# TO TAX, OR NOT TO TAX, THAT IS THE QUESTION: SEARCHING FOR A SOLUTION TO THE INCREASING COMMERCIALIZATION OF INTERCOLLEGIATE ATHLETICS

CHRISTOPHER L. TAZZI *



* J.D., Notre Dame Law School, 2011; B.S., Cornell University, 2008. The author would like to thank Professor Ed Edmonds for his assistance on this project—from topic development all the way to publication. He truly cares for every student in his class and wants to see them succeed. The author would also like to thank Jonathan Gaynor for providing research assistance during the editing stages. Finally, the author would like to thank his wife, Maria, for her love and support, without which, he would not be where he is today.

## INTRODUCTION

On October 2, 2006, Representative William M. Thomas of the House Ways and Means Committee sent an eight-page letter to National Collegiate Athletic Association (NCAA) President Myles Brand. The letter asked the NCAA to provide "information on whether major intercollegiate athletics further the exempt purpose of the NCAA and, more generally, educational institutions."[1] Thomas's letter to the NCAA created a firestorm of public debate regarding whether the NCAA and athletic departments deserve tax exemption in light of their exponentially increasing commercialization.[2] In a twenty-five-page response letter, Brand attempted to justify the tax-exemption for intercollegiate athletics by explaining its important connection to the educational experience.[3] He claimed that what athletes "learn on the playing field or court is integral to their educational experience," and that athletes learn "[l]essons on leadership and how to follow, on self-discipline and self-sacrifice, on teamwork and hard work, and learning to pursue excellence . . . ."[4] Americans have a unique connection to sports and surely understand Brand's comments on a visceral level, but has intercollegiate athletics strayed too far from the path? The consideration of major conference realignment in college football,[5] the dawning of the Texas Network,[6] and

---

1. Letter from Rep. Bill Thomas, Chairman, House Comm. on Ways & Means, to Dr. Myles Brand, President, NCAA (Oct. 2, 2006), *available at* http://www.usatoday.com/sports/college/2006-10-05-congress-ncaa-tax-letter_x.htm [hereinafter *Thomas Letter*].

2. *See, e.g.*, Daniel Golden, *Tax Breaks for Skyboxes: Suite Fees at College Stadiums Are Charitable Gifts, Sparking Building Room—And Scrutiny,* WALL ST. J., Dec. 27, 2006, at B1; Greg Johnson, *Coaches' Pay Put Colleges to the Test,* L.A. TIMES, Jan. 16, 2007, at A1; Greg Johnson, *Lawmaker Challenges NCAA on Tax Exemption*, L.A. TIMES, Oct. 6, 2006, at D13; Selena Roberts, *Big-Time College Sports May Be Due For an Audit*, N.Y. TIMES, Oct. 29, 2006, at SP1; George F. Will, *Tax Breaks for Football*, WASH. POST, Oct. 25, 2006, at A17.

3. *See* Letter from Dr. Myles Brand, President, NCAA, to Rep. Bill Thomas, Chairman, House Comm. on Ways & Means 1 (Nov. 13, 2006), *available at* http://www.nacua.org/documents/NCAALetter_TaxExempt_ResponsetoHouseWaysMeansCmte.pdf [hereinafter *Brand Letter*].

4. *Id*. at 4.

5. *See* Gene Wojciechowski, *Ex-SEC Commish Discusses Expansion*, ESPN (Jun. 11, 2010, 1:26 PM), http://sports.espn.go.com/espn/columns/story?columnist=wojciechowski_gene&id=5272309&sportCat=ncf.

6. *See Texas, ESPN Announce New Network*, ESPN (Jan. 19, 2011, 5:51 PM), http://sports.espn.go.com/espn/news/story?id=6037857.

CBS's decision in 2011 to air the opening rounds of the NCAA men's basketball tournament instead of President Obama's news conferences[7] are just three examples from the recent past suggesting that perhaps intercollegiate athletics has sacrificed the educational experience for the commercial experience. Bearing this in mind, should colleges and universities, and the NCAA lose their tax-favored status? Are there perhaps other avenues of relief?

In exploring these issues, this Note proceeds in five parts. Part I details the historical development of intercollegiate athletics. Although American intercollegiate athletics began as a mere "jolly lark"[8] between members of the Harvard and Yale crew teams on Lake Winnipesaukee in New Hampshire,[9] the current state of college athletics is far removed from these humble beginnings; the overall history paints a story of increasing commercialization. Part II surveys public and governmental responses to this increasing commercialization of intercollegiate athletics—from a 1929 report issued by the Carnegie Commission[10] to a March 2011 call to restrict eligibility for the NCAA men's basketball tournament.[11] Of particular import to this Article, much of the inquiry has concerned whether or not the increasing commercialization of college athletics threatens the tax-exempt status of universities and the NCAA (or at least whether they should be subjected to the Unrelated Business Income Tax). In order to understand this particular inquiry, Part III will provide a primer on applicable tax-exempt law. Part IV will then proceed to apply these tax rules to intercollegiate athletics, and ultimately will conclude that despite increasing commercialization, colleges and universities, and the NCAA are at little risk of losing their tax-exempt status (or being subject to the Unrelated Business Income Tax) under current tax law. Finally, Part V will analyze whether this result is normatively correct.

---

7. *NCAA Tourney Ratings Up 16 Percent*, ESPN (Mar. 18, 2011, 6:34 PM), http://sports.espn.go.com/ncb/tournament/2011/news/story?id=6234366.

8. RONALD A. SMITH, SPORTS AND FREEDOM: THE RISE OF BIG-TIME COLLEGE ATHLETICS 28 (1988).

9. *Id*. at 27–28.

10. *See* Charles Farrell, *Historical Overview*, *in* THE RULES OF THE GAME: ETHICS IN COLLEGE SPORT 3, 8 (Richard E. Lapchick & John Brooks Slaughter eds., 1989).

11. Arne Duncan, Op-Ed., *The Real March Madness: Stop Rewarding Schools that Don't Educate Their Players*, WASH. POST, Mar. 17, 2011, at A21.

## I. THE HISTORICAL DEVELOPMENT OF INTERCOLLEGIATE ATHLETICS: A STORY OF INCREASING COMMERCIALIZATION

### A. The Emergence of Intercollegiate Athletics: A Student Run Phenomenon

Intercollegiate athletics can be traced back to an 1827 cricket match in England between the University of Oxford and the University of Cambridge.[12] Two years later, in 1829, the universities of Oxford and Cambridge again met, but this time for a crew race.[13] It would be more than two decades until the birth of American intercollegiate athletics, when on August 3, 1852, the crew teams of Harvard and Yale raced on Lake Winnipesaukee in New Hampshire.[14] The next intercollegiate sport to appear was baseball with Amherst playing Williams on July 1, 1859.[15] The turning point in intercollegiate athletics, however, was the emergence of intercollegiate football with Rutgers playing Princeton in New Brunswick, New Jersey on November 6, 1869.[16]

During these formative years, college and university administrators not only considered intercollegiate sports to fall outside of their institution's function but also considered it to detract from educational pursuits because of the tendency for students to spend their time on athletics at the expense of their education.[17] As a result, intercollegiate athletics were originally entirely organized and run by students.[18] College and university administrators might have put aside their concern that athletics detracted from the educational experience and allowed for this autonomous

12. SMITH, *supra* note 8, at 6.

13. *Id*. at 7.

14. *Id*. at 3–4. As the reader will soon understand, the story of intercollegiate athletics is one of increasing commercialization. One might imagine that there was not even a trace of commercialization at such an early stage of intercollegiate athletics, and this would make sense considering that the crew race between Harvard and Yale was completely self-organized and described by the participants as merely a "jolly lark." *Id*. at 28. Interestingly enough, however, commerce was at least partially responsible for the birth of American intercollegiate athletics. *See id*. at 3. After all, James Elkins, a railroad magnate, approached a member of the Yale Boat Club and presented him with an offer too good to pass up: "If you will get up a regatta on the Lake between Yale and Harvard, I will pay all the bills." *Id*. at 3. Elkins believed that hosting the race on one of the stops on his unprofitable Boston-Montreal line would increase profits for his railroad. *Id*. at 3–4.

15. *Id*. at 219. For more information regarding the emergence and development of intercollegiate baseball see *id*. at 52–66.

16. Joanna Davenport, *From Crew to Commercialism—The Paradox of Sport in Higher Education*, *in* SPORT AND HIGHER EDUCATION 5, 7 (Donald Chu et al. eds., 1985).

17. *Id*. at 6–7.

18. *Id*. at 6.

arrangement to continue, but the emergence of football only fueled concerns because of the "violence and brutality" of the sport.[19] As the sport became even more violent with the introduction of set formations,[20] college and university administrators called for the outright banning of football on campuses because they thought it was completely at odds with the educational mission of their institutions.[21]

In 1905, only thirty-six years after its inception, intercollegiate football had reached a turning point: eighteen players were killed and 143 were seriously injured while playing football in that year alone.[22] In response, President Roosevelt charged a committee with the task of reforming the sport.[23] Representatives of approximately thirty major institutions gathered in New York and ultimately formed the Intercollegiate Athletic Association of the United States (IAAUS) in 1906.[24] In 1910, the IAAUS changed its name to the National Collegiate Athletic Association (NCAA).[25] Although some college and university administrators might have preferred to completely ban football (and perhaps sports altogether), the formation of the NCAA was a compromise solution. While sports were not banned from campuses, the NCAA provided college and university administrators with the opportunity to supervise and control intercollegiate athletics.[26] The founding constitution of the NCAA makes this supervisory arrangement clear: "[i]ts object shall be the regulation and supervision of college athletics throughout the United States, in order that the athletic activities in the colleges and universities of the United States may be maintained on an ethical plane in keeping with the dignity and high purpose of education."[27] To establish their supervisory control, some college and university

---

19. SMITH, *supra* note 8, at 67–69.

20. *Id.* at 88–94. As an example, Harvard introduced the "Flying Wedge," a formation developed by Lorin F. Deland in 1892. *Id*. at 90–92. Deland was a Boston businessman who had no connection to Harvard and was not even a fan of football. *Id*. Instead, Deland was a military strategist who adopted Napoleon's principle on the concentration of force to develop a violent and brutal football formation. *Id*.

21. *Id*. at 131. Some administrators succeeded, and football was banned at certain times at Brown, Yale, Williams, and West Point. *Id*. at 69. Furthermore, "[a]t Harvard, the annual 'Bloody Monday' contest on the first day of each fall term became such a ferocious meeting of the college new-comers and the cocky sophomores that the faculty banned the annual battle in 1860." *Id*. at 68.

22. Davenport, *supra* note 16, at 7.

23. *Id*.

24. *Id*. at 8.

25. *Id*.

26. *See* Allen Guttmann, *The Anomaly of Intercollegiate Athletics*, *in* RETHINKING COLLEGE ATHLETICS 17, 18–19 (Judith Andre & David N. James eds., 1991).

27. Davenport, *supra* note 16, at 8.

administrators created departments of physical education and placed intercollegiate sports into these departments.[28]

### B. From Student-Run Activities to Quasi-Commercial Enterprises

Under the guidance of the NCAA, and with the advent of commercial radio, intercollegiate sports saw a period of boom in the 1920s.[29] The Great Depression and World War II stymied the boom period, but the end of the war and the advent of national television[30] created a resurgence of intercollegiate athletics.[31] Not only was there simply a resurgence of the popularity of intercollegiate athletics, but also it is arguable that commercialization can be traced back to this time period—a time period when money became a driving factor.[32] It was during this time that some "college athletic departments became significant revenue generators."[33] It was also during this time that many athletic departments separated themselves from control of their institution's physical education department.[34]

In large part due to the popularity of Division I Football Bowl Subdivision (FBS)[35] football and Division I men's basketball (and the revenue-generating potential of these sports), the commercialization of intercollegiate athletics has continued to grow since the 1950s until the

28. Guttmann, *supra* note 26, at 19.

29. JAMES J. DUDERSTADT, INTERCOLLEGIATE ATHLETICS AND THE AMERICAN UNIVERSITY: A UNIVERSITY PRESIDENT'S PERSPECTIVE 71–72 (2000).

30. Interestingly enough, at one time, both the NCAA and college athletic programs did not want to televise football games because of the belief that it would hurt ticket sales. *See* Davenport, *supra* note 16, at 12. Considering that the majority of the costs were already "borne by the institutions themselves or subsidized by ticket sales," however, broadcasting rights were potentially very lucrative. DUDERSTADT, *supra* note 29, at 73. Once this became apparent to college and university athletic departments, they reversed their original stance. *See* Davenport, *supra* note 16, at 12.

31. Matthew J. Mitten, James L. Musselman & Bruce W. Burton, *Targeted Reform of Commercialized Intercollegiate Athletics*, 47 SAN DIEGO L. REV. 779, 790 (2010).

32. *Id*.

33. *Id*.

34. *Id*.

35. For most intercollegiate sports the NCAA divides programs into three divisions. *See Differences Among the Divisions*, NATIONAL COLLEGIATE ATHLETIC ASSOCIATION, http://www.ncaa.org/wps/wcm/connect/public/NCAA/About+the+NCAA/Who+We+Are/Differences+Among+the+Divisions/ (last updated Dec. 11, 2011). For purposes of intercollegiate football the NCAA further subdivides Division I into two subdivisions: the Football Bowl Subdivision (formerly Division I–A) and the Football Championship Subdivision (formerly Division I–AA). *Id*.

present day.[36] For example, in 1999, CBS and the NCAA renewed their agreement for broadcast rights to the men's basketball tournament for $6 billion.[37] The eleven-year renewal agreement covers the years 2003 to 2013 at $545 million per year.[38] Furthermore, a May 2009 Congressional Budget Office (CBO) paper, entitled *Tax Preferences for Collegiate Sports*, states that the 2008 NCAA men's basketball tournament generated revenue of approximately $143 million for college and university athletic departments and that FBS bowl games generated about the same amount of revenue.[39] The CBO paper also contains data illustrating that the average 2004 to 2005 athletic program revenues for Division I colleges and universities with FBS and men's basketball programs was $35.2 million.[40]

Not only are athletic departments generating revenue like big businesses, but they are also spending money like big businesses. For example, according to a 2009 study, Division I athletic departments with FBS and men's basketball programs increased spending by an average of 10.7% annually from 2004 to 2007.[41] This increased spending is even more noteworthy in light of the fact that the annual average increase in overall nonathletic spending during the same time period was only 4.7%—less than half of the annual increase in athletic spending.[42] A contributor to these skyrocketing expenditures is coaches' salaries. In 2007, for example, the average annual salary of the 120 FBS coaches exceeded $1 million, and this figure does not include perks and bonuses such as cars and country club memberships.[43] Over a dozen coaches make at least $2 million with some coaches making significantly more than that.[44] For example, in December 2009, the University of Texas renegotiated head football coach

---

36. *Id*. at 791.

37. *CBS Renews NCAA B'Ball*, CBS MONEY (Nov. 18, 1999, 8:39 PM), http://money.cnn.com/1999/11/18/news/ncaa.

38. *Id*.

39. CONG. BUDGET OFFICE, TAX PREFERENCES FOR COLLEGIATE SPORTS, at vii (2009).

40. *Id*. at 4.

41. JONATHAN ORSZAG & MARK ISRAEL, COMPASS LEXECON, THE EMPIRICAL EFFECTS OF COLLEGIATE ATHLETICS: AN UPDATE BASED ON 2004-2007 DATA 3–4 (2009), *available at* http://web1.ncaa.org/web_files/DI_MC_BOD/DI_BOD/2009/April/04,%20EmpiricalEffects.pdf (the study, although representing only the views of the authors was commissioned by the NCAA). The study also found data that supports the existence of an "arms race," which is "a situation in which the athletic expenditures by a given school tend to increase along with expenditures by *other* schools in the same conference." *Id*. at 11.

42. *Id*.

43. *See* Steve Wieberg & Jodi Upton, *College Football Coaches Calling Lucrative Plays*, USA TODAY (Dec. 5, 2007, 1:56 PM), http://www.usatoday.com/sports/college/football/2007-12-04-coaches-pay_N.htm.

44. *Id*.

Mack Brown's contract to increase his salary from $3 million to at least $5 million for the remainder of his contract through 2016.[45] Furthermore, it is not just the salaries of the coaches. The athletic directors at a number of schools also make a significant amount of money. For example, Jeremy Foley, the Athletic Director at the University of Florida, for example, tops the list at $965,000.[46]

It is obvious that today's intercollegiate athletics are a far cry from the 1852 crew match between Harvard and Yale, a race that was described by one of the competitors as a "jolly lark."[47] Furthermore, three recent events seem to suggest that there is no end in sight to the increasing commercialization of intercollegiate athletics. First, during the summer of 2010, the major conferences in college football flirted with the idea of significant conference realignment.[48] Taken to the extreme possibility, realignment could result in a number of conferences vanishing and college athletics being ruled by as few as five "super-leagues" composed of sixteen teams or more.[49] With conferences being set up in such a manner, some student-athletes would be required on occasion to travel to locations two time zones away to compete. The intercollegiate system would resemble professional sports teams sending millionaires to major cities for competition. This possibility was ultimately avoided, at least temporarily, but the possibility remains. Second, on January 19, 2011, the University of Texas announced a twenty-year deal for $300 million with ESPN.[50] As part of the deal, ESPN will develop, launch, operate, and distribute the Longhorn Network, a station dedicated to University of Texas sports and news.[51] Finally, CBS's decision to air first round games of the 2011 NCAA basketball tournament either in lieu of or simultaneously with President Obama's news conferences seems to offer a final exclamation point on the commercial focus of intercollegiate athletics today.[52]

For the Thursday round games, CBS decided to not cover Obama's news conference at all, and instead opted to summarize his speech in a one-

---

45. *Brown to Receive $5M a Season*, ESPN, Dec. 10, 2009, http://sports.espn.go.com/ncf/news/story?id=4728932 (last visited March 12, 2012).

46. *See* Curtis Eichelberger, *Florida Enters BCS Title Game With Top-Paid Athletic Director*, Bloomberg News (Jan. 6, 2009, 1:41 PM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aYYY_mDwYMkY&refer=us.

47. Smith, *supra* note 8, at 28.

48. *See* Wojciechowski, *supra* note 5.

49. *Id*.

50. *See Texas, ESPN Announce New Network*, *supra* note 6.

51. *Id*.

52. *See NCAA Tourney Ratings Up 16 Percent*, *supra* note 7; Burgess Everett, *Obama, NCAA Tourney Share Stage*, Politico (Mar. 18, 2011, 8:28 PM), http://www.politico.com/blogs/onmedia/0311/Obama_NCAA_tourney_share_stage.html.

minute report aired during a commercial break in NCAA game coverage within thirty minutes of the news conference.[53] For the Friday round games, CBS took a different approach that at least provided coverage for Obama's news conference.[54] Rather than completely air the games over the news conference, CBS ultimately decided to run "a split screen, with audio of Obama and his picture on the top, and a silent broadcast of the game on the bottom."[55] CBS News President, David Rhodes, justified the separate treatment by stating that U.S. military involvement was more newsworthy than the Japanese radiation consequences,[56] but both decisions can be seen to reflect how commercially driven intercollegiate athletics has become.[57]

## II. PUBLIC AND GOVERNMENTAL RESPONSE TO THE COMMERCIALIZATION OF INTERCOLLEGIATE ATHLETICS

For as long as intercollegiate athletics has been popular, there has been public concern regarding its rightful role and proper scope in colleges and universities. As early as the initial boom period in the 1920s, the public became attuned to the issue of commercialism in college athletics. In 1929, for example, the Carnegie Commission released a report entitled *American College Athletics*, which found "rampant professionalism, commercialization, and exploitation that were corrupting virtually all aspects of intercollegiate athletics."[58] The Carnegie Report concluded:

> In the United States the composite institution called a university is doubtless still an intellectual agency. But it is also a social, a commercial, and an athletic agency, and these activities have in recent years appreciably overshadowed the intellectual life for which the university is assumed to exist . . . . The question is not so much whether athletics in their present form should be fostered by the university, but how fully can a university that fosters professional athletics discharge its primary function.[59]

Although the Carnegie Report did not lead to any reform, it stands as the first evidence of public discontent.

---

53. *See NCAA Tourney Ratings Up 16 Percent*, *supra* note 7.

54. *Id*.

55. *Id*.

56. *Id*.

57. Thursday's games averaged 7.4 million viewers, which was an increase of 16% from last year. *Id*. Since big viewership equates to big money, it is easy to infer CBS's motives regarding their decisions concerning Obama's press conferences.

58. Farrell, *supra* note 10, at 8 (citing HOWARD JAMES SAVAGE ET AL., AMERICAN COLLEGE ATHLETICS (1929)).

59. Guttmann, *supra* note 26, at 120.

It did not take long for the critics to suspect that the commercialization of intercollegiate athletics not only threatened the *educational integrity* of colleges and universities, but that it also threatened *the tax-exempt status* of both the athletic departments and their sponsoring colleges and universities. For example, only two years after the Carnegie Report was published, the Carnegie Foundation warned that athletic departments would be taxed once legislators realized "that intercollegiate football games . . . are merely amusement enterprises masquerading in the guise of education."[60] Despite this warning, athletic programs avoided tax scrutiny for a number of decades. The first shot across the bow occurred, however, in the summer of 1977 when the Internal Revenue Service (IRS) asserted that the sale of broadcast rights amounted to "unrelated business income," which was taxable to the colleges and universities receiving the money.[61] Although the IRS ultimately reversed its position by issuing two formal rulings stating that broadcasting revenues were not subject to the unrelated business income tax,[62] it still had fired an important warning shot—athletic programs could potentially be subject to tax if they ventured too far into the commercial world.[63]

The IRS again responded to the increasing commercialization of intercollegiate athletics a little over a decade later. In 1991, the IRS

60. Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430, 1440 (1980) (quoting H. SAVAGE, J. MCGOVERN & H. BENTLEY, CURRENT DEVELOPMENTS IN AMERICAN COLLEGE SPORT 33 (Carnegie Foundation for the Advancement of Teaching Bull. No 26) (1931)).

61. *Id*. at 1431.

62. *See* Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-296, 1980-2 C.B. 195; *see also* Brett T. Smith, Note, *The Tax-Exempt Status of the NCAA: Has the IRS Fumbled the Ball?*, 17 SPORTS LAW. J. 117, 129 (2010). The IRS had already determined that admission receipts did not amount to unrelated business income and ultimately determined that broadcasting revenue should not amount to unrelated business income either because there was no rational tax distinction between people viewing a game live and people viewing a game on television. *Id*. It also helped that Southern Methodist University, Texas Christian University, and the University of Kansas, the three institutions that stood to pay the tax, enlisted the help of a former IRS Commissioner and fought back ferociously. *See* Kaplan, *supra* note 60, at 1431.

63. It should be noted that the purpose of this section is to illustrate the various instances of public and governmental reaction to the increasing commercialization of intercollegiate sports. Naturally, legal arguments overlap, especially when the IRS has attempted to impose an unrelated business income tax as a consequence of increasing commercialization. This section, however, will not delve into these legal arguments. Rather, the legal arguments will be fully explored in Section IV of this Note, after the history and reaction to the rise of intercollegiate athletics are established.

published two Technical Advice Memoranda (Bowl TAMs)[64] finding that payments from businesses to sponsor the Mobil Cotton Bowl[65] and John Hancock Bowl[66] were unrelated business income taxable to the bowl organizations.[67] The overall effect of the Bowl TAMs was that sponsorship fees paid by a business to a university or bowl association was taxable because it was merely advertising payments. Although intercollegiate athletics could not count on the IRS to reverse its position this time, Congress stepped in by amending the unrelated business income tax rules to eliminate the possibility that corporate "sponsorship payments" could be taxed under this theory.[68]

Although intercollegiate sports again found a way to avoid the potential tax consequences of increased commercialization, it did not come without cost. For one, intercollegiate athletics had to spend a great deal of time and resources lobbying for and defending their interests in these battles.[69] Perhaps much more importantly, however, the battles with the IRS in the 1970s and 1990s led to heightened public scrutiny, with many mainstream

---

64. I.R.S. Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991), 1991 PLR LEXIS 2722; I.R.S. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991), 1991 PLR LEXIS 1778.

65. The sponsorship payments at issue for the Cotton Bowl involved a $1.5 million contract between the Cotton Bowl Athletic Association (CBAA) and Mobil Oil Corporation (Mobil), which included the following provisions: (1) the CBAA had to change the name of the *Cotton Bowl* to the *Mobil Cotton Bowl*, as well as add the Mobil logo to the Cotton Bowl logo; (2) The new logo and name had to be used exclusively and mentioned in all press releases; (3) The CBAA had to imprint the new logo in a prominent spot on the field; (4) the CBAA had to display Mobil's commercials on the jumbotron and broadcast Mobil's commercials over the P.A. system; (5) Mobil could cancel the contract if the Cotton Bowl was not televised; (6) and the CBAA was entitled to an additional sponsorship fee if the Cotton Bowl met a certain Nielsen rating threshold. *See* I.R.S. Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991), 1991 PLR LEXIS 2722.

66. The provisions of the contract at issue for the *John Hancock Bowl* included the following: (1) the sponsor was able to design the game's name and logo and include the sponsor's name and logo; (2) the sponsor would purchase a number of thirty second commercials from the *John Hancock Bowl*; (3) the new logo would be placed prominently around the field and stadium and on the player's uniforms; (4) and the sponsor's commercial advertisements would air during the game's commercial breaks. *See* I.R.S. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991), 1991 PLR LEXIS 1778.

67. I.R.S. Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991), 1991 PLR LEXIS 2722.

68. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 965, 111 Stat. 788, 893-94 (codified at I.R.C. § 513(i) (2006)). *See generally* Ethan G. Stone, *Halos, Billboards, and the Taxation of Charitable Sponsorships*, 82 IND. L.J. 213 (2007).

69. *See* Lobbying Expenses in Sports, Street & Smiths's Sports Bus. J., Jan. 14, 2008, available at http://www.sportsbusinessjournal.com/article/57760.

newspapers picking up the issue.[70] Although the fire of public scrutiny largely subsided with time, the embers still remained. It would not take much to reignite the fire, and the conclusions of a 2001 report by the Knight Commission heightened concern over the issue again:

> After digesting the extensive testimony offered over some six months, the Commission is forced to reiterate its earlier conclusion that "at their worst, big-time college athletics appear to have lost their bearings." Athletics continue to "threaten to overwhelm the universities in whose name they were established." Indeed, we must report that the threat has grown rather than diminished. More sweeping measures are imperative to halt the erosion of traditional educational values in college sports.[71]

Ultimately, the fuel that set the fire ablaze again was a letter sent by a California legislator to the NCAA.[72] At least partially motivated by rising salaries of head coaches, Representative William M. Thomas of the House Ways and Means Committee sent an eight-page letter to NCAA President Myles Brand on October 2, 2006, asking the NCAA to provide "information on whether major intercollegiate athletics further the exempt purpose of the NCAA and, more generally, educational institutions."[73] Thomas's letter to the NCAA reignited interest among both the press and the average blogger, and the legitimacy of the tax-exemption for the NCAA and athletic departments has been of popular concern ever since.[74] In fact, a Google blog search of "NCAA Tax Exemption" for the period from October 5, 2006, to June 1, 2007, revealed 2,145 entries on the subject.[75]

---

70. *See IRS Returns Again to Bowl Controversy*, WASH. POST, Jan. 20, 1993, at C2; Richard Sandomir, *Tax Ruling Worries Officials of Bowls,* N.Y. TIMES, Dec. 6, 1991, at B9; *IRS Moves to Tax College Football Bowls on Payments*, L.A. TIMES, Jan. 20, 1993, at D2; David S. Hilzenrath, *College Football Coaches Score a Tax Touchdown in House*, WASH. POST, Nov. 4, 1993, at B11.

71. KNIGHT FOUND. COMM'N ON INTERCOLLEGIATE ATHLETICS, A CALL TO ACTION: RECONNECTING COLLEGE SPORTS AND HIGHER EDUCATION 11 (2001) *available at* http://knightcommission.org/images/pdfs/2001_knight_report.pdf [hereinafter A CALL TO ACTION].

72. *See Thomas Letter*, *supra* note 1. In question two, Thomas specifically mentioned that "highly paid coaches" are a reason why "many believe that major college football and men's basketball more closely resemble professional sports than amateur sports." *Id*. Also important to Thomas were the things that the IRS and intercollegiate athletics have already fought over: "corporate sponsorships" and "multimillion dollar televisions deals." *Id*.

73. *Id*.

74. *See, e.g.*, articles cited *supra* note 2.

75. John D. Colombo, *The NCAA, Tax Exemption, and Collegiate Athletics*, 2010 U. ILL. L. REV. 109, 110 n. 3 (2010).

As yet another recent example of intercollegiate athletic scrutiny, a Washington political action committee, Playoff PAC, filed a twenty-seven-page complaint with the IRS against BCS Bowls on September 23, 2010.[76] Playoff PAC reviewed over 2,300 pages of tax records and public documents and determined that the BCS Bowls were abusing their tax-exempt status by running what should be charitable enterprises as "their own private fiefdoms."[77] Of particular note, the Playoff PAC found inflated salaries were paid from charitable funds.[78] For example, "[t]he Sugar Bowl's top three execs received $1,225,136 in fiscal year-end (FYE) 2009 on revenue of $12.7 million, meaning that just three people skimmed almost $1 of every $10 the Bowl earned."[79] Furthermore, Fiesta Bowl CEO John Junker's "total compensation package from all Fiesta Bowl-related entities was $592,418 for FYE 2009, nearly quadruple the CEO pay at similarly sized charities."[80] The Playoff PAC also found frivolous spending such as the Orange Bowl spending $535,764 on "gifts," $331,938 for "parties" and a "summer splash," and $42,281 for "golf."[81] Finally, the Playoff PAC found that the Fiesta Bowl made undisclosed lobbying payments and political contributions with charitable funds.[82]

As perhaps the most recent example of intercollegiate athletic scrutiny, U.S. Secretary of Education Arne Duncan wrote a *Washington Post* op-ed on March 16, 2011. In his op-ed, Duncan backed a proposal that had been made for the past ten years by Knight Commission officials. The proposal requires that any team that fails to score a 925 out of 1,000 on the NCAA's multiyear Academic Progress Rate (APR) scale (which amounts to graduating at least half of the players on a given team) shall be barred from participating in that sport's NCAA tournament.[83] A Knight Commission

76. Playoff PAC Complaint against College Football's Bowl Championship Series (Sept. 23, 2010), *available at* http://www.playoffpac.com/blog/read.aspx?id=287 [hereinafter Playoff PAC Complaint].

77. Katie Thomas, *Political Heavy Hitters Take on College Bowls*, N.Y. TIMES, Jan. 10, 2011, at A1.

78. Playoff PAC Complaint, *supra* note 76, at 1.

79. *Id*.

80. *Id*.

81. *Id*. at 3. Other items of note: the Fiesta Bowl spent $1,325,753 on "Fiesta Frolic," an "annual weekend golf retreat for college-football officials at a Phoenix-area resort." The Fiesta Bowl also spent $444,948 on "hospitality," and the Sugar Bowl spent $710,406 on an impossibly vague category called "special appropriations." *Id*. at 3.

82. *Id*. at 2.

83. *See* Duncan, *supra* note 11. Ten out of the sixty-eight teams that competed in the 2011 NCAA Tournament failed to meet the threshold APR score and would have been banned from competing under this proposal: The University of Alabama at Birmingham (APR: 825), The University of Texas at San Antonio (APR: 825), The University of California, Santa Barbara (APR: 902), Morehead

analysis recently revealed that, over the preceding five years, almost $179 million had been paid out to tournament teams that were not on course to graduate at least half of their players.[84] Duncan thought that this was wrong and stated that "it is time that the NCAA revenue distribution plan stopped handsomely rewarding success on the court with multi-million dollar payouts to schools that fail to meet minimum academic standards."[85] The concern is clear: why should intercollegiate athletics continue to receive favorable treatment and large amounts of cash if they abandon the supposed educational purpose for which they stand?

## III. AN INTRODUCTION TO THE NON-PROFIT TAX EXEMPTION AND THE UNRELATED BUSINESS INCOME TAX

### A. Tax Exemption Under I.R.C. § 501(c)(3)

Section 501(c)(3) of the Internal Revenue Code of 1986 (I.R.C. or The Code) is the textual source that provides colleges and universities (as well as the NCAA) with their tax-exempt status.[86] In relevant part, the specific section states that the following organizations are exempt:

> Corporations, . . . or foundation[s], *organized and operated exclusively for* religious, charitable, scientific, testing for public safety, literary, or *educational purposes*, *or to foster national or international amateur sports competition* (but only if no part of its activities involve the provision of athletic facilities or equipment), . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . , and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.[87]

---

State (APR: 906), Alabama State (APR: 907), Syracuse (APR: 912), Purdue (APR: 919), San Diego State (APR: 921), The University of Southern California (APR: 924), and Kansas State (APR: 924). *See* Chris Good, *The Teams Arne Duncan Wants Out of the NCAA Tournament*, THE ATLANTIC (Mar. 17, 2011, 4:37 PM), http://www.theatlantic.com/politics/archive/2011/03/the-teams-arne-duncan-wants-out-of-the-ncaa-tournament/72642/.

84. *Arne Duncan Follows Push for Reform*, ESPN (Mar. 17, 2011, 4:39 PM), http://sports.espn.go.com/ncb/tournament/2011/news/story?id=6228459. For more information regarding the Knight Commission's findings, *see* RESTORING THE BALANCE: DOLLARS, VALUES AND THE FUTURE OF COLLEGE SPORTS, *available at* http://www.knightcommission.org/images/restoringbalance/KCIA_Report_F.pdf.

85. Duncan, *supra* note 11.

86. *See* I.R.C. § 501(c)(3) (2006).

87. *Id*. (emphasis added).

At the most basic level, tax exemption under § 501(c)(3) requires that two tests are met: (1) the "organizational test" (from the "organized" language); and (2) the "operational test" (from the "operated" language).[88] The organizational test requires that any organization seeking to obtain a tax exemption must demonstrate that it was established to promote a tax-exempt purpose.[89] In order to adequately demonstrate that the organization was established to promote a tax-exempt purpose, the organization's articles of organization[90] must limit its purpose to one, or more, of the exempt purposes provided in section 501(c)(3).[91] Furthermore, the articles of organization must not authorize the organization to conduct activities which are "in themselves . . . not in furtherance" of the exempt purpose.[92] In other words, the organizational test is a formal test that merely requires the organization to ensure that it has followed certain technicalities.

In addition to satisfying the technical organizational test, however, an organization that seeks tax-exempt status must also satisfy the operational test, which requires that the organization demonstrate that its activities substantively further an exempt purpose.[93] In other words, rather than merely looking to the stated purpose of the organization, the operational test looks to the actual motivation of the organization.[94] Ultimately, the operational test is meant to ensure that the organization is engaged "primarily in activities which accomplish one or more . . . exempt purpose."[95] Through either statute, Treasury Regulations, IRS interpretations, or judicial opinions, the operational test imposes the following five requirements: (1) the organization must ensure that its net revenue does not benefit a private shareholder or individual (private

88. *See generally* Treas. Reg. § 1.501(c)(3)-1 (2008).

89. *Id*. § 1.501(c)(3)-1(b)(1)(i) (2008). "Organized" has been interpreted to mean "established to promote" or "created to perform" within the context of the federal tax code. *See also* Samuel Friedland Found. v. United States, 144 F. Supp. 74, 84 (D.N.J. 1956).

90. The regulations define "articles of organization" as "the trust instrument, the corporate charter, the articles of association, or any other written instrument by which an organization is created." Treas. Reg. § 1.501(c)(3)-1(b)(2) (2008).

91. *Id*. § 1.501(c)(3)-1(b)(1)(i)(a) (2008). In the case of colleges and universities (and their athletic departments), the stated purpose is education. In the case of the NCAA, the stated purpose is to foster national or international amateur sports competition. *See* I.R.C. § 501(c)(3) (2006).

92. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(B) (2008).

93. *Id*. §1.501(c)(3)-1(c)(1) (2008).

94. As John D. Colombo eloquently characterized it: "One might think of the organizational test, therefore, as embodying a requirement that an organization have a prima facie charitable purpose and then comply with several distinct operational limitations in order to achieve exempt status." Colombo, *supra* note 75, at 114.

95. Treas. Reg. § 1.501(c)(3)-1(c)(1) (2008).

inurement doctrine);[96] (2) the organization cannot be an "action organization," which means that a substantial part of its activities cannot seek to influence legislation or partake in political campaigning;[97] (3) the organization cannot partake in illegal activities or activities that violate a clearly established "fundamental" public policy;[98] (4) the organization cannot partake in activities that confer an excessive benefit on individuals outside of the charitable class ("private benefit" doctrine);[99] and (5) the organization must not run significant commercial businesses ("commerciality limitation" doctrine).[100] The determination of whether or not an organization passes the operational test is a question of fact, which requires an analysis of the specific facts and circumstances of each case.[101]

A deceptive modifier of the organizational and operational tests is the word "exclusively." Although the reader might have already noticed that the operational test requires that "exclusively" not actually be interpreted in the plain meaning sense of the word, a more direct explanation is important. In 1945, the Supreme Court determined that so long as the substantial portion of the university's activities constitutes tax-exempt activities, the "exclusively" language is satisfied.[102] In other words, "exclusively" actually means substantially[103] or primarily, and the first factor of the operational test makes this clear. So long as an organization is

---

96. *Id*. § 1.501(c)(3)-1(c)(2).

97. *Id*. § 1.501(c)(3)-1(c)(3).

98. Colombo, *supra* note 75, at 115, *citing* Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983) ("A corollary to the public benefit principle is the requirement, long recognized in the law of trusts, that the purpose of a charitable trust may not be illegal or violate established public policy."); Rev. Rul. 75-384, 1975-2 C.B. 204 (stating that an educational organization that promoted civil disobedience was not exempt because it violated the prohibition on engaging in illegal activity).

99. Colombo, *supra* note 75, at 115.

100. *Id*. at 1126.

101. *See* St. Louis Union Trust Co. v. United States, 374 F.2d 427, 432 (8th Cir. 1967).

102. *See* Better Bus. Bureau of Wash., D.C., Inc. v. United States, 326 U.S. 279, 283 (1945). It should be noted that the Court in *Better Business Bureau* was actually dealing with section 811(b)(8) of the Social Security Act, but courts have found it "substantially the same as § 501(c)(3) of [the Code]." Stevens Bros. Found., v. Comm'r, 324 F.2d 633, 638 (8th Cir. 1963).

103. Of course there is even a wrinkle within the wrinkle. An organization's tax exemption is not threatened even if more than an insubstantial part of its activities involves a trade or business, which is a non-exempt activity, if "the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business." Treas. Reg. § 1.501(c)(3)-1(e)(1). This is related to, but different than, the UBIT. Rather, this deals with the commercial activity limitation of the operational test.

primarily engaged in tax-exempt purposes, the "exclusively" language is satisfied.[104]

### B. The Unrelated Business Income Tax

Even if an organization has passed through the statutory hoops to gain tax-exempt status under section 501(c)(3), a corporate tax may still be applied to net revenues from an "unrelated trade or business" of the tax-exempt organization.[105] Understanding the Unrelated Business Income Tax (UBIT) requires the synthesis of Code Sections 511-513, which ultimately reveal that the business activities of a tax-exempt organization will only be subject to UBIT if: (1) the income is from a trade or business; (2) the trade or business is regularly carried on by the organization; and (3) the conduct of the trade or business is not substantially related to the organization's performance of its exempt functions.[106] Even if an exempt organization's business activities meet the statutory definition of an "unrelated trade or business," the organization can still avoid the imposition of UBIT if it falls under one of three exceptions stated in section 513(a)(1)-(3), which exclude any trade or business:

> (1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or
> (2) which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students . . . ; or
> (3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.[107]

Two final notes about UBIT are worth mentioning. First, and most importantly, the presence of UBIT does not affect the underlying tax-exempt status of an organization in any way.[108] In other words, the UBIT provisions in the Code do not speak at all to whether a charity will lose its overall exempt status if it undertakes a trade or business of a certain size or type. Second, by way of the "fragmentation rule," the IRS is able to apply the UBIT to separate revenue streams, even if those revenue streams would

---

104. *See* Treas. Reg. § 1.501(c)(3)-1(c)(1). This interpretation might seem odd because it goes against the obvious plain meaning sense of the word, and although Colombo's analysis might not provide much solace, it hits the nail on the head: "Remember, folks, that this is the IRC, where a "person" includes a partnership, corporation, etc." Colombo, *supra* note 75, at 114 n.17.

105. *See generally* I.R.C. §§ 511–13 (2006).

106. Treas. Reg. § 1.513-1(a) (1983).

107. I.R.C. § 513(a)(1)-(3) (2006).

108. *See* I.R.C. § 501(b) (2010).

normally be considered to be a part of one single business.[109] For example, the IRS may determine that sales of coffee mugs at a museum are subject to the UBIT but sales of cards with art reproductions are not.[110]

## IV. APPLICATION OF NON-PROFIT TAX LAW TO INTERCOLLEGIATE ATHLETICS

### A. Tax Exemption Under I.R.C. Section 501(c)(3)

Armed with an introductory understanding of non-profit tax law, this subsection explores whether the increasing commercialization of intercollegiate athletics risks the tax-exempt statuses of colleges and universities, or the NCAA. As a preliminary matter, the reader should understand that "it makes no sense to talk about 'college athletics' as being tax-exempt."[111] Entities, rather than particular activities of those entities, are what technically are considered as tax-exempt.[112] In other words, revenues obtained through operation of an athletics department may be tax-free if the overall activities of that department are part of a tax-exempt entity.[113] Therefore, when determining whether revenue from college athletic departments are tax-free, the threshold question is whether the college or university in which it resides is a tax-exempt entity.[114]

#### i. Organizational Test

Colleges and universities are clearly organized for "educational" purposes, which is defined in the regulations as: "(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) The instruction of the public on subjects useful to the individual and beneficial to the community."[115] Therefore, colleges and universities are universally recognized as section 501(c)(3) tax-exempt

---

109. *See* I.R.C. § 513(c) (2010).

110. *See, e.g.*, Rev. Rul. 73-105, 1973-1 C.B. 264 (finding that sales of art reproductions were not subject to UBIT because they were substantially related to the museum's exempt purpose of promoting public understanding of art, but sales of general souvenirs were subject to UBIT).

111. Colombo, *supra* note 75, at 117.

112. *See id*.

113. *See id*. Of course, not every activity of a tax-exempt organization is free from tax. As already explained above, the UBIT allows the IRS to tax revenues from activities that constitute unrelated trades or businesses even though those activities are run by an otherwise tax-exempt entity. *See supra* Part III.B.

114. *See id*.

115. Treas. Reg. §§ 1.501(c)(3)-1(d)(3)(i)(a), (b) (1982). It should be noted that most colleges and universities also have a "scientific" basis for exemption because they engage in research "carried on in the public interest." *See* Treas. Reg. § 1.501(c)(3)-1(d)(5) (1982) (defining "scientific" and "scientific research").

entities because they are organized for an explicitly stated charitable purpose: education.[116] In contrast to the obvious qualification of a college or university as a tax-exempt entity under section 501(c)(3), the NCAA was on shakier grounds through 1976. Thanks to a broad reading of the word "educational," certain athletic related organizations qualified for section 501(c)(3) status before 1976.[117] But the NCAA arguably could not have relied on these interpretations because of the fact that the IRS had seemed to reserve the exemption for organizations that provided athletic education, such as Little League baseball.[118] Luckily for the NCAA, however, Congress passed an amendment to section 501(c)(3) in 1976, which made "foster[ing] national or international amateur sports competition" a prima facie charitable purpose.[119] As John D. Colombo notes, "[e]ven if one believes that Division I football and basketball programs are no longer 'amateur athletics,'" it would still be difficult to claim that the NCAA is not a tax-exempt entity because it also "fosters competitions in college tennis, baseball, wrestling, track, gymnastics, and all sorts of other 'nonrevenue' sports that surely would meet anyone's definition of 'amateur athletics.'"[120]

---

116. As already seen in the context of the meaning of the word "exclusively," the Code is not always interpreted as the plain meaning would suggest. Colombo explains the wrinkle regarding the list of tax-exempt purposes under section 501(c)(3):

> Although the statute seems to make "charitable" one of several possible purposes that are exempt under § 501(c)(3), in fact, an organization must conform to common law definitions of charity to obtain exemption under this subsection. The listing of religious, educational, and other purposes is best thought of as a sort of presumptive list—that is, religious organizations are presumed to be charitable organizations, but in fact simply being a religious (or educational) organization standing alone is insufficient to be tax exempt. Rather, an entity must prove it is a *charitable* religious organization, or a *charitable* educational organization in order to obtain § 501(c)(3) exemptions.

Colombo, *supra* note 75, at 113 n.13. *See also* Bob Jones Univ. v. United States, 461 U.S. 574, 586–89 (1983) (rejecting Bob Jones University's argument that it did not have to meet the common law standard of charity because it was a legitimate educational institution).

117. Colombo, *supra* note 75, at 118.

118. *See id*.

119. Tax Reform Act of 1976, Pub. L. No. 94-455 § 1313(a), 90 Stat. 1520, 1730 (codified as amended at I.R.C. § 501(c)(3) (2006)). It is also notable that even without this statutory change, the NCAA probably would have been viewed as engaging in a charitable purpose considering the Tenth Circuit's decision in *Hutchinson Baseball Enterprises v. Commissioner*, finding that "the furtherance of recreational and amateur sports" is a charitable activity. 696 F.2d 757, 762 (10th Cir. 1982).

120. Colombo, *supra* note 75, at 119.

ii. Operational Test

Merely being capable of forming an organization with a stated exempt purpose, of course, is not enough. Doing so only satisfies the organizational test's requirement of a prima facie charitable purpose.[121] But the organization must still prove that it is "primarily" engaged in charitable activities, and it does so by successfully jumping through the five limitations of the operational test described above.[122] Generally only three of the five limitations are potentially applicable in the world of intercollegiate athletics: the private inurement limitation, the private benefit limitation, and the commercial activity limitation. Of course, an athletic department or the NCAA might theoretically engage in activities that would violate the illegal activity/public policy limitation and the political action limitation, but for purposes of this paper, these possibilities are not considered.

1. Private Inurement

Section 503(c)(3) explicitly states that "no part of the net earnings [of a tax-exempt organization may] inure[] to the benefit of any private shareholder or individual."[123] It is well settled that this operational limitation is meant to prohibit a "siphoning off" of the tax-exempt organization's assets to an "insider."[124] As part of the operational test, the traditional consequence for siphoning off assets to an insider was the elimination of the tax-exempt status for the entity in question, but more forgiving consequences were proposed in the early 1990s and became law in 1996.[125] Rather than "blowing up"[126] the tax-exempt status of the entity in question, section 4958 imposes excise taxes on an "excess benefit transaction," which is defined as a transaction where "the value of the economic benefit provided exceeds the value of the consideration . . . received . . . ."[127] Furthermore, the legislative history of section 4958

121. *Id*.

122. *See* text accompanying *supra* notes 93–101.

123. I.R.C. § 501(c)(3) (2006).

124. Colombo, *supra* note 75, at 120, *citing* United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1176 (7th Cir. 1999) ("A charity is not to siphon its earnings to its founder, or the members of its board, or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager.").

125. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168 § 1311(a), 110 Stat. 1452, 1475 (1996) (codified as amended at I.R.C. § 4958).

126. Colombo, *supra* note 75, at 120.

127. I.R.C. § 4958(c)(1)(A) (2010). Excess benefit transactions only occur between a tax-exempt organization and a "disqualified person," which is defined as a person who is (or was in the preceding five years) "in a position to exercise substantial influence over the affairs of the organization." *Id*.

makes it clear that unless the violations are particularly egregious, the excise tax avenue should be pursued rather than blowing up the tax-exempt status of the entity involved.[128]

There is a natural inclination to think that the exponential rise in coaches' salaries must amount to a private inurement transaction or an "excess benefit transaction." After all, a classic example of a private inurement transaction is when a charitable organization pays an insider more for his services than they are actually worth (paying an unreasonable salary).[129] The Treasury Regulations associated with section 4958, however, make it clear that this is not the case for coaches' salaries.[130] When determining what amounts to "reasonable compensation," for example, the Treasury Regulations explain that (1) the fair market value for similar services *including the for-profit sector* is considered;[131] and (2) the entire compensation package of the employee is considered.[132] Considering that many NFL and NBA coaches (the for-profit comparison) are paid well over three or four million dollars per year,[133] there is no legal support for the argument that coaches' salaries should either be subject to an excise tax or risk a college or university's tax exemption.

---

128. *See* H.R. REP. NO. 104-506, at 59 n.15 (1996). In 2008, the IRS set forth regulations that describe when the elimination of the organization's tax exemption should be pursued. *See* T.D. 9390, 2008-18 I.R.B. 855 (codified at Treas. Reg. § 1.501(c)(3)-1(f)).

129. *See* Colombo, *supra* note 75, at 120.

130. *See* Treas. Reg. § 53.4958-4(b)(1)(ii) (2009).

131. *Id*. at § 53.4958-4(b)(1)(ii)(A) ("The value of services is the amount that would ordinarily be paid for like services by like enterprises (*whether taxable or tax-exempt*) . . . .") (emphasis added). *See also* H.R. REP. NO. 104-506, at 56 n.5 (1996) ("[T]he Committee intends that an individual need not necessarily accept reduced compensation merely because he or she renders services to a tax-exempt, as opposed to a taxable, organization.").

132. Treas. Reg. § 53.4958-4(b)(1)(ii)(B) (2009) ("[C]ompensation for purposes of determining reasonable under section 4958 includes all economic benefits provided by an applicable tax-exempt organization in exchange for the performance of services.").

133. As an NFL coach of the Miami Dolphins, Nick Saban was paid $4.5 million per year, which means that he actually took a pay cut to become the head coach at Alabama. Associated Press, *Saban's $4 Million Salary Raises Questions*, MSNBC, Jan. 4, 2007, http://nbcsports.msnbc.com/id/16472828/. Furthermore, Mike Holmgren of the NFL's Seattle Seahawks was believed to be owed $9 million for his services in 2008. Gerry Dulac, *The Money Question: It's Not Everything, But It Is Something*, PITTSBURGH POST-GAZETTE, Dec. 31, 2006, at D-1, *available at* http://www.post-gazette.com/pg/06365/750301-66.stm. Finally, an article in the *Gatson Gazette* reported that Phil Jackson of the NBA's Los Angeles Lakers was making over $10 million a year as far back as 2007. Richard Walker, *Phil Paid Top Dollar Yet Again*, GATSON GAZETTE, Feb. 16, 2007, at 5C, *available at* http://www.gastongazette.com/sports/million-3839-salary-year.html.

### 2. Private Benefit

The private benefit doctrine, a doctrine which dictates that a tax-exempt organization can lose its exemption if it confers an excessive benefit on "outsiders,"[134] derives from IRS and court interpretations of Treasury Regulation section 1.502(c)(3)-1(d)(1)(ii), which states:

> An organization is not organized or operated exclusively for [a charitable purpose] unless it serves a public rather than a private interest. Thus, to meet the requirement [for tax exemption], it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.[135]

The seminal case establishing the private benefit doctrine is *American Campaign Academy v. Commissioner*.[136] The questionable entity at issue in the case was an organization that trained individuals in the art of political campaigning.[137] Although the organization was technically involved in education, the Tax Court found that the organization could not qualify for a tax exemption because it benefited the Republican Party—almost all of the individuals trained by the organization subsequently worked for Republican candidates.[138]

Although it is not clear from *American Campaign Academy*, a 1987 IRS General Counsel's Memorandum makes it clear that the private benefit doctrine is essentially a balancing test between the private benefit received by various individuals and organizations from a certain kind of charitable activity and the charitable benefits produced by the same charitable activity.[139] Utilizing such a balancing test, an argument can be made that

---

134. The private benefit doctrine is similar to the private inurement doctrine of section 4598, but instead of applying to transactions with "insiders," the doctrine applies to transactions with "outsiders." Colombo, *supra* note 75, at 122. Furthermore, the private benefit doctrine can theoretically apply to fair market value transactions. *Id*.

135. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2008).

136. Am. Campaign Acad. v. Comm'r, 92 T.C. 1053 (1989).

137. *Id*. at 1078–79.

138. *Id*.

139. Specifically, the IRS General Counsel's Memorandum stated:

> An organization is not described in section 501(c)(3) if it serves a private interest more than incidentally. If, however, the private benefit is only incidental to the exempt purposes served, and not substantial, it will not result in a loss of exempt status . . . .
>
> A private benefit is considered incidental only if it is incidental in both a qualitative and a quantitative sense. In order to be incidental in a qualitative sense, the benefit must be a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be

the private benefit that universities and the NCAA give to television networks and the professional sports leagues ("outsiders") substantially outweighs any educational benefits that might be provided to the college athletes (the charitable class). As John D. Colombo noted, because the IRS has applied the private benefit doctrine even to arm's length transactions, there is technically no theoretical difficulty in applying it to deals between colleges and universities (and the NCAA), and television networks, even considering the fact that rights fees are paid in exchange.[140] Furthermore, the private benefit received by professional football and basketball organizations can be characterized as the cost avoidance of otherwise having to have a development system.[141]

For various reasons, however, Colombo noted that "a successful private benefit argument [in the context of intercollegiate athletics] seems highly unlikely."[142] Although the private benefit doctrine is potentially broad enough textually to include completely arm's length transactions resulting in a fair market value price,[143] courts inevitably look to some kind of "bad deal" or negligent underpricing that gives an excessive benefit to for-profit outsiders.[144] Since there is no reason to believe that colleges and universities or the NCAA have negligently underpriced their product thereby giving an excessive private benefit to outsiders, a private benefit argument would likely not prove fruitful. Another important reason that the private benefit doctrine has not been construed as applying to intercollegiate athletics, a reason that Colombo failed to address, is the harshness of the consequences. If the IRS were to find private benefit in the context of intercollegiate athletics, colleges and universities as a whole could lose their tax-exempt statuses. This reason alone might go a long way in justifying why the IRS has never shown much inclination in applying the private benefit doctrine to intercollegiate athletics. Like the case for applying the private inurement doctrine to coaches' salaries,

---

> accomplished only be benefiting certain private individuals. To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity.

I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22 1991).

140. Colombo, *supra* note 75, at 125.

141. *Id*.

142. *Id*. at 126.

143. *See* John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1067–73 (2006).

144. Colombo noted that the private benefit doctrine is probably better thought of as a doctrine ensuring that there is not a "failure to conserve assets for the benefit of the charitable class." *Id*. at 1084. In other words, it will likely be applied in instances where the charity "*negligently* 'diverts' assets to for-profit interest in arm's length transactions." *Id*. *See also* United Cancer Council v. Comm'r, 165 F.3d 1173, 1179–80 (7th Cir. 1999).

attractive as it might initially sound on paper, the sometimes non-literal construction of tax law prevents such arguments from proceeding any further.

### 3. Commercial Activity

The commercial activity limitation is best understood as the checks and balances corollary to the IRS's decision to interpret "exclusively" as actually meaning primarily or substantially.[145] Although, an organization is considered to satisfy the operational test "if it engages *primarily*" (as opposed to "exclusively," the literal word used in the statute) "in activities which accomplish one or more . . . [exempt purposes], . . ."[146] the commercial activity limitation illustrates the point of no return: "[a]n organization will not [be regarded as tax-exempt] if *more than an insubstantial* part of its activities is not *in furtherance* of an exempt purpose."[147] Therefore, the crucial questions in determining whether the commerciality limitation applies are (1) whether the activity in question is "more than . . . insubstantial" and, if so, (2) whether the activity in question is "in furtherance" of an exempt purpose.

The meaning of "more than insubstantial" or substantial is clearer than the meaning of "in furtherance." Substantiality is generally measured by calculating size: amount of revenues and/or expenditures *vis-à-vis* other revenues and/or expenditures of the charitable organization as one possibility and the amount of employees engaged in the activity in question as another potentially relevant calculation.[148] In addition to calculations concerned with the size of the activity in question, courts have also suggested that the substantive importance of the activity to the charitable organization is also relevant.[149] With this in mind, the application of the substantiality requirement to intercollegiate athletics (at least for Division I football and basketball) is clear. As Colombo noted, "football and basketball programs often involve tens of millions in revenues and expenditures, employ dozens if not hundreds of people, and are used by

---

145. *See* Colombo, *supra* note 75, at 1084.

146. Treas. Reg. § 1.501(c)(3)-1(c)(1) (2008) (emphasis added).

147. *Id*. (emphasis added).

148. *See* Colombo, *supra* note 75, at 128, *citing* JAMES J. FISHMAN & STEPHEN SCHWARTZ, TAXATION OF NONPROFIT ORGANIZATIONS 357 (2d ed. 2006) (suggesting use of a "50 percent of total revenue" benchmark for "substantiality"); *see also* Goldsboro Art League v. Comm'r, 75 T.C. 337, 341–42 (1980) (rejecting the IRS's commercial limitation argument in part because of the small amount of receipts involved: $6,500 a year).

149. *See, e.g.*, Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 855–56 (10th Cir. 1972) (suggesting that a balancing test be used measuring the importance of the activity in question to the underlying purpose of the organization).

colleges and universities as major generators of alumni interest and donations."[150] For the NCAA, a whopping ninety percent of its budget is comprised of the revenues generated from the NCAA men's basketball tournament.[151] By any understanding of the word "substantial," it seems pretty clear that these facts rise to an adequate threshold.

Despite a more agreed upon understanding of "substantial," however, the meaning of "in furtherance" is much less clear because there are two plausible interpretations: (1) "in furtherance" means that the activity in question must be related functionally to the charitable organization's exempt purpose, or (2) "in furtherance" merely means that the revenue produced from the activity in question must be used to support charitable activities of the organization.[152] The first possibility, that "in furtherance" means that the activity in question must be related functionally to the charity's exempt purpose, equates "in furtherance" to the meaning of "substantially related" for UBIT purposes. As already explained above in Section III, a charity's activities may be subject to UBIT, if, among other things, the conduct of the trade or business is not substantially related to the organization's performance of its exempt functions.[153] The Treasury Regulations associated with the UBIT code section explain that "substantially related" requires a substantial "causal relationship" between the business activities in question and the achievement of exempt purposes of the charitable organization.[154] It is not enough for the destination of the commercial activity's income to be the charity ("destination of income" principle).[155] The activities in question must *functionally* advance the charitable purposes of the organization, rather than advance the purposes of the organization indirectly through mere contribution of funds.

The second possibility, that "in furtherance" merely means that the revenue produced from the activity in question must be used to support charitable outputs, takes the view that although mere contribution cannot shelter the revenues of an unrelated business activity from tax for UBIT purposes, it does protect the tax-exempt status of the entity. In other words, Congress's enactment of the UBIT in 1950 did not repeal the "destination of income"[156] test in relation to the underlying tax-exempt

150. Colombo, *supra* note 75, at 131.

151. Pete Thamel & Richard Sandomir, *Why Would the N.C.A.A. Expand its Tournament? It's About the Money*, N.Y. TIMES, Mar. 13, 2010, at SP1.

152. *See* Colombo, *supra* note 75, at 128.

153. *See supra* Part III.B.

154. Treas. Reg. § 1.513-1(d)(2) (1983).

155. *Id*. ("other than through the production of funds"). *See also* I.R.C. § 513(a) (2006) ("aside from the need of such organization for income or funds or the use it makes of the profits derived").

156. The "destination of income" test establishes the principle that a charity could run a commercial business, and the revenues from that business would be tax-free, so long as the business revenues were used to fund charitable activities.

status.[157] Rather, the "destination of income" test was only repealed for the purpose of ensuring that those activities are taxable as UBIT.[158] While the UBIT enactment ensured that revenues from side business could be taxed even if they were all contributed back to the charity, the enactment said nothing about the underlying tax exemption of the charity.[159] Under this view, even a substantial commercial activity will not endanger the tax-exempt status of the organization, so long as the revenues from the activity are contributed back to the charity.[160]

Although there is no definitive answer regarding the correct interpretation of "in furtherance,"[161] none is needed for the purposes of this paper because each construction leads to the same result when applying the law to intercollegiate athletics—that the tax exemption of universities is likely not at risk from their running of intercollegiate athletics programs.[162]

---

*See* Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578, 581 (1924). This principle reached its height in *C.F. Mueller Co. v. Comm'r*, where the Third Circuit upheld the tax exemption of Mueller, a macaroni company, merely because it contributed all of its profits to New York University School of Law. *See* 190 F.2d 120, 121–22 (3d Cir. 1951).

157. *See* Colombo, *supra* note 75, at 129.

158. *See id*.

159. *See id*.

160. The revenues will be taxable as UBIT, but they will not endanger the underlying exemption.

161. On the one hand, some cases have sided with the first possible interpretation in finding that a charity's tax exempt status is at risk if it engages in substantial activities with a "commercial hue." *See, e.g.*, Presbyterian & Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 155 (3d Cir. 1984) ("If, for example, an organization's management decisions replicate those of commercial enterprises, it is a fair inference that at least one purpose is commercial, and hence nonexempt. And if this nonexempt goal is substantial, tax exempt status must be denied."). *See also* Living Faith, Inc. v. Comm'r, 950 F.2d 365, 373–74 (7th Cir. 1991) (applying commercial hue analysis). On the other hand, however, a number of IRS rulings have sided with the second possible interpretation in finding that the tax exemption of a charity is not at risk, even if it operates significant commercial activities, so long as the profits of those activities are used for the charitable purposes of the organization. This has become known as the "commensurate in scope" test. *See* Rev. Rul. 64-182, 1964-1 C.B. 186 (finding that an exempt organization that received a substantial amount of revenue from renting commercial office space was subject to the UBIT because the activity was "unrelated," but the tax-exempt status of the organization was not at risk because the revenues were used to make grants to others charities). *See also* I.R.S. Gen. Couns. Mem. 34,682 (Nov. 17, 1971) ("[T]here is no quantitative limitation on the 'amount' of unrelated business an organization may engage in under section 501(c)(3), other than that . . . [the] charity properties must be administered exclusively in the beneficial interest of the charitable purpose to which the property is dedicated.").

162. Despite the fact that no definitive answer is needed, scholars such as John D. Colombo convincingly argue that the second interpretation of "in furtherance"

Firstly, even if one takes the more restrictive meaning of "in furtherance," which requires that the activities in question be functionally related to the charitable purpose of the organization, the tax-exempt status of colleges and universities would likely not be at risk. This is because the legislative history of the UBIT explicitly created a presumption that intercollegiate athletics is substantially related to education.[163] In addition, the NCAA would likely find little problem under such a standard considering their tax-exempt purpose is the promotion of intercollegiate athletics. Secondly, the application to intercollegiate athletics is even clearer if one takes the second interpretation of "in furtherance," which only requires that revenues generated from commercial activities be used to fund charitable outputs. Considering that both colleges and universities, and the NCAA use the profits generated from Division I basketball and football programs to fund "non-revenue sports" and scholarships, the standard would surely be met under such an interpretation of "in furtherance."[164]

### B. Unrelated Business Income Tax (UBIT)

Although it is reasonably clear under current law that the increasing commercialization of intercollegiate athletics will not threaten the *tax-exempt status* of colleges and universities, or the NCAA, this subsection explores whether the *revenues* generated from intercollegiate football and basketball might be subject to taxation as UBIT.[165] As already noted, the

---

is the better approach. *See* John D. Colombo, *Reforming Internal Revenue Code Provisions on Commercial Activity by Charities*, 76 FORDHAM L. REV. 667, 672 (2007) ("The only sensible harmonization of these regulations . . . is that in enacting the UBIT Congress did not intend to alter the destination of income test for the purpose of granting exemption to an entity in the first instance.").

163. *See* H.R. REP. NO. 81-2319, at 37 (1950) ("[A] university would not be taxable on income derived from a basketball tournament sponsored by it, even where the teams were composed of students of other schools."). *See also id*. at 109 ("[I]ncome of an educational organization from charges for admissions to football games would not be deemed to be income from an unrelated business, *since its athletic activities are substantially related to its educational program*.") (emphasis added). The issue will be addressed further in the UBIT section since the more restrictive interpretation of "in furtherance" adopts the UBIT understanding of "substantially related."

164. *Brand Letter*, *supra* note 3, at 1 ("Divisions I and II intercollegiate sports provide $1.5 billion annually in athletic scholarships . . . ."); *id*. at 17 ("These excess revenues are redistributed to support other sports programs that do not generate revenues sufficient to cover expenses . . . ."); *id*. at 22 ("In furtherance of its tax-exempt mission, the NCAA sponsors 88 championships in 24 sports.").

165. The "fragmentation rule" allows the IRS to separately analyze the revenue streams of intercollegiate football and basketball even though those revenue streams normally would be considered to be part of one single business: intercollegiate athletics. *See* I.R.C. § 513(c) (2006).

business activities of a tax-exempt organization will be subject to UBIT if: (1) the income is from a trade or business; (2) the trade or business is regularly carried on by the organization; and (3) the conduct of the trade or business is not substantially related to the organization's performance of its exempt functions.[166] This subsection will consider the "trade or business" and the "regularly carried on" requirements together since their application to intercollegiate athletics is relatively straightforward. The "substantially related" requirement will then be analyzed separately since most of the UBIT application revolves around this concept.

i. "Trade or Business" and "Regularly Carried On"

For purposes of determining whether an activity is subject to the UBIT, "trade or business" is defined as "any activity which is carried on for the production of income from the sale of goods or the performance of services."[167] In a 1978 General Counsel Memorandum, the IRS further defined the test by stating that "the *profit motive* rather than the extent of activity is relevant in determining whether an activity is a trade or business. . . ."[168] In the more than thirty years since the IRS advocated for a profit motive test, more than half of the circuit courts have explicitly agreed by adopting the test.[169] An important inference from the profit motive test is that activities of a charitable organization are not automatically presumed to fall outside of the definition of a trade or business "merely because it does not result in profit."[170] It is the presence of a profit motive rather than the presence of a profit itself that is the key when determining whether the activity in question constitutes a "trade or business." Considering that fifty-three percent of FBS programs and twenty-eight percent of Division I basketball programs turned a profit at the time of the NCAA's response letter to Chairman Thomas, it seems clear that these intercollegiate football and basketball programs constitute a trade or business.[171] Furthermore, because of the profit motive test, even programs that do not generate a profit might still be considered a "trade or business" for UBIT purposes so long as a primary purpose of the program is to produce income.[172]

166. Treas. Reg. § 1.513-1(a) (1983).

167. I.R.C. § 513(c) (2006). *See also* Treas. Reg. § 1.513-1(b) (1983).

168. I.R.S. Gen. Couns. Mem. 37,513 (Apr. 25, 1978).

169. *See, e.g.*, Am. Acad. of Family Physicians v. United States, 91 F.3d 1155, 1157–58 (8th Cir. 1996); Am. Postal Workers Union v. United States, 925 F.2d 480, 483–84 (D.C. Cir. 1991); Fraternal Order of Police, Ill. State Troopers, Lodge No. 41 v. Comm'r 833 F.2d 717, 722 (7th Cir. 1987); Prof'l Insurance Agents of Mich. v. Comm'r, 726 F.2d 1097, 1102 (6th Cir. 1984); Carolinas Farm & Power Equip. Dealers Assoc. v. United States, 699 F.2d 167(4th Cir. 1983).

170. Treas. Reg. § 1.513-1(b) (1983).

171. *See Brand Letter*, *supra* note 3, at 17–18.

172. *See* § 1.513-1(b).

Colombo, for example, noted that a profit motive is "signified by being substantially self-funding," which many programs can claim.[173]

In addition to constituting a "trade or business," the charity's commercial activity must also be "regularly carried on." There are two determinative factors regarding whether a charity's commercial activity meets this second requirement: (1) "the frequency and continuity" of the activities and (2) "the manner in which [the activities] are pursued."[174] If a charity's trade or business is pursued in the same manner and with the same frequency and continuity as a comparable for-profit trade or business, the charity's activities will be considered to meet the "regularly carried on" requirement.[175] Particularly relevant to the case of intercollegiate athletics, if the commercial activity at issue is typically conducted by a for-profit business on a seasonal basis, a charity that conducts the same commercial activity for a "significant portion of the season" is considered to have met the "regularly carried on" requirement.[176] The for-profit comparison for both intercollegiate football and basketball is their professional counterparts: the National Football League (NFL) and the National Basketball Association (NBA). The NFL plays games once a week with both the regular and postseason spanning from September to early February, while intercollegiate football plays games once a week with both the regular and postseason spanning from August to early January.[177] A comparison between the NBA and intercollegiate basketball is not as close of a fit as football, but college basketball still plays games for a "significant portion" of the NBA's season: five months of the year compared to the NBA's eight months.[178] With this in mind, it is clear that the "regularly

173. Colombo, *supra* note 75, at 136. It should be noted that intercollegiate programs that do not generate a profit would not be subject to UBIT because there would be no tax base to impose the tax, but the point to take from the test is that an activity does not lose its characterization as a "trade or business" merely because it does not turn a profit every year. *But see* Ballard v. Comm'r, 71 T.C.M. (CCH) 2120 (1996) (finding that the intent "to break even" is not an intent to make a profit).

174. *See* § 1.513-1(b).

175. *Id*. at § 1.513-1(c)(1).

176. *See id*. at § 1.513-1(c)(2)(i) ("Where income producing activities are of a kind normally undertaken by nonexempt commercial organizations only on a seasonal basis, the conduct of such activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of a trade or business.").

177. *Compare* NFL schedule, *available at* http://www.nfl.com/schedules?seasonType=REG *with* College Football schedule, *available at* http://espn.go.com/college-football/schedule.

178. *Compare* NBA Schedule, *available at* http://www.nba.com/master calendar/masterCalendar.html *with* College Basketball Schedule, *available at* http://www.cbssports.com/collegebasketball/schedules.

carried on" requirement is met for both intercollegiate football and basketball.[179]

ii. "Substantially Related"

Although the "trade or business" and "regularly carried on" UBIT requirements are clearly met, "the substantially related" requirement poses a significant hurdle for imposing the UBIT on intercollegiate athletics. The Treasury Regulations explain that a charity's activity is "substantially related" to its exempt purpose only if the activity has a "causal relationship to the achievement of [the organization's charitable purpose.]"[180] For a causal relationship to exist, the charity's activity must "contribute importantly to the accomplishment" of its charitable function, and the *activity* itself must functionally contribute to the exempt purpose rather than the mere *contribution* of funds from the activity furthering the exempt purpose.[181]

In considering the application of the "substantially related" standard to intercollegiate athletics, the IRS has relied on the legislative history of the UBIT to bolster its long-standing position that college sports are "integral"

---

179. Although the "regularly carried on" requirement seems to apply to intercollegiate football and basketball, there is an anomaly that must at least be noted. In 1990, the Tenth Circuit held that the advertising revenue generated from the commemorative programs of the NCAA basketball tournament was not taxable as UBIT because the basketball tournament was not a "regularly carried on" business. Nat'l Collegiate Athletics Assoc. v. Comm'r, 914 F.2d 1417, 1425–26 (10th Cir. 1990). In reaching its conclusion, the court used sports magazines like *Sports Illustrated* as the for-profit analogue, and because these sports magazines are operated year-round, it determined that the NCAA basketball tournament commemorative program was not "regularly carried on" because it did not occur year round. *Id*. at 1425 ("The competition in this case is between the NCAA's program and all publications that solicit the same advertisers. The competition thus includes weekly magazines such as *Sports Illustrated* . . . ."). But this decision has met much criticism. As Colombo notes, for example, "the proper comparison is not *Sports Illustrated*; it is the sales of advertising by the NFL for the playoffs and Super Bowl, or the NBA for its playoffs and Finals, both of which are limited-duration seasonal activities." Colombo, *supra* note 75, at 137. *See also* Treas. Reg. § 1.513-1(c)(2)(ii) (1983) (stating that "intermittent" activities will normally not be subject to UBIT, unless the intermittent activities constitute "the competitive and promotional efforts typical of commercial endeavors."). Probably realizing the faulty reasoning of the opinion, the IRS announced its decision to not acquiesce in the Tenth Circuit's decision, even though it was a favorable ruling for the IRS. *See* Nat'l Collegiate Athletics Assoc., 914 F.2d, *action on dec.*, 1991-15 (July 3, 1991).

180. Treas. Reg. § 1.513-1(d)(2) (1983).

181. *Id*.

to education and therefore "substantially related."[182] After all, when reporting on the UBIT legislation, the House Ways and Means Committee stated that "athletic activities are substantially related to [a university's] educational program."[183] Furthermore, the Senate Finance Committee reported that "[a]thletic activities of schools are substantially related to their educational functions."[184] Because of this longstanding presumption, it has been nearly impossible to characterize an intercollegiate program's activities as not being substantially related to education.[185] Therefore, although intercollegiate athletics satisfies the first two elements of the UBIT analysis, it fails the third element under current law.[186]

## V. POSSIBILITIES FOR REFORM

### A. Possible UBIT Tax Reforms

One possible tax reform that might alleviate the problems associated with the increasing commercialization of intercollegiate athletics would not even require a change to the existing tax law. Rather, it would only require

182. *See, e.g.*, Rev. Rul. 67-291, 1967-2 C.B. 184 (determining that a "training table" for coaches was an "integral part" of the educational exempt purpose of the university). Rev. Rul. 80-296, 1980-2 C.B. 195 (finding that broadcast revenues were not subject to UBIT because "[a]n athletic program is considered to be an integral part of the educational process of a university, and activities providing necessary services to student athletes and coaches further the educational purposes of the university.").

183. H.R. REP. NO. 81-2319, at 109 (1950).

184. S. REP. NO. 81-2375, at 505 (1950).

185. On two separate occasions the IRS has tried to subject intercollegiate athletics to the UBIT, but the presumption established by the legislative history has been too much to overcome. The first instance occurred in 1977 when the IRS attempted to subject the broadcasting rights of the Cotton Bowl to UBIT, but it later reversed its position in two Revenue Rulings. *See* Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-296, 1980-2 C.B. 195. For a more in-depth analysis, see Kaplan, *supra* note 60. The second instance occurred in 1991 when the IRS attempted to subject sponsorship fees to the UBIT, but this position was ultimately rejected by statute. *See* I.R.S. Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991); I.R.S. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991); *see also* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 965, 111 Stat. 788, 893–94 (codified at I.R.C. § 513(i) (2006)) (rejecting the IRS's position). For a more in-depth analysis, see Stone, *supra* note 68.

186. The NCAA is a more curious case because it does not benefit from the same "substantially related" presumption that college athletic programs do. But the tax-exempt purpose of the NCAA is also entirely different: the promotion of amateur athletics rather than education. Arguably, no matter how commercialized the NCAA gets, its activities still technically promote amateur athletics. After all, the more publicized intercollegiate athletics become, the more the sports are promoted.

an interpretative change, which would give teeth to an otherwise dormant Treasury Regulation, which states:

> In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, *but which are conducted on a larger scale than is reasonably necessary for performance of such functions*, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business.[187]

This regulation has largely been overlooked perhaps because of the difficulty in determining whether an activity is conducted on too large of a scale, but if it were applied to intercollegiate athletics, it could be read to require that the revenues generated from college sports be proportionate to their educational contribution. Anything in excess would be taxable. In other words, the presumption would still be that intercollegiate athletics are "substantially related" to education, but if a given program is conducted on too large of a scale, the excessive amount will be deemed not substantially related and taxable.

A second possibility, one suggested by Gabriel A. Morgan while a student at the University of Southern California Gould School of Law, goes even further by completely eliminating the long-standing presumption that intercollegiate athletics is substantially related to education.[188] Following the test used in *American College of Physicians*, Morgan states that an athletic department "contribute[s] importantly" (and therefore is substantially related) to education only if its activities "enrich [the] educational experience of its student-athletes."[189] Morgan suggested three methods of inquiry to determine whether any given athletic department is contributing importantly to education. The first inquiry examines "the number, recency, and severity of NCAA or institutional rule infractions" committed by the athletic program in question.[190] The second inquiry compares the "student-athletes' academic performance to that of the

187. Treas. Reg. § 1.513-1(d)(3) (1983) (emphasis added).

188. *See* Gabriel A. Morgan, Note, *No More Playing Favorites: Reconsidering the Conclusive Congressional Presumption that Intercollegiate Athletics are Substantially Related to Educational Purposes*, 81 S. CAL. L. REV. 149 (2007) (citing United States v. Am. Coll. of Physicians, 475 U.S. 834, 848–49 (1986)).

189. *Id*. at 191.

190. *Id*.

general student body."[191] Finally, the third inquiry compares "graduation rates among student-athletes" with those of "their counterparts in the general student body."[192] In addition to possibly failing the substantial relationship test under any of these three factors, a program that contributes importantly to education might still find itself subject to UBIT under the first possible reform: conducting the program on a greater scale than necessary.

Such reforms, however, are not without their problems. As a preliminary issue, breathing life into the otherwise dormant Treasury Regulation discussed above would introduce an almost intolerable amount of ambiguity into the UBIT determination.[193] How would the IRS fairly distinguish between athletics programs with its only guidance being that the athletic program cannot conduct its activities on so large of a scale as to call into question its connection to education? When thought of from this perspective, it becomes obvious why this Treasury Regulation has not been employed; it is impossible to administer. Furthermore, even though Morgan's suggestion provides a much more specific standard than the indefinable proportional standard, there is still a significant concern regarding horizontal equity. What is an equitable distinction between a program that is not substantially related to education, and, therefore, subject to UBIT, and one that is substantially related to education? Although Morgan's offered solution provides more objectivity to the inquiry, a program that is otherwise identical to another program not subject to UBIT might find itself subject to the tax for incidental reasons out of its control, such as a number of players exercising their legally entitled right to leave the institution early to begin their professional careers. It is unlikely Congress intended for the UBIT to be administered in a fashion that is so ripe for discriminatory treatment.

Furthermore, even if a method can be produced that would fairly impose the UBIT on college programs deserving of the tax, there is a strong possibility that creative accounting would be used to ensure that these programs have no business revenue to tax.[194] John Colombo, for example, referred to the UBIT as a "paper tiger" because "[a]lthough some schools report net positive revenues from football or basketball programs, these revenues are rarely subject to the kind of rigorous cost accounting used in the business world," and if rigorous cost accounting were employed, there would be "no net profit from these programs to tax after factoring in depreciation on athletic facilities and a reasonable apportionment of

191. *Id*.

192. *Id*.

193. Perhaps even more problematic is the fact that some scholars have suggested that such a reading of this Treasury Regulation is "misguided" and taken "out of context." Mitten, Musselman & Burton, *supra* note 31, at 823.

194. Colombo, *supra* note 75, at 142–45.

overhead."[195] Surely, there could be some legislative changes made to prevent such a result, but perhaps it sheds light on the bigger problem—the inadequacy of tax law to fully deal with the increasing commercialization of college sports.

### B. Other Possible Reforms

Even putting aside the functional inadequacy of the UBIT to deal with the increasing commercialization of intercollegiate sports, even more problematic is the fact that the UBIT is not even the right theoretical medium for dealing with the problem. As Matthew Mitten, James Musselman, and Bruce Burton have argued, athletic programs allow colleges and universities the ability to meet the following education related objectives: "providing a lens through which the nature, scope, and quality of their higher educational services is discovered by the public; attracting high quality faculty, students, and student-athletes; diversifying their student bodies; forging a continuing bond with alumni, the local community, and other constituents . . . ; and enhancing their institutional reputations."[196] Admittedly, the recent recruiting scandals and the poor academic performance that has accompanied the increasing commercialization of intercollegiate athletics suggest that, for some programs, these benefits have generated great costs.[197] Still, recent appeals to Congress for tax reform constitute a misguided attempt to use the wrong tool to regulate intercollegiate athletics. As Mitten, Musselman, and Burton point out:

> Congress did not intend for the UBIT to be a regulatory device for college or university athletic programs or for any other exempt organization. On the contrary . . . it was intended to address congressional concerns that colleges and universities conducting trades or businesses were able to deprive the government of significant tax revenue from those business operations and enjoy an unfair competitive advantage over commercial business entities required to pay taxes on their income.[198]

For these reasons, the use of the UBIT to regulate intercollegiate athletics is without theoretical and practical justification. As a result, other methods of regulation must be explored.

---

195. *Id*. at 135, 143–46.

196. Mitten, Musselman & Burton, *supra* note 31, at 781.

197. *See, e.g.*, Nicholas Stanlet, *NCAA Violations: Recruiting and Player Management System Broken*, BLEACHER REPORT, (Aug. 22, 2011) http://bleacherreport.com/articles/815490-college-football-ncaa-violations-recruiting-and-player-management-system-broken (recruiting scandals); Duncan, *supra* note 11 (poor academic performance).

198. Mitten, Musselman & Burton, *supra* note 31, at 824.

One regulatory alternative suggested by Colombo would be to condition continued tax exemption on certain requirements that colleges and universities must meet.[199] Moving away from the UBIT, which was not designed to incentivize behavior, and towards a results driven alternative would not be unusual as Congress has often used the tax exemption itself as a means to incentivize results.[200] Congress might (1) "require that a certain percentage of revenues from revenue-producing sports such as football and basketball be used to expand nonrevenue athletic opportunities;"[201] (2) impose "targeted expenditure limits, such as capping coaches' salaries or limiting annual expenditures on recruiting or sports facilities;"[202] and (3) require "the NCAA and [colleges and] universities with athletic programs to provide detailed information both on the financial aspects of their programs (using standardized accounting methods) and on the academic progress of student-athletes."[203] Such a regulatory alternative essentially amounts to Congress using tax-exemption status to further the public policy goal of limiting excessive commercialization of intercollegiate athletics.

Although Colombo's alternative is far superior to any reform attempting to use the UBIT as a regulatory tool, it still poses a considerable problem. The threat of revoking tax-exempt status from a college or university that does not abide by Congress's requirements would surely prove to be a powerful motivator for those institutions, but it also limits the requirements that Congress will feel comfortable imposing. In other words, the strength of Colombo's regulatory alternative—the strong motivation inherent in losing tax-exempt status—is also its weakness. Revoking a college or university's tax-exempt status has tremendous consequences for the institution as a whole, and because of this, Congress would probably impose only those requirements that a college or university could easily meet with a reasonable amount of effort. For this reason, it should be of no surprise that Colombo does not suggest that a college or university lose its tax-exempt status if it does not meet certain academic progress thresholds for its student-athletes; losing its tax-exempt status would be too high of a price to pay for such a transgression. Instead, Colombo suggests (1) that colleges and universities disclose information about the academic progress of student-athletes (which is already public information for the most part); (2) that colleges and universities be required to use a certain amount of

---

199. Colombo, *supra* note 75, at 155.

200. *Id*. One example is section 145, which allows for charities to issue tax-exempt bonds, but only if ninety-five percent of the proceeds from the bonds are used to benefit tax-exempt purposes. *See* I.R.C. § 145 (2006). Another example is § 501(c)(3), which limits lobbying activities of a tax-exempt organization to "substantial" amounts. *See* I.R.C. § 501(c)(3) (2006).

201. Colombo, *supra* note 75, at 156 (emphasis omitted).

202. *Id*. at 157.

203. *Id*. at 113.

revenue from football and basketball to expand nonrevenue athletics (which is already done by most schools); and (3) that there be imposed expenditure limits.[204]

Because imposing expenditure limits, such as capping coaches' salaries, is the only substantial step forward in Colombo's regulation, even his tax-exemption alternative falls drastically short. And so it appears that any tax proposal is inherently flawed. Instead, any real regulatory changes to intercollegiate athletics must start with the NCAA. Borrowing from U.S. Secretary of Education Arne Duncan,[205] a meaningful reform would call for a post-season ban for programs failing to graduate at least half of their players within six years of their matriculation. Furthermore, although programs have been banned from post-season play for committing NCAA violations, the NCAA might consider using this method more frequently. Finally, the NCAA might consider establishing uniform rules regarding spending caps to prevent the "arms race" of intercollegiate athletics. Although these rules might be subject to antitrust litigation under section 1 of the Sherman Act, Congress could exempt them from antitrust law to ensure that the NCAA is able to effectively maintain the amateurism of intercollegiate athletics.[206]

## CONCLUSION

It is abundantly clear that intercollegiate athletics is far removed from its rather humble beginnings. For at least a handful of Division I programs, winning has become synonymous with profit, and this has fueled an arms race to build the biggest and best programs in the country. Expressing their concern that intercollegiate athletics has lost its connection to education, politicians and commentators have suggested that tax law should be used to remedy the commercialization of intercollegiate athletics. Although there is surely merit to the concern over the increasing commercialization of intercollegiate athletics, this Note finds that tax law is a poor avenue to remedy the problem. The first problem with utilizing tax law as a remedy became clear after surveying the current doctrine and its application to intercollegiate athletics, which revealed that despite the increasing commercialization of intercollegiate athletics, the current tax law would have to be amended to have any impact on the problem. The second problem with utilizing tax law as a remedy is that even if amendments were made for the specific reason to curb the increasing commercialization of intercollegiate athletics, it would be a rather inefficient and misdirected

---

204. Colombo, *supra* note 75, at 112–13.

205. Duncan, *supra* note 11 (proposing that teams that fail to score a 925 out of 1,000 on the NCAA's multiyear Academic Progress Rate (APR) scale, which amounts to graduating at least half of the players on the team, shall be barred from participating in the NCAA tournament).

206. *See* Mitten, Musselman & Burton, *supra* note 31, at 830–43.

solution to the problem. Why cut with a machete when you can use a scalpel? Rather than using tax law to remedy the problem, this Note concludes that the NCAA must more effectively regulate the increasing commercialization of intercollegiate sports. The NCAA is more able to institute a more directed solution to the problem of increasing commercialization while still being able to acknowledge the important role that college sports can play in the educational process.