

Like-kind exchanges changed

Internal Revenue Code Section 1031 provides that an exchange of things that are alike will not be taxable except to the extent that cash changes hands. The most important application of this provision has been in the area of exchanges of real estate, but it also has been applied in other contexts as well, such as for fine art.

Until this year.

One of the notable reforms included in last year's Tax Cuts and Jobs Act was a limitation on the application of the like-kind exchange rule. Only real estate swaps remain eligible for this treatment. An exchange of one famous painting for another, for example, is now a taxable transaction. The amount of the tax will be determined by the fair market value of the paintings and their tax basis.

This rule change may have a much broader impact than legislators imagined. For example, professional sports teams are now concerned about how it may affect them.

In 1967 Major League Baseball obtained a ruling from the IRS that trading players under contract was a like-kind exchange, so that gain would be recognized only to the extent that cash was involved. All the sports teams have relied upon that ruling ever since. Now it doesn't apply.

Saying that trading players is now a taxable transaction doesn't answer the hard questions, however. What is the fair market value of the contract? How has the player's recent performance affected the value of the contract? If he has outperformed expectations, the contract value may have gone up, but if he's viewed as "past the career peak," the value could be lower. Some players might be worth more to one team than to another.

The valuation issues will be different in the National Football League, in which contracts are not guaranteed, compared to baseball and the National Basketball Association, where they are.

What about trading players for draft choices? The IRS already has said that such trades never qualified for like-kind exchange treatment, though the Service is not known to have actively pursued these cases.

Another unknown is what happens if a U.S.-based team trades players with one in, say, Canada.

According to a recent item in the professional journal *Tax Notes*, owners of sports teams who are hoping for some guidance from the IRS on these thorny issues may have to wait a long time. The Service has bigger issues affecting many more taxpayers that have to be addressed first.

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