the sports industry. The announcement comes on the heels of other IRS pronouncements detailing the agency's enhanced enforcement measures and efforts, collectively geared towards ensuring tax compliance with applicable sections of the Internal Revenue Code (IRC).

Below we outline the IRS's announcement and its implications.

COMPLIANCE CAMPAIGN ANNOUNCEMENT

On January 19, 2024, the IRS added Sports Industry Losses to the list of compliance campaigns operated by its Large Business and International (LB&I) Division of the IRS. The limited description provided by LB&I provides that the campaign is intended to "identify partnerships within the Sports Industry that report significant tax losses" and "determine if the income and deductions driving the losses are reported in compliance with the applicable sections of the Internal Revenue Code."

WHAT IS AN IRS LB&I CAMPAIGN?

In 2017, the IRS shifted its enforcement strategy, moving away from broad, one-size-fits-all approaches to a more targeted and data-driven approach focused on different enforcement areas based on data analysis. LB&I compliance campaigns represent a departure from an entity-based approach and, instead, are intended to focus on improving return selection, identifying potential non-compliance risks, and maximizing its resources. Other recent and notable LB&I campaigns include the Business Aircraft Campaign (related to business aircraft usage by large corporations, large partnerships, and high-income taxpayers), and the Puerto Rico Act 22, Individual Investors Act (related to taxpayers who have incorrectly claimed benefits through Puerto Rico Act 22).

LB&I's current practice includes issuing and maintaining a list of its currently active campaigns with descriptions including practice area, lead executive, and points of contact. Compliance campaigns are added and removed from the IRS as the agency adjusts its focus of audit resources committed to campaign issues.

WHY THE SPORTS INDUSTRY?

No specific background has been expressly articulated as to why the sports industry has been singled out or, alternatively, how the campaign originated as an area of concern and attention.

Nevertheless, it should be noted that the ownership of sports teams is often associated with tax losses—i.e., losses potentially able to offset the taxable amounts from other profitable businesses operated or other incomes earned by the sports teams' wealthy owners. These tax losses (often flowing through to owners of partnerships owning the sports franchises) are oftentimes contrasted against both the large revenues earned by these sports franchises through various income streams including TV rights, ticket sales, etc., and the steadily increasing valuation of sports franchises. Recent sales of sports teams have consistently netted record amounts. Accordingly, it is possible that the IRS's compliance program is intended to understand the perceived dual realities, while ensuring proper compliance with the Code.

It should be noted that the campaign is consistent with a number of key announcements made by the IRS since receiving a projected US$80B of appropriations under the Inflation Reduction Act to increase the IRS's enforcement capabilities. A large portion of the IRS's articulated focus has been on large corporations, partnerships, and high-income taxpayers. This latest compliance campaign announcement should be viewed as part of the agency's broader strategy to close the gap in tax compliance and ensure that large corporations and wealthy individuals pay their appropriate share of taxes. Scenarios of wealthy sports organizations (and their owners) producing significant revenues and consistently increasing in value, all while, perhaps, not paying the appropriate amount of tax, presents itself as an ideal target of the IRS's recent enforcement efforts and priorities.

WHAT CAN TAXPAYERS DO TO PREPARE?

Inquiries into and audits related to sports industry losses promise to be thorough, informed by the use of artificial intelligence (AI) and data analytics, and primed to ensure compliance with all applicable provisions of the Code. The IRS will undoubtedly use some of its recently appropriated funding to step up its enforcement efforts in this area.

To successfully navigate these audits, applicable taxpayers should work proactively to identify potential compliance issues and reduce audit risks. Taxpayers should review and prepare relevant records and papers related to the losses that may become the center of focus of an IRS audit. Furthermore, taxpayers should carefully consider working with external tax and legal providers to ensure proper application of the procedurally complex partnership audit rules, while avoiding potential conflicts of interest, preserving protections and privileges like the attorney-client privilege and work-product doctrine, and properly navigating traps for the unwary that could arise in the context of the partnership rules.

For more information or to discuss further, please contact the authors or your Winston relationship attorney.

3 Min Read

Authors

Susan Elizabeth Seabrook

James N. Mastracchio

Karl Kurzatkowski

Nicholas Netland

Related Topics

Internal Revenue Service (IRS) | Compliance | Tax | Sports

Related Capabilities

Government Investigations, Enforcement & Compliance | Tax Controversy & Criminal Tax

Sports

Related Professionals

Susan Elizabeth Seabrook

James N. Mastracchio

Karl Kurzatkowski

Nicholas Netland

This entry has been created for information and planning purposes. It is not intended to be, nor should it be substituted for, legal advice, which turns on specific facts.