THE NCAA, TAX EXEMPTION, AND COLLEGE ATHLETICS

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This Article discusses the contentious topic of the National Collegiate Athletic Association's (NCAA) status as a tax-exempt organization. In late 2006, Congress asked the NCAA to justify its exempt status, and since that time many have called for a change in that status. Calls for reform cite reasons such as the amount of money paid to Division I football and basketball coaches, the fact that NCAA football and basketball are essentially minor-league systems for the NFL and NBA, and an alleged lack of relation between college athletics and academics. The Article serves two purposes: first, it seeks to clarify the manner in which tax rules apply to the NCAA and universities' operation of Division I football and basketball programs; and second, it provides a policy-oriented view of whether big-time college athletic programs—and the NCAA—fit into a standard theoretical paradigm for exemption.

The first part of the Article explains that, under the current laws, it would be nearly impossible for the Internal Revenue Service (IRS) to withdraw the NCAA's tax exemption and the tax exemptions of its member institutions. A more feasible alternative would be to tax Division I athletics revenues using the Unrelated Business Income Tax (UBIT). This option, however, presents its own legal obstacles and, if successful, would likely be a "paper tiger," as the NCAA and universities would possess little or no taxable net income after applying cost accounting. Further, the disclosures that universities would be required to make under Form 990-T would not approach the level of disclosure desired by reform advocates.

The second part of the Article contends that the tax system should not be changed haphazardly to promote reform of NCAA athletics, and examines whether college sports fall into an existing paradigm for exemption or should be considered a class of their own for tax law purposes. If NCAA athletic programs do not fall into a

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standard paradigm, Congress would be able to attach conditions to their exemption without damaging established tax principles.

Finally, the Article points out the existence of several regulatory approaches that could be applied to the taxation of college athletics. Those approaches consist of placing conditions upon the use of proceeds from collegiate football and basketball revenues, limiting athletic department expenditures, and mandating enhanced disclosure by the NCAA and its member institutions of financial information as well as the academic progress of student-athletes.

I. INTRODUCTION

In early October 2006, Representative Bill Thomas, then the chair of the House Ways and Means Committee, sent a letter to Myles Brand, then the President of the National Collegiate Athletic Association (NCAA), that essentially asked the NCAA to defend its status as a tax-exempt organization.[1] The letter, and the subsequent response from the NCAA,[2] brought out the talking heads in droves; even George Will wrote a column criticizing "the NCAA's tax-free lifestyle."[3] Unfortunately, most of the folks who opined on the subject revealed virtually no knowledge of the actual law surrounding tax exemption for the NCAA or, more broadly, exemption for universities engaged in Division I football and basketball.[4]

1. *See, e.g.*, Elana Schor, *Rep. Thomas Seeks Answers from NCAA*, HILL, Oct. 5, 2006, at 3; Steve Wieberg, *NCAA's Tax-Exempt Status Questioned*, USA TODAY, Oct. 5, 2006, at 3C, *available at* http://www.usatoday.com/sports/college/2006-10-04-ncaa-tax-status_x.htm?POE=SPOISVA; *see also* Letter from 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. Letter from Myles Brand, President, NCAA, to William Thomas, Chairman, House Comm. on Ways & Means (Nov. 13, 2006), http://coia.comm.psu.edu/News%20of%20interest/NCAA%20response%20to%20Thomas%20letter%2013%20Nov%2006.pdf [hereinafter *NCAA Response*].

3. George F. Will, *Tax Breaks for Football*, WASH. POST, Oct. 25, 2006, at A17, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/10/24/AR2006102400911.html. Will, of course, was just one of many to opine on the subject. The blogosphere quickly picked up on the issue; a Google blog search of "NCAA Tax Exemption" for the period from Oct. 5, 2006 to June 1, 2007, revealed some 2145 entries on the subject.

4. NCAA Division I is the domain of the big-time college sports programs; prior to 2006, Division I was further subdivided for men's football into Division I-A (the "highest" division) and Division I-AA. These two subdivisions had their names officially changed to the "Football Bowl Subdivision" (formerly Division I-A) and the "Football Championship Subdivision" (formerly Division I-AA). *See generally* NCAA, What's the Difference Between Divisions I, II and III?, Feb. 1, 2007, http://www.ncaa.org/wps/ncaa?ContentID=418; NCAA, NCAA Members by Division, http://web1.ncaa.org/onlineDir/exec/divisionListing (click on "Run Report"). As of 2009, 120 universities participated in Football Bowl Subdivision (FBS) football, while over 300 schools participated in Division I basketball. The programs at the heart of the debate over amateurism and commercialism of college athletics tend to be those that have FBS football programs, though a few schools that do not participate in FBS football may have highly commercialized basketball programs part of Division I—for example, Georgetown University, which competes in the Big East conference in basketball but does not have a FBS football program. Similarly, some FBS football schools have relatively modest programs (e.g., Western Kentucky University). Nevertheless, for the sake of brevity this Article often will refer to the pro-

For example, a common theme of the opinions was that tax exemption should be denied because of escalating coaches' salaries,[5] even though the actual law states quite clearly that the only issue involving salaries in the tax exemption world is whether they are "reasonable"—that is, comparable to the market rate for similar work in both the non-profit and for-profit sector.[6] We might blanch at the decision of the University of Alabama to pay Nick Saban $32 million over eight years for his services as head football coach[7] or the decision of the University of Kentucky to pay John Calipari nearly the same,[8] but these salaries certainly are not out of line with other highly successful coaches in the collegiate and pro ranks. And remember, Alabama hired Saban from a pro coaching job, the Orlando Magic of the NBA tried to hire Billy Donovan from the University of Florida to fill its head coaching vacancy for a cool $27.5 million,[9] and Calipari himself coached the New Jersey Nets in the NBA for a period.

Even Chairman Thomas's letter itself often confuses the terminology relating to tax-exempt status with the rules for the application of the Unrelated Business Income Tax (UBIT).[10] If those who wish to reform the way the NCAA and universities treat big-time athletics want to use the tax laws to advance their agenda, they should start with knowing what the law is and how to best formulate an argument for change. So far, that knowledge from the critics of college athletics has appeared woefully inadequate.

The purpose of the Article, therefore, is twofold. The first purpose is to educate those familiar with college athletics but perhaps less famili-

grams in question by the general "Division I" moniker, and I think it is safe to assume that if the reader has any familiarity with college athletics, she will know whom I am talking about.

5. *See, e.g.*, Will, *supra* note 3 ("Also, tax exemption is financing an escalation of coaches' salaries.").

6. Treas. Reg. § 53.4958-4(b)(1)(ii)(A) (2002) ("The value of services is the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax-exempt) under like circumstances (*i.e.*, reasonable compensation). Section 162 standards apply in determining reasonableness of compensation . . . ."). In fact, the regulations under § 4958 provide a safe-harbor provision for compensation arrangements if the arrangement is approved by an independent board or compensation committee of the board that relies on "appropriate data as to comparability prior to making its determination" and documents the basis for its decision. *Id.* § 53.4958-6(a)(2)–(3) (2002). For further discussion, see *infra* text accompanying notes 44–62.

7. Monty Burke, *The Most Powerful Coach in Sports*, FORBES, Sept. 1, 2008, at 92, *available at* http://www.forbes.com/forbes/2008/0901/092.html.

8. Associated Press, *Calipari Accepts Kentucky's Offer*, MSNBC.COM, Mar. 31, 2009, http://nbcsports.msnbc.com/id/29956570/.

9. *See Donovan Takes Big-Money Deal to Coach Magic*, ESPN.COM, June 4, 2007, http://sports.espn.go.com/nba/news/story?id=2888555.

10. For example, question three of the letter questions the "tax-exempt status of college sports" even though, as discussed below in the text accompanying notes 12–22, our law does not exempt activities but rather the entities themselves. *Thomas Letter*, *supra* note 1. Of course, in a broad sense, individual activities can be tax-exempt or not, depending on (1) whether the organization itself is tax-exempt and (2) whether the activity is subject to the UBIT. But it is generally not helpful to the underlying analysis to confuse distinct concepts. For a discussion of the UBIT, see *infra* notes 23–32 and accompanying text, and *infra* Part IV.

ar with the intricacies of tax exemption and the UBIT about how the tax rules apply to the NCAA and to the universities operating Division I football and basketball programs. This is the province of Parts II–IV of the Article, which illustrate that current law makes it virtually impossible for the IRS to withdraw exemption from either the NCAA or universities operating major athletic programs. These Parts also show that although it is somewhat more plausible that the IRS could tax revenues from Division I football and/or basketball under the UBIT, even that course of action would have to scale considerable legal hurdles. Moreover, even if the IRS applied the UBIT to big-time athletic revenues, doing so may not have much benefit in the eyes of the reform movement. Evidence suggests that applying the UBIT might be largely a "paper tiger" because virtually none of these programs would have taxable net income in the tax accounting sense after applying appropriate cost accounting. Moreover, though universities would be forced to make some disclosure about these programs as a result of filing Form 990-T (the unrelated business income tax return), this disclosure would not be anything like the kinds of disclosure reformers suggest are necessary.

The second purpose is more policy oriented. Many parties interested in reforming Division I college athletics have targeted the tax exemption and UBIT laws as one method of promoting reform. In essence, their plea is that Congress (or the IRS) "should do something" via the tax rules to promote the reform agenda. But our tax system is just that—a *system*, and the rules should not be changed willy-nilly without consideration of how the changes affect underlying tax policy.

The second part of the Article, therefore, examines the tax policy issues raised by college athletics, particularly whether these programs fit within a theoretical paradigm that demands they be exempt from taxation, or whether instead big-time college athletics should be considered a sui generis exception to general tax policy. The reason this is important is that if major college football and basketball do not fit in any standard theoretical paradigm for exemption, then we should forthrightly recognize that continuing tax-favored treatment for these activities is an "exception" to general tax policy—much like a local community abating property taxes to induce a business to locate there. Such a conclusion, in turn, means that Congress could consider attaching special conditions to continuing tax exemption for the NCAA and universities engaged in Division I football and/or basketball without worrying about any damage to established tax policy or principles. In other words, this is the "hook" reformers can use to press their case.

Though the exact scope of these special conditions should be debated by experts in college athletics (of which I am not one), I note in the final Section of the Article that there are precedents in tax law for a variety of regulatory approaches that might be especially appropriate for college athletics. These approaches include (1) attaching conditions on the use of proceeds from an exempt activity (e.g., a requirement that men's football and/or basketball athletic revenues be used to subsidize other charitable outputs, such as increased athletic opportunities in nonrevenue sports or for women;[11] (2) expenditure limits, such as caps on coaching salaries or recruiting budgets; and (3) expanded disclosure via a schedule to Form 990, similar to the new Schedule H for hospitals, that would require the NCAA 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.

II. TAX EXEMPTION AND THE UBIT: A PRIMER

A. Tax Exemption

The Internal Revenue Code (Code, or IRC) in § 501 lists twenty-eight different kinds of entities that are exempt from paying the corporate income tax usually imposed on corporate enterprises.[12] The NCAA and private universities, however, rely for their exempt status on § 501(c)(3), which provides exemption for charitable organizations, including religious and educational organizations.[13] Charitable exemption status is particularly important to private universities, because in general

11. The term "nonrevenue sports" generally describes those sports that receive little, if any, revenue from gate receipts or media contracts. Gymnastics (both men's and women's), golf, tennis, soccer, lacrosse, rowing, and similar sports generally fall into this category. College baseball does attract some level of revenue from both gate receipts and television contracts (for the College World Series), as does women's basketball, but these revenues are insignificant in comparison to those generated by Division I college basketball and FBS football. For purposes of this Article, the term "nonrevenue sports" should be viewed as encompassing all sports programs on college campuses other than men's Division I basketball and FBS football.

12. I.R.C. § 501(c) (2006).

13. *Id.* § 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 exempt. Rather, an entity must prove it is a *charitable* religious organization, or a *charitable* educational organization in order to obtain § 501(c)(3) exemption. *See generally* Bob Jones Univ. v. United States, 461 U.S. 574, 586–89 (1983) (rejecting argument of Bob Jones University that it need not meet common law standards of charity as long as it was a legitimate educational institution).

Public universities technically are exempt either under the broad doctrine of intergovernmental tax immunity or under Code § 115, which exempts from federal taxation the income of States or "any political subdivision thereof" derived from "the exercise of any essential governmental function." I.R.C. § 115; *see infra* notes 110–12 and accompanying text. Donations to a government unit, moreover, are tax deductible under § 170(c)(1). Nevertheless, many public universities request recognition of exemption under § 501(c)(3) simply to avoid confusion in the minds of potential donors and because grants from private foundations are often limited to "charitable" organizations exempt under § 501(c)(3). Just like their private brethren, moreover, public universities are subject to the unrelated business income tax discussed in the text at Part IV. *See* I.R.C. § 511(a)(2)(B).

only charitable organizations are permitted to receive tax-deductible contributions under § 170 of the Code.[14]

Exemption under § 501(c)(3) requires an organization to meet two broad requirements. First, the entity must be properly organized as a charitable organization.[15] This "organizational test" generally means that it must observe certain organizational technicalities: it must be organized as a state-law nonprofit organization (either a nonprofit corporation or charitable trust), must limit its authorized activities to charitable ones, and must have a provision in its organizing documents that its assets will be transferred to another charity or to the government if it goes out of business.[16]

The second general requirement is the "operational test" and is where the real action is. The operational test requires that the entity in question actually must engage "primarily" in charitable activities, such as educational activities.[17] But the statute and common law also have specific operational limitations that an organization must observe in order to qualify as charitable: for example, an organization cannot engage in more than an "insubstantial" amount of legislative lobbying and cannot intervene in any way in a political campaign.[18] 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.

The operational limitations break down as follows. First, there are the limitations specifically listed in § 501(c)(3): the "private inurement"

14. Section 170(c) lists the organizations eligible to receive deductible donations. Subsection (c)(2) essentially adopts the language defining a § 501(c)(3) organization as one of the organizations eligible to receive deductible contributions. Government units, certain veterans organizations, and certain cemetery societies are the other eligible organizations, which means that public universities—as units of state government—qualify for deductible donations without regard to § 501(c)(3). Section 501(c)(3) status is likely somewhat less important to the NCAA; in its 2006 Form 990 (the most recent Form 990 available from Guidestar), the NCAA reported receiving only $318,939 from donations, as opposed to "program service revenue" *of more than $584,000,000*. NCAA, Return of Organization Exempt from Income Tax Return (Form 990) (2006), http://www.guidestar.org/FinDocuments/2007/440/567/2007-440567264-0484608e-9.pdf [hereinafter *Form 990 Filing*]. Qualification for exemption as a social welfare organization under § 501(c)(4), or even as a trade association under § 501(c)(6) (which, by the way, is the Section that provides tax exempt status for the NFL, NBA, MLB, and NHL), would probably provide the NCAA with as much federal tax benefit as § 501(c)(3) status. Nevertheless, § 501(c)(3) status carries a certain cachet for exempt organizations, and may be important to establishing exemption from local property taxes, which often limit exemption to "charitable" organizations. *See* Janne Gallagher, *The Legal Structure of Property-Tax Exemption*, *in* PROPERTY-TAX EXEMPTION FOR CHARITIES: MAPPING THE BATTLEFIELD 3, 3–4 (Evelyn Brody ed., 2002). Given that the NCAA has a very nice office building in Indianapolis, it is probable that § 501(c)(3) status is of some financial import to the organization.

15. Treas. Reg. § 1.501(c)(3)-1(a), 1(b) (as amended in 2008).

16. *Id.* § 1.501(c)(3)-1(b).

17. *Id.* § 1.501(c)(3)-1(c)(1). Although the statute states that an exempt entity must be "organized and operated exclusively" for charitable purposes, I.R.C. § 503(c)(3), "exclusively" actually means "primarily" in this context. Treas. Reg. § 1.501(c)(3)-1(c)(1). Remember, folks, that this is the IRC, where a "person" includes a partnership, corporation, etc. *See* I.R.C. § 7701(a)(1).

18. I.R.C. § 501(c)(3).

limitation, which prohibits an organization from "siphoning off" money or other assets to "insiders" such as by paying excessive compensation, and the lobbying limitation and the political activity limitation discussed above.[19] Then there are additional limitations imposed by the Treasury Regulations, IRS interpretations, and judicial opinions. These include the prohibition on illegal activities, or activities that violate a clearly established "fundamental" public policy;[20] a prohibition on excessive "private benefit";[21] and a prohibition on excessive commercial activity.[22] The application of the "operational" rules and limitations in the context of college athletic programs and the NCAA is discussed in more detail in Part III.

B. The UBIT

Even if an organization is tax-exempt under Code § 501(c), it may be required to pay the corporate income tax on net revenues from "unrelated" businesses. Prior to 1950, a line of cases beginning with a 1924 Supreme Court decision had established the proposition that a charity could run a substantial commercial business and avoid paying any tax on the profits from that business as long as the revenues from that business were used to fund charitable activities.[23] This "destination of income" test perhaps reached its zenith in the famous case involving Mueller Macaroni Company, in which the Third Circuit upheld tax exemption for Mueller itself (clearly nothing more than a commercial business) because it funneled all its profits to support the New York University School of Law.[24]

In 1950, however, ostensibly out of concern that allowing charities to operate businesses tax-free would result in a reduction of corporate tax revenues[25] and also would allow charities to compete "unfairly" (pre-

19. *Id.*

20. Bob Jones Univ. v. United States, 461 U.S. 574, 591 ("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 prohibition on engaging in illegal activity).

21. *See* JAMES J. FISHMAN & STEPHEN SCHWARZ, TAXATION OF NONPROFIT ORGANIZATIONS 237–45 (2d ed. 2006); FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS ¶ 4.02 (2009); BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS § 19.10 (8th ed. 2003); John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1064–65 (2006).

22. FISHMAN & SCHWARZ, *supra* note 21, at 355–57; HOPKINS, *supra* note 21, § 25; John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM. & MARY L. REV. 487, 491 (2002).

23. FISHMAN & SCHWARZ, *supra* note 21, at 356; Colombo, *supra* note 22, at 498–99.

24. C. F. Mueller Co. v. Comm'r, 190 F.2d 120, 121–22 (3d Cir. 1951).

25. The theory surrounding the UBIT and how college athletics fits with that theory is discussed in detail in Part V.B. As explained more fully there, our current tax laws do not permit corporations to "zero-out" their income via charitable contributions. Though it may come as a surprise to those not steeped in the technicalities of our tax laws, neither individuals nor corporations can eliminate their tax liability by giving their income to charity. Individuals cannot deduct more than 50 percent of their adjusted gross income for charitable contributions. I.R.C. § 170(b)(1)(A) (2006). On the corporate

sumably by using tax-free profits to either charge lower prices or expand the business in ways that for-profit, tax-paying competitors could not afford to do), Congress enacted the UBIT precisely to address cases like *Mueller*.[26] Under the UBIT, if a business is "substantially related" to the organization's charitable purpose, then any business profit continues to be tax-free; if, however, the business is not substantially related, any profit is taxed at the usual corporate tax rates.[27] In effect, the UBIT replaced the "destination of income" test with a "relatedness" test for purposes of taxing the profits of commercial businesses run by charities. Note, however, that the UBIT itself does not affect the underlying tax-exempt status of a given organization;[28] that is, nothing in the UBIT says that the charity will lose its overall exempt status if it undertakes a certain commercial activity of a given type or size. Instead, the sole purpose of the UBIT is to tax certain commercial-activity revenues earned by organizations that otherwise are tax-exempt.

Though it requires piecing together the requirements of three different Code Sections,[29] the UBIT applies to net income from (1) a trade or business, (2) that is regularly carried on, and (3) is not substantially related to the exempt organization's accomplishment of its exempt purpose. One additional key aspect to analyzing the application of the UBIT to college athletics is the "fragmentation" rule that permits the IRS to apply the UBIT to separate revenue streams, even if those revenue streams are part of what normal people would view as a single business.[30] As examples, the fragmentation rule allows the IRS to apply the UBIT to advertising revenues separately from other revenues,[31] or to

side, unless a corporation is itself considered a charity, and thus exempt from the corporate tax, it can reduce its taxable income by only 10 percent through charitable contributions. *Id.* § 170(b)(2)(A). Thus a corporation like Newman's Own, which operates a business but donates all its profits to charity, must still pay tax on 90 percent of its net revenues. Why this is so is a matter of some academic debate, although the tax laws have had a limit on charitable contributions deductions virtually since the inception of the income tax. For a thorough discussion of this point and the various policy reasons that have been offered to justify the charitable contribution deduction limits, see Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165 (2008). I have used the word "ostensibly" in the text because some academics have suggested that forces other than unfair competition and tax-base protection were at work in the adoption of the UBIT. See *infra* text accompanying notes 169–81 for a further discussion.

26. Revenue Act of 1950, Pub. L. No. 81-814, §§ 301, 331, 64 Stat. 906, 947, 957.

27. I.R.C. §§ 501(b), 511–513. Code § 513(a) states, "The term 'unrelated trade or business' means . . . any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose . . . ." Note the parenthetical in this quotation, which makes clear that a business cannot be substantially related simply because it provides a source of funds to carry on charitable activities. The regulations define a "substantially related" activity as one that has a "causal relationship" to the achievement of the exempt purpose. Treas. Reg. § 1.513-1(d)(2) (as amended in 1983).

28. *See* I.R.C. § 501(b).

29. *Id.* §§ 511–13.

30. The fragmentation rule comes from Code § 513(c).

31. *See, e.g.*, United States v. Am. Coll. of Physicians, 475 U.S. 834, 849–50 (1986) (finding advertising revenue from tax-exempt medical journal subject to the UBIT).

conclude that revenues from the sale of souvenir coffee mugs at a museum gift shop are subject to the UBIT but sales of greeting cards with art reproductions are not.[32] The fragmentation rule is particularly important to analyzing college athletics, because it permits the IRS to apply the UBIT separately to football and/or basketball revenues rather than the athletic department as a whole. The application of the UBIT rules to the NCAA and university college athletic programs is considered in more detail in Part IV.

III. APPLYING THE TAX EXEMPTION RULES TO THE NCAA AND COLLEGE ATHLETICS

A. The Prima Facie Charitable Purpose

As noted above, one can think of the operational test for tax exemption as first requiring an organization to have a prima facie charitable purpose. Universities and colleges meet this prima facie requirement by virtue of being educational organizations, one of the "presumptive" categories of charitable exemption listed in § 501(c)(3).[33] Therefore, unless an athletic department were separately incorporated,[34] it makes no sense to talk about "college athletics" as being tax-exempt. Particular activities are not tax-exempt—entities are (though particular activities of an exempt organization might nevertheless be subject to tax under the UBIT, as described above). Colleges and universities clearly are engaged in the "instruction or training of the individual for the purpose of improving or developing his capabilities," which the Treasury Regulations define as an educational purpose.[35] Therefore, they clearly meet the prima facie charitable purpose piece of the operational test.

32. *See, e.g.*, Rev. Rul. 73-105, 1973-1 C.B. 264 ("[S]ales of a particular line of merchandise may be considered separately to determine their relatedness to the exempt purpose."). In this ruling, the IRS found that sales of art reproductions were substantially related to the museum's exempt purpose of promoting public understanding of art, but sales of science books and general souvenir items relating to the city in which the art museum was located were not substantially related. *See also* Rev. Rul. 73-104, 1973-1 C.B. 263 (finding that sales of greeting cards with art reproductions are not subject to UBIT).

33. *See supra* note 13 and accompanying text.

34. The IRS requires that separate corporations "stand on their own" for exemption purposes and separately justify tax exemption. Although there are some very narrow exceptions, in general, one corporation cannot claim "derivative" exemption via its relationship with another exempt organization. *See* Colombo, *supra* note 22, at 514–17 (discussing the IRS' separate-identity principle for corporations and their subsidiaries). Nevertheless, a separately incorporated athletic department just might be a kind of entity that would fit under the narrow exception that we in the tax exemption world call the "integral part" test (from the regulations under § 502 of the Code). In general, the "integral part" test permits derivative exemption for "captive" subsidiaries, such as a subsidiary corporation that generates electrical power for a parent charity. *See* Treas. Reg. § 1.502-1(b) (as amended in 1970). At least one case has applied the integral part doctrine to a captive university book store, Squire v. Students Book Corp., 191 F.2d 1018 (9th Cir. 1951), so it is reasonable to assume that a captive athletic department might also come within this test.

35. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(a) (as amended in 2008).

Prior to 1976, the question whether the NCAA as an entity was engaged in a charitable purpose (as opposed to universities conducting athletic programs) might have carried some doubt. After all, the NCAA is not itself engaged in "the training of individuals" or "the instruction of the public," activities deemed educational in the Treasury Regulations under § 501(c)(3).[36] Though the IRS has applied the "educational" label very broadly to include all sorts of organizations that disseminate information to the public, it is not obvious that the NCAA necessarily is equivalent to a museum, zoo, symphony orchestra, planetarium, or even the Newport Jazz Festival, all of which the IRS has recognized as educational organizations.[37] Rather, the NCAA is engaged primarily in "advancing" college athletics by organizing championships and by serving as a central licensing body for media outlets (television, radio, internet) that want to use college athletic events as a programming source.[38] Prior to this time, moreover, the statute itself did not reference "promoting" athletics as a charitable purpose, and the IRS generally had limited the exemption to organizations that provided specific athletic education, such as Little League baseball teams, or that organized youth sports programs to combat juvenile delinquency.[39] But in 1976, Congress made clear that promoting amateur athletics was, in fact, a prima facie charitable purpose by passing an amendment to § 501(c)(3) that specifically declared fostering "national or international amateur sports competition" as a charitable purpose.[40] Moreover, in *Hutchinson Baseball Enterprises v. Commissioner*,[41] the Tenth Circuit upheld a Tax Court decision that even without the legislative change, "the furtherance of recreational and amateur sports" would be a charitable activity.[42]

36. *Id.* § 1.501(c)(3)-1(d)(3)(i)(a), (b).

37. *See, e.g.*, *id.* § 1.501(c)(3)-1(d)(3)(ii) ex. 4 (listing "museums, zoos, planetariums, symphony orchestras, and other similar organizations" as educational); Rev. Rul. 65-271, 1965-2 C.B. 161 (holding jazz festival exempt as educational organization).

38. *See* NCAA v. Comm'r, 914 F.2d 1417, 1418–19 (10th Cir. 1990). Media licensing and sports championships account for 98.51 percent of the NCAA's budgeted revenue for the fiscal year-end August 31, 2009. NCAA, Revised Budget for Fiscal Year End August 31, 2009, http://www.ncaa.org/wps/ncaa?key=/ncaa/ncaa/about+the+ncaa/budget+and+finances/budget+information/2008-09+budget+detail.

39. *See* FISHMAN & SCHWARZ, *supra* note 21, at 210–16.

40. 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)). This Act added "foster[ing] national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment)" to the list of exempt purposes in § 501(c)(3). The parenthetical limitation on sports equipment was thought necessary to prevent private gyms and athletic clubs from gaining exemption under § 501(c)(3), but it also potentially affected "legitimate" amateur athletic organizations (such as Olympic training). So in 1982, Congress added § 501(j) to provide exemption for "real" amateur athletic organizations, even if they provided equipment or facilities. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 286(a), 96 Stat. 324, 569–70 (codified as amended at I.R.C. § 501(j)). *See generally* FISHMAN & SCHWARZ, *supra* note 21, at 216 (discussing the 1976 amendment to § 501(c)(3)).

41. 696 F.2d 757 (10th Cir. 1982).

42. *Id.* at 762.

Thus by the early 1980s, both the statute and the common law recognized that promoting amateur athletics was a prima facie charitable purpose. Even if one believes that Division I football and basketball programs are no longer "amateur athletics" for this purpose, the NCAA as an entity 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." Accordingly, it would be exceedingly difficult under current law to claim that the NCAA as an entity does not have a prima facie charitable purpose.

B. The Limitations on Charitable Exemption

Of course, having a prima facie charitable purpose is only the beginning of some very complex analysis. In addition to having such a purpose, the operational test imposes a variety of limitations to ensure that an organization is in fact "primarily" pursuing charitable activities. Fortunately, for the purposes (and length) of this Article, three of the six limitations set forth in Part II above—the public policy/illegal activity limitation and the limitations on legislative lobbying and political campaign activity—have no specific application to college athletics. That is, college athletics by its nature does not specifically involve legislative lobbying or political campaign activity and does not (or perhaps I should say "should not") involve illegal activities or violations of established public policy.[43] The other three limitations—private inurement, private benefit, and commercial activity—do have a specific application to college athletics, however, and are analyzed more fully below.

1. Private Inurement and Coaches' Salaries

As far back as 1909, the provision of the federal tax laws exempting charitable organizations has contained a form of the somewhat cryptic language requiring that "no part of the net earnings of [an exempt organization] inures to the benefit of any private shareholder or individual."[44]

43. Though academics debate what the scope of "established public policy" is in this context, so far the IRS has applied the doctrine only to cases of racial discrimination against a minority class. *See* Bob Jones Univ. v. United States, 461 U.S. 574, 598–99 (1983) (holding that a school that discriminated against African Americans violated an established fundamental public policy and was not eligible for exemption). *See generally* FISHMAN & SCHWARZ, *supra* note 21, at 172–74; Donald C. Alexander, *Validity of Tax Exemptions & Deductible Contributions for Private Single-Sex Schools*, 70 TAX NOTES 225, 225–27 (1996); David A. Brennen, *The Power of the Treasury: Racial Discrimination, Public Policy, and "Charity" in Contemporary Society*, 33 U.C. DAVIS L. REV. 389, 394–97 (2000); Miriam Galston, *Public Policy Constraints on Charitable Organizations*, 3 VA. TAX REV. 291, 293–97 (1984); Johnny Rex Buckles, *Do Law Schools Forfeit Federal Income Tax Exemption When They Deny Military Recruiters Full Access to Career Services Programs?: The Hypothetical Case of* Yale University v. Commissioner, 41 ARIZ. ST. L. REV. 1 (2009).

44. I.R.C. § 501(c)(3). The 1909 version of this language permitted exemption only if "no part of the profit of [the organization] inures to the benefit of any private stockholder or individual." 44 CONG. REC. 4157 (1909), *quoted in* Harvey P. Dale, *The Crux of Charity: Inurement, Private Benefit, and Excess Benefit Transactions*, *in* NAT'L CTR. ON PHILANTHROPY & THE LAW, DIVERSIONS OF

Though the language invites some odd literal interpretations, it has been well-defined over years of IRS and court interpretations as prohibiting a "siphoning off" of the assets of an exempt organization to an "insider."[45] This siphoning off takes one of two general forms: either the charity pays more than fair market value for property owned by or services provided by an insider, or else the charity charges too little for property or services that it provides to an insider. The classic example of the former is paying an "unreasonable" salary—that is, compensation in excess of what the services are worth on the market.[46] The classic examples of the latter are an interest-free loan from a charity to an insider or rent-free use of office space.[47]

For many years, the IRS's only sanction for private inurement transactions was to withdraw tax exemption from the entity involved. Because this sanction had the effect of "blowing up" the exempt entity without punishing the real wrongdoer (the insider who benefited from the siphoning off), in the early 1990s the Treasury proposed an "intermediate sanctions" regime that would use excise taxes to punish inurement transactions.[48] This "intermediate sanctions" suggestion became law in 1996 in the form of Code § 4958,[49] and therefore today inurement transactions are almost exclusively dealt with via the excise taxes imposed by that Section, as opposed to withdrawal of exemption.[50]

In the world of college athletics, the § 4958 private inurement issue is joined via the escalating salaries for top Division I football and basketball coaches. The deals between the University of Alabama and Nick Saban (on the football side) and the University of Kentucky and John Calipari (on the basketball side), each for approximately $32 million over

CHARITABLE ASSETS: CRIMES AND PUNISHMENTS 3 (2004 conference materials), http://www1.law.nyu.edu/ncpl/pdfs/2004/Conf2004_Dale_DRAFT.pdf.

45. *See* 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."); HILL & MANCINO, *supra* note 21, ¶ 4.03; HOPKINS, *supra* note 21, § 19.1.

46. HILL & MANCINO, *supra* note 21, ¶ 4.03[5][a].

47. See, for example, HILL & MANCINO, *supra* note 21, ¶ 4.03[7], for a convenient list of, and case citations for, common inurement transactions beyond paying excessive compensation.

48. *See, e.g.*, FISHMAN & SCHWARZ, *supra* note 21 at 246–47.

49. *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). Section 4958 provides for excise taxes on an "excess benefit transaction," defined as a transaction in which "the value of the economic benefit provided exceeds the value of the consideration . . . received." I.R.C. § 4958(c). This is the § 4958 analog to the "siphoning off" concept in private inurement. *See id.*; HILL & MANCINO, *supra* note 21, ¶ 4.03. Excess benefit transactions can occur only between an exempt organization and a "disqualified person," defined as a person who, during the preceding five years, was "in a position to exercise substantial influence over the affairs of the organization." I.R.C. § 4958(f).

50. The legislative history indicates that the excise tax sanction would be used exclusively unless the violations were so egregious as to call into question an organization's charitable purpose. *See* H.R. REP. NO. 104-506, at 59 n.15 (1996). In 2008, the IRS finalized regulations under § 4958 that detail when the agency might still invoke revocation of exemption as an inurement sanction. T.D. 9390, 2008-18 I.R.B. 855 (codified at Treas. Reg. § 1.501(c)(3)-1(f) (as amended in 2008)).

eight years,[51] are perhaps the most visible recent examples of this, but the salaries of head coaches for major sports at Division I schools routinely exceed those of even the most experienced faculty and the highest levels of university administration.[52] The discomfort with these rising salaries was evident in Chairman Thomas's letter to the NCAA,[53] and has been part of the fodder for press and blog commentary on the subject.[54]

The law, however, does not support the popular angst. The regulations under § 4958 make abundantly clear that (1) reasonable compensation is determined based upon an employee's entire compensation package[55] and that (2) the "reasonableness" of compensation is measured by what the market is paying for similar services *including the for-profit market*.[56] Thus, whether Nick Saban's and John Calipari's salaries are "reasonable" depends not only on the market for other Division I coaching jobs at similar high-profile football and basketball programs, but also on what NFL and NBA coaches make.[57] Saban's salary is hardly out of

51. *See supra* text accompanying notes 7–8.

52. *See, e.g.*, FISHMAN & SCHWARZ, *supra* note 21, at 234 ("At several major universities, employees other than the president, such as football and basketball coaches . . . are the highest paid.").

53. *Thomas Letter*, *supra* note 1, at 2 (question 2), 7 (question 11).

54. *See, e.g.*, Will, *supra* note 3.

55. Treas. Reg. § 53.4958-4(b)(1)(ii)(B) (2002) ("[C]ompensation for purposes of determining reasonableness under section 4958 includes *all economic benefits* provided by an applicable tax-exempt organization in exchange for the performance of services." (emphasis added)).

56. *Id.* § 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) . . . ."). The House Report on § 4958 also confirms that "reasonableness" should be measured by a comparison to both the for-profit and nonprofit markets. 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.").

57. Although one can argue that the job responsibilities of a Division I college football head coach and an NFL head coach are somewhat different, there are enough similarities in duties that NFL salaries likely would be probative comparisons. The fact that coaches often move from the college ranks to the pro ranks and vice-versa (as in Saban's case) is additional evidence that the pro market is a useful comparison for reasonable salaries. In fact, the most recent confirmation of this was the Orlando Magic's hiring of Billy Donovan, the head basketball coach of the University of Florida. Though Donovan ultimately changed his mind about taking the Magic job and returned to the University of Florida, the *Orlando Sentinel* reported that Donovan's new contract would have paid him an average of $5.5 million per season, about $2.5 million more than what he stood to make at Florida. *See* Brian Schmitz, *How Magic Pulled Shocker*, ORLANDO SENTINEL, June 1, 2007, at A1; *see also* Associated Press, *Very Apologetic Donovan Returns to Florida*, MSNBC.COM, June 7, 2007, http://nbcsports.msnbc.com/id/18965269/ns/sports-college_basketball/.

The general standard for "reasonable compensation" under § 4958 is the same as the standard of comparison in § 162. Treas. Reg. § 53.4958-4(b)(1)(ii)(A); *see also* 4A BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 100.4 (2d ed. 1992); HILL & MANCINO, *supra* note 21, ¶ 4.03[6][b] (listing twelve factors from the *Internal Revenue Manual* that the IRS and courts consider in § 162 cases, including the "[e]mployee's contribution to profit-making," "[t]ime devoted by employee to the business," and "[c]haracter and amount of responsibility of the employee" (citing I.R.M. 4233, § 232.2)). *See generally* 1 BITTKER & LOKKEN, *supra*, ¶ 22.2.2 (3d ed. 1999) (listing the same reasonableness criteria as the *Internal Revenue Manual* and discussing each in depth). While courts have not determined which reasonableness factors are more important than others, *see id*., the Tax Court has noted that "[p]erhaps the most significant factor in passing upon the reasonableness of compensation in a tax case is a comparison between the compensation that is under consideration and the prevailing rates of compensation paid to the holders of comparable positions by comparable companies within the same industry." HILL & MANCINO, *supra* note 21, bounds under these comparisons: at the time Saban signed his contract with Alabama, Oklahoma's Bob Stoops was paid about $3.4 million per year,[58] eight other college football coaches made in excess of $2 million per year,[59] and several NFL coaches were paid over $5 million per year.[60] Similar data exist with respect to basketball.[61] Accordingly, current law simply does not support the argument that escalating coaches' salaries are an exemption problem.[62]

2. *Private Benefit*

Since at least the mid-1970s, the IRS has taken the position that an organization can lose its exemption if, as a result of serving its charitable class, it confers an excessive benefit (usually, but not necessarily, a *financial* benefit) on parties outside of the charitable class. The primary differences between the § 4958 private inurement concept discussed above and private benefit are that the private benefit doctrine (1) can apply to transactions with "outsiders" (that is, independent parties who have no influence over the charity), and (2) can apply even to transactions entered into at fair market value.[63]

For example, in the key court decision establishing the private benefit doctrine, *American Campaign Academy v. Commissioner*,[64] the Tax Court held that an organization that trained individuals to run political campaigns could not be exempt as an educational organization (despite the fact that it quite clearly was involved in educating individual students) because most of the students of the Academy ultimately went to

¶ 4.03[6][b] (quoting John Marshall Law Sch. v. United States, 81-2 U.S. Tax Cas. (CCH) ¶ 9514 (Ct. Cl. Trial Div.), *aff'd*, 228 Ct. Cl. 902 (1981)).

58. Associated Press, *Saban's $4 Million Salary Raises Questions*, MSNBC.COM, Jan. 4, 2007, http://www.msnbc.msn.com/id/16472828/.

59. USA Today, Compensation for Div. I-A College Football Coaches, http://www.usatoday.com/sports/graphics/coaches_contracts/flash.htm (last visited Nov. 10, 2009).

60. Saban actually took a *pay cut* from his $4.5 million annual salary as the head coach of the NFL Miami Dolphins in order to take the Alabama job. Associated Press, *supra* note 58. NFL coach salary data is harder to come by, but one story pegged Mike Holmgren's salary at $7 million and Mike Shanahan's and Joe Gibbs's salaries at $5 million per year. 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.

61. An article in the *Gaston Gazette* in 2007 reported that salaries of the top ten NBA coaches ranged from over $10 million per year for Phil Jackson (L.A. Lakers) to a paltry $4.4 million for Mike Dunleavy (L.A. Clippers). Even the lowest-paid NBA coach at the time of the survey made $1.6 million per year (Sam Mitchell, Toronto). Richard Walker, *Phil Paid Top Dollar Yet Again*, GASTON GAZETTE, Feb. 16, 2007, at 5C.

62. Whether "reasonableness" for salaries paid by tax-exempt organizations *should* be measured in relation to for-profit salaries of course is a different question and one hotly debated in the nonprofit community. *See generally* FISHMAN & SCHWARZ, *supra* note 21, at 232–37. In 2004, the Senate Finance Committee produced a "discussion draft" of potential reforms for the nonprofit sector that included a proposal to cap board and executive compensation. *Id.* at 236–37. These proposals were opposed by many in the nonprofit community, and ultimately were not enacted into law.

63. *See* Colombo, *supra* note 21, at 1067–73 (comparing the private inurement and private benefit doctrines).

64. 92 T.C. 1053 (1989).

work for Republican candidates and because the curriculum and faculty were largely drawn from programs that previously had been conducted directly by the Republican Party.[65] Hence, the close connections between the school and the Republican Party resulted in excessive "secondary" benefits accruing to the Republican Party, which was not a part of the charitable class served by the organization, even though there was no evidence that the Republican Party somehow "siphoned off" money from the Academy and even though the Republican Party would not be considered an "insider" under traditional private inurement concepts.[66]

In another case, Judge Posner of the Seventh Circuit opined that if a charitable organization and a for-profit service provider enter into a "bad deal" that provides excessive benefits to that service provider at the expense of the organization's charitable mission, such a transaction might raise private benefit issues even though the contract was negotiated at arm's length and the service provider had no prior relationship with the charity.[67] Similarly, the IRS has a long history of challenging transactions in which a charity enters into a joint venture with private investors, such as a hospital forming a joint venture with doctors to provide outpatient services, on private benefit grounds.[68] More recently, the IRS has used private benefit to attack exemption for credit-counseling agencies[69] and down-payment assistance programs,[70] again in circumstances where transactions did not involve insiders or "siphoning off."

Unfortunately (or perhaps fortunately, depending on your viewpoint), pinning down the exact doctrinal scope of the private benefit prohibition is exceedingly difficult. The doctrine itself does not appear anywhere in the statute; instead, it comes from IRS and court interpretations of Treasury Regulation § 1.501(c)(3)-1(d)(1)(ii), which provides:

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65. *Id.* at 1078–79.

66. *Id*. at 1073–79. For a more thorough discussion of this case and its effect on private benefit doctrine, see Colombo, *supra* note 21, at 1073–74.

67. United Cancer Council v. Comm'r, 165 F.3d 1173, 1176, 1179–80 (7th Cir. 1999). The private benefit issue was not directly addressed in the case, which was actually about private inurement; rather, Judge Posner hypothesized at the very end of his opinion that private benefit might be an available remedy to the IRS even though he ruled that private inurement did not exist. *Id*. at 1179–80. The "bad deal" in this case was a contract with an outside fund-raiser, under the terms of which the charity received less than 10 percent of the money raised ($2.3 million out of $28.8 million). *Id.* at 1175. Because the contract between the charity and fund-raiser was negotiated at arm's length with no prior relationship between the two, Judge Posner found that the private inurement doctrine was inapplicable to this situation. *Id.* at 1178. But he suggested that if the contract was found on remand to be so one-sided that entering into it was effectively a breach of fiduciary duties of the charity's board, the private benefit doctrine could be used to attack the transaction. *Id.* at 1180. The case was settled on remand, however, and the private benefit issue was never tried. For further discussion, see Colombo, *supra* note 21, at 1076–77.

68. *See, e.g*., I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991), 1991 GCM LEXIS 39, at *39–47 (holding that "revenue stream" joint venture arrangements between doctors and a hospital for outpatient services violated private benefit doctrine); *see also* Colombo, *supra* note 21, at 1071–75.

69. *See* I.R.S. Chief Couns. Mem. 200431023 (July 30, 2004), at 20, http://www.irs.gov/pub/irs-wd/0431023.pdf.

70. Rev. Rul. 2006-27, 2006-21 I.R.B. 915.

> An organization is not [qualified for exemption] unless it serves a public rather than a private interest. Thus, . . . 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.[71]

The most detailed statement of the doctrine comes from an IRS General Counsel's Memorandum issued in 1987, in which the IRS 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 accomplished only by 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.[72]

This statement of private benefit is a quintessential balancing test in which the benefits to private individuals or organizations as a result of a particular activity must be weighed against the charitable benefits the activity produces. If a transaction appears to be structured in a manner that excessively favors private interests, it is objectionable even though it also serves the charitable class. For example, in another General Counsel's Memorandum from 1991, the IRS opined that certain joint ventures between an exempt hospital and doctors that were designed primarily to give doctors a financial stake in certain outpatient procedures violated the private benefit doctrine because the direct and substantial financial benefit to the participating doctors could not be justified as "incidental" to the hospital's mission of providing health services to the community.[73] According to the Service, "Obtaining referrals or avoiding new competition may improve the competitive position of an individual hospital, but that is not necessarily the same as benefitting its community."[74] The Service, however, indicated in a later part of the Memorandum that if a joint venture was needed to expand health care resources in the area, create a new provider, reduce treatment costs, or provide new treatment modalities, then the arrangement might pass muster.[75]

71. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2008).

72. I.R.S. Gen. Couns. Mem. 39,598 (Jan. 23, 1987), 1987 GCM LEXIS 2, at *14–16 (citations omitted).

73. *See* I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991), 1991 GCM LEXIS 39, at *30–47.

74. *Id*. at *36.

75. *Id*. at *67 ("We recognize that there may well be legitimate purposes for joint ventures, whether analyzed under the anti-kickback statute or the tax Code. These may include raising needed

In theory, the private benefit doctrine could be used to attack the exempt status of universities and the NCAA on the grounds that modern Division I football and basketball programs provide excessive private benefit to television networks and the professional sports leagues in comparison to the educational benefits provided to the charitable class (i.e., the participating student-athletes). The television networks that broadcast college athletics certainly benefit by making profits from these programs, even though they are paying rights fees for doing so.[76] And professional football and basketball benefit from avoiding the costs that would be associated with "minor league" development programs such as those funded by Major League Baseball. As to the former, the fact that the television rights fees are negotiated at arm's length is not a bar to the IRS's assertion of the private benefit doctrine; indeed, the IRS has applied the doctrine in many cases (particularly joint venture arrangements) where it conceded that the transaction was at arm's length and fair market value.[77] As for the benefits to the professional sports leagues, one can imagine an argument in the vein of the *American Campaign Academy* case, urging that the "secondary" benefits of Division I football and basketball in the form of a pipeline of trained athletes for the pros outweigh any incremental educational benefits that these athletic programs produce for the charitable class (the student-athletes)—e.g., do athletes need to appear on national or regional television in order to capture whatever educational benefits accrue from team sports?

Though this argument seems plausible given the extraordinarily broad scope of the private benefit doctrine,[78] the IRS certainly has never shown any inclination to apply the doctrine in this manner. Not even Chairman Thomas's letter to the NCAA suggests a private benefit as an

capital; bringing new services or a new provider to a hospital's community; sharing the risk inherent in a new activity, or pooling diverse areas of expertise.").

76. Remember, the IRS has applied the private benefit doctrine even where transactions were negotiated at arm's length with "outsiders." *See supra* notes 63–70 and accompanying text.

77. For example, in I.R.S. General Counsel Memorandum 39,862, discussed in the text at note 73, *supra*, the IRS assumed that the joint ventures involved fair market value exchanges. I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991), 1991 GCM LEXIS 39, at *2 ("X-Corp represented that the purchase price for the revenue stream was established at fair market value after arm's length negotiations, and was properly discounted to present value."). Similarly, the IRS has applied the private benefit doctrine to prohibit a nonprofit hospital from entering into a "whole hospital" joint venture with a for-profit health care provider unless the nonprofit organization remains in control of the resulting venture, despite the fact that these transactions are negotiated at arm's length and involve fair market value exchanges. *See, e.g.*, Rev. Rul. 98-15, 1998-1 C.B. 718. This all may sound very strange (perhaps even "crazy") to those not steeped in tax exemption doctrine, but in the immortal words of Dave Barry, "I am not making this up." I have suggested in a recent article that the private benefit doctrine as it currently exists grants far too much discretion to the IRS, and that the doctrine should be limited to certain specific transactions that involve "wasting" charitable assets. Colombo, *supra* note 21, at 1065–66. This Section, however, deals with what the law *is*, not what it *should be*.

78. I should disclose that I have argued strongly against the breadth of the doctrine. *See* Colombo, *supra* note 21, at 1080 (noting that "the doctrine currently has no theoretical grounding to set its outer boundaries"). As a result, my assessment of the strength of a private benefit argument is not unbiased.

issue in college athletics.[79] Moreover, unlike the taxpayer in *American Campaign Academy*, the NCAA can legitimately argue that it tries to keep its distance, and tries to distance college athletes from the pro leagues; witness the rule that an athlete who enters the pro draft with an agent is no longer eligible to play at the collegiate level.[80] In addition, unlike the Campaign Academy, the NCAA was not started by the professional sports leagues as a means of sloughing off their training costs to an exempt organization. As for the television contracts, the NCAA seems on solid ground in claiming that it did not in some way "give away the store" in these contracts, and thus whatever profits the networks make on the contracts are truly incidental to maximizing the value to the NCAA and member institutions (which value is used to expand athletic opportunities for students). Absent evidence that the NCAA or universities negligently or intentionally "underpriced" their product to give a bigger profit margin to the networks (à la Judge Posner's argument discussed above),[81] a successful private benefit argument seems highly unlikely.

3. Commercial Activity

The third limitation on exemption that might be brought to bear on the NCAA and universities running Division I football and basketball programs centers on the "commerciality limitation," as those of us in the tax exemption field sometimes refer to it.[82] To summarize, the commerciality limitation refers to the fact that when charities run significant commercial businesses, they risk losing their tax exemption, even if they also have significant charitable activities. Note that the commerciality limitation is different from (though related to) the UBIT: the UBIT taxes certain commercial enterprises carried on by charities while still leaving

79. *See Thomas Letter*, *supra* note 1.

80. NCAA Bylaw 12.1.2, addressing "Amateur Status," states that "[a]n individual loses amateur status and thus shall not be eligible for intercollegiate competition in a particular sport if the individual: . . . (f) [a]fter initial full-time collegiate enrollment, enters into a professional draft; or (g) [e]nters into an agreement with an agent." NCAA, 2009-10 NCAA DIVISION I MANUAL, BYLAW 12.1.2 (Aug. 1, 2009), http://www.ncaapublications.com/Uploads/PDF/D1_Manual9d74a0b2-d10d-4587-8902-b0c781e128ae.pdf (citations omitted).

Recent activities by the NCAA, however, indicate that the "wall" between the NCAA and the pro sports leagues may be breaking down. A report in the *Sports Business Journal* in 2008 details a historic $50 million partnership between the NCAA and NBA to improve youth basketball training and programs. John Lombardo & Ross Nethery, *NBA, NCAA Team Up for 'Historic Deal,'* SPORTSBUSINESS J., Apr. 7, 2008, http://www.sportsbusinessjournal.com/article/58587. One wonders if the NBA sees this partnership as a way to reduce long-term training costs via the participation of the NCAA, a situation that might be more akin to *American Campaign Academy*. Still, it is unlikely that the IRS would try to make a private benefit argument with regard to a program aimed at training young athletes; if a stand-alone entity engaged in such an activity, it would undoubtedly qualify for tax exemption under § 501(c)(3). *See supra* text accompanying notes 36–42 (noting that the IRS has always considered "educating" young athletes in a particular sport as a charitable activity).

81. *See, e.g.*, Colombo, *supra* note 21, at 1084–85.

82. *See, e.g.*, FISHMAN & SCHWARZ, *supra* note 21, at 355–57; Colombo, *supra* note 22, at 491.

exempt status intact for the entity in question; the commerciality limitation, on the other hand, withdraws exempt status completely (which means that all income of the entity, including passive income from stocks and bonds, is taxed).

The commerciality limitation is part of the interpretation of the Treasury Regulations regarding the operational test for exemption. As noted in Part II, although the statute states that an organization will qualify for exemption only if it is "organized and operated exclusively" for a charitable purpose, the statute has never been interpreted literally.[83] As far back as 1924, the Supreme Court held that incidental sales of wine and chocolate by a religious order would not adversely affect its charitable tax exemption.[84] The current regulations recognize this elasticity in the test for exemption by noting that "[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages *primarily* in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)."[85] The next sentence of the regulations, however, warns, "An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[86]

The most common application of this regulatory language comes when a charity operates a commercial business. A commercial business generally is not itself charitable;[87] hence the key questions that arise from an exemption standpoint are whether the business is "substantial" and, if so, whether it is "in furtherance of" an exempt purpose.[88] If a business is insubstantial, it will not affect exemption per the last line of the quoted regulations. If a business is substantial, then it must be "in furtherance of" an exempt purpose or else exemption is at risk.

Unfortunately, neither the IRS nor the courts have provided very clear guidance on what constitutes a "substantial" business or when an activity is "in furtherance of" an exempt purpose. What evidence exists

83. I.R.C. § 503(c)(3) (2006); *see also supra* note 17.

84. Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas, 263 U.S. 578, 582 (1924).

85. Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 2008) (original emphasis removed) (emphasis added).

86. *Id*.

87. I use the word "generally" here because some commercial businesses are, in fact, charitable. Nonprofit hospitals, for example, are generally tax-exempt under § 501(c)(3) despite the fact that they essentially run a commercial enterprise of charging fees to patients for health care services. *See* Rev. Rul. 69-545, 1969-2 C.B. 117 (recognizing that the promotion of health for the general benefit of the community is a charitable purpose, even if the hospital excludes indigent patients). At least one court has held that a religious publisher was exempt, notwithstanding the fact that its operations were essentially indistinguishable from commercial publishers. Presbyterian & Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 158–59 (3d Cir. 1984). Another common example is a low-income housing development, often done through a limited partnership in which the sole general partner is a § 501(c)(3) entity. *See* FISHMAN & SCHWARZ, *supra* note 21, at 137 (discussing IRS standards for exempting low-income housing projects). For further discussion of ways in which exempt charities carry on noncommercial charitable missions, see Colombo, *supra* note 22, at 525–26.

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

on the "substantiality" question seems to measure it by both traditional indicators of size (e.g., the amount of revenues and/or expenditures as compared to other revenues/expenditures of the organization, the number of employees involved, and so forth)[89] and perhaps its substantive importance to the organization.[90]

The interpretation of "in furtherance of" is even more muddled. The key issue with this language is whether "in furtherance of" means that the activity must be functionally related to one's exempt purpose (that is, the equivalent of being "substantially related" for UBIT purposes) or whether "in furtherance of" encompasses a situation in which a business produces revenue to support other charitable activities.[91]

In order to understand the difficulties of interpreting the "in furtherance of" phrase, we must return for a moment to the history of the UBIT. As noted in Part II.B., Congress enacted the UBIT to make clear that business activity would be taxed if the activity were "unrelated" to an organization's underlying charitable activities, even if the income from that business was used to expand charitable services. Thus the income from Mueller Macaroni would be subject to the corporate income tax despite the fact that the company's revenues were used to support the New York University School of Law, because manufacturing macaroni is not functionally related to providing higher education to students.[92] In contrast, having a performing arts center that brings in professional acts and charges admission for those acts could be seen as directly promoting public appreciation of the performing arts, and therefore would be functionally related to a university's educational mission.[93]

Unfortunately, in enacting the UBIT, Congress said nothing about the effects of operating a commercial business *on the underlying exempt status* of a charity. That is, the UBIT declared that commercial profits would be taxable in certain circumstances, but the UBIT did not address whether (and if so, when) running a commercial business would cause an

89. For example, the regulations state that whether the operation of an unrelated business is a primary purpose of an organization is measured in part by "the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes." *Id.* § 1.501(c)(3)-1(e). *See* FISHMAN & SCHWARZ, *supra* note 21, at 357 (suggesting that practitioners use a "50 percent of total revenue" benchmark for "substantiality"). In *Goldsboro Art League, Inc. v. Commissioner*, the Tax Court rejected the IRS's argument that exemption should be denied to Goldsboro because it operated two art galleries at which it sold art to the public (a "commercial" activity) in part because of the minor amount of money involved (gross receipts never exceeded $6,500 per year, and profits were negligible). *See* 75 T.C. 337, 341–42 (1980).

90. *See, e.g.*, Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 855–56 (10th Cir. 1972) (opining that the "no substantial part" test for the lobbying limitation is not purely a mathematical assessment but rather a balancing test that measures how important lobbying is to the underlying objectives of the organization).

91. *See* FISHMAN & SCHWARZ, *supra* note 21, at 356–57; John D. Colombo, *Reforming Internal Revenue Code Provisions on Commercial Activity by Charities*, 76 FORDHAM L. REV. 667, 671–72 (2007).

92. C. F. Mueller Co. v. Comm'r, 190 F.2d 120, 121 (3d Cir. 1951).

93. Treas. Reg. § 1.513-1(d)(4)(iv) ex. 2 (as amended in 1983).

organization to lose tax exemption completely. Indeed, one could interpret enacting the UBIT as strong evidence that running a commercial business should *not* affect exemption, because Congress chose to tax unrelated business profits rather than withdraw exemption from organizations running unrelated businesses. The current regulations under § 501(c)(3), adopted in 1959, reflect this uncertainty. Regulation § 1.501(c)(3)-1(c)(1) tells us that activities must be insubstantial if they are not "in furtherance of" an exempt purpose.[94] Two subsections later, Regulation § 1.501(c)(3)-1(e) states that a charity can be exempt even if "it operates a trade or business as a *substantial part* of its activities, 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."[95]

Thus the key question in interpreting the commerciality limitation would appear to be what the phrase "in furtherance of" means. The legal history surrounding this language offers two possibilities. The first is that "in furtherance of" means essentially the same thing as "substantially related" in the UBIT: that is, an activity is "in furtherance of" if it functionally advances the charitable mission.[96] So, for example, if the Chicago Symphony Orchestra (CSO) reaps profits from the sale of recordings, those profits generally would be considered "substantially related" because the sale of recordings advances the charitable mission of "spreading the word" to the public about symphonic music. On the other hand, if the CSO opens a Starbucks in Symphony Hall, profits from the Starbucks presumably are not "substantially related" to its charitable mission of providing symphonic music to the public. Accordingly, if "in furtherance of" requires a commercial activity to be functionally related to an organization's charitable purpose, the CSO in this case presumably would lose tax-exempt status completely (if the Starbucks is also "substantial" activity).

On the other hand, one might argue that Congress's enactment of the UBIT in 1950 did not overturn the "destination of income" principle *as it relates to underlying exempt status*. Under this view, a commercial business would be "in furtherance of" an exempt purpose if the profits from that business were used to support charitable activities. Note that the business might still be taxed under the UBIT because it is "unrelated," but as long as the profits from the business were used to support charitable outputs, the operation of the business would not endanger the underlying exemption. Put another way, per the UBIT a charity cannot escape paying tax on the net revenues of a commercial business simply because it uses those revenues for charitable purposes; however, a chari-

94. *Id.* § 1.501(c)(3)-1(c)(1).
95. *Id.* § 1.501(c)(3)-1(e) (emphasis added).
96. *See supra* note 27 and accompanying text.

ty *can avoid losing its exemption completely* by showing that those revenues are used for charitable purposes.

Despite my strong views that this latter interpretation is the correct one,[97] IRS rulings and court decisions shed little light on the proper interpretation of "in furtherance of," and in fact do much to obfuscate the meaning of that section. For example, a number of court cases have held that a charity risks its exempt status if it conducts substantial activities with a "commercial hue"—that is, the activity is one that competes with commercial providers, is priced similarly to how a for-profit would price the same service or sale of goods, and in fact produces significant profits.[98] On the other hand, some IRS rulings have indicated that a charity can operate a significant commercial business without risking its exemption as long as the profits of that business are used to expand charitable outputs—what has become known as the "commensurate-in-scope" test.[99]

97. *See* John D. Colombo, *Regulating Commercial Activity by Exempt Charities: Resurrecting the Commensurate-in-Scope Doctrine*, 39 EXEMPT ORG. TAX REV. 341, 346 (2003); Colombo, *supra* note 91, at 672.

98. *See, e.g.*, Presbyterian & Reformed Publ'g Co. v. Comm'r, 743 F.2d 148 (3d Cir. 1984). In reversing the Tax Court, the Third Circuit nevertheless seemed to approve in general of the Tax Court's "commercial hue" analysis:

> Where a nonexempt purpose is not an expressed goal, courts have focused on the manner in which activities themselves are carried on, implicitly reasoning that an end can be inferred from the chosen means. 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.

Id. at 155 (quoting Presbyterian & Reformed Publ'g Co. v. Comm'r, 79 T.C. 1070, 1083–85 (1982)). *See also* Living Faith, Inc. v. Comm'r, 950 F.2d 365, 373–74 (7th Cir. 1991) (applying commercial hue analysis to health foods store affiliated with the Seventh Day Adventist church). *See generally* Colombo, *supra* note 22, at 501–04 (discussing revival of commerciality doctrine and how courts have inconsistently applied commercial hue analysis). The Third Circuit's statement in *Presbyterian & Reformed Publishing Co.*, however, fails to recognize that even substantial commercial activity is consistent with exemption *if* the commercial activity is "in furtherance of" an exempt purpose.

99. In Rev. Rul. 64-182, 1964-1 C.B. 186, the IRS considered a case in which an exempt organization derived its revenues largely from renting space in a commercial office building, but used its revenues to make grants to other charitable entities. Concluding that the rental activity was "unrelated" for purposes of the UBIT, the IRS nevertheless ruled that the organization was entitled to retain its exempt status as an organization described under § 501(c)(3) because it was carrying on a charitable program "commensurate in scope" with its financial resources. *Id.* In 1971, the IRS General Counsel's office reiterated the "commensurate-in-scope" analysis, stating:

> [A]side from express statutory limitations on business activity, such as section 502 and the newly enacted provisions relating to private foundations, there is no quantitative limitation on the "amount" of unrelated business an organization may engage in under section 501(c)(3), other than that implicit in the fundamental requirement of charity law that charity properties must be administered exclusively in the beneficial interest of the charitable purpose to which the property is dedicated.
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> . . . .
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> . . . [F]or some time now it has been increasingly apparent that our earlier approach to the problem of permissibility or nonpermissibility of business activities of charities has been based on a misconception that somehow in the enactment of the provisions for exemptions of charities from income tax, Congress intended an implied restriction on the extent of their engagement in business activities. In the years past, the Service sought by ruling and by litigation to deny the right of charities to engage in business, insisting that somewhere, somehow in the enactment of the exemption provisions Congress must have intended to limit the classification of exempt charities to those charities not engaging to any substantial extent in commercial endeavors.

So, the next question is, what does all this have to do with Division I athletics and the NCAA? The answer is as follows. If Division I football and basketball have really become primarily commercial entertainment activities, then the operation of these commercial businesses potentially could affect the exempt status of the NCAA (and universities undertaking these activities) if (1) the activities are considered "substantial," and (2) the activities are not "in furtherance of" an exempt purpose. How this analysis would come out is unclear, although there are substantial hurdles to attacking either the NCAA's or universities' tax exemption in this manner.

The "substantiality" part is probably easy: Division I football and basketball programs are pretty clearly "substantial" under any definition of the word. For the NCAA, the Division I men's basketball tournament television revenues are the bulk of its budget;[100] for individual universities, football and basketball programs often involve tens of millions in revenues and expenditures, employ dozens if not hundreds of people, and are used by universities as major generators of alumni interest and donations.[101]

The problem is with the "in furtherance of" piece. On the one hand, one could argue that modern Division I football and basketball programs are indeed "imbued with a commercial hue": they compete generally with other entertainment dollars (though perhaps not with professional sports[102]), tickets are certainly priced to earn a profit (and in fact a number of Division I football and basketball programs do have reve-

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> Exhaustive research of legislative history from the earliest enactment of the charitable provisions of our income tax laws fails to provide support for such proposition. To the contrary, the evidence is clear that the first provision for exemption of charities from imposition of tax under the Corporation Excise Tax of 1909, from which the present income tax exemption provisions derive, was accompanied not by any intention to limit exemption to charities not engaged in business, but an intention to assure exemption of certain charities that were engaged in business.

I.R.S. Gen. Couns. Mem. 34,682 (Nov. 17, 1971), 1971 GCM LEXIS 38, at *25–28. More recent applications of the commensurate-in-scope doctrine include rulings approving exemption for an organization that published textbooks for religious schools, even though revenues from the publishing business counted for over half of the organization's total revenues and enjoyed 75 percent profit margins, I.R.S. Tech. Adv. Mem. 96-36-001 (Jan. 4, 1996), 1996 PLR LEXIS 1026; for an organization that helped developmentally disabled children, despite receiving 98 percent of its gross income from bingo games, I.R.S. Tech. Adv. Mem. 97-11-003 (Nov. 8, 1995), 1995 PLR LEXIS 2320; and for an organization formed to give financial assistance to needy women that produced 66 percent of its revenues from the operations of a gift shop and tea room, I.R.S. Priv. Ltr. Rul. 2000-21-056 (Feb. 8, 2000), 2000 PRL LEXIS 562.

100. In its 2006 Form 990, the NCAA reported income of over $512 million from "television rights fees." *Form 990 Filing*, *supra* note 14, pt. VII, l. 93.

101. *See, e.g.*, Robert H. Frank, *Challenging the Myth: A Review of the Links Among College Athletic Success, Student Quality, and Donations*, May 2004, http://www.knightfdn.org/dotAsset/131763.pdf (paper prepared for the Knight Foundation Commission on Intercollegiate Athletics disputing the argument that sports programs strongly impact alumni interest and donations); Welch Suggs, *Big Money in College Sports Flows to the Few*, CHRON. HIGHER EDUC., Oct. 29, 2004, at A46, *available at* http://chronicle.com/weekly/v51/i10/10a04601.htm (detailing how the Big Ten took in $117 million in athletic revenue in 2002–03).

102. The Supreme Court, for example, has suggested in the antitrust context that NCAA football does not compete with professional football. *See* NCAA v. Bd. of Regents, 468 U.S. 85, 101–02 (1984).

nues in excess of expenditures with ticket prices that rival professional alternatives),[103] and both the NCAA and participating universities engage in extensive advertising using commercial advertising methods.[104] Even Myles Brand has been quoted recently stating that college athletics should be run in a more businesslike fashion, as the NCAA promotes (or at least sanctions) the use of college athletes' physical appearance in video games and other commercial ventures.[105] One could also argue that these programs are not functionally related to the educational mission of universities or the promotion of *amateur* athletics by the NCAA. The arguments here would track those made under the UBIT and examined more fully in Part IV below:[106] Division I football and basketball have become largely minor leagues for the pros, they benefit only a tiny proportion of any university's student body, they are actually detrimental to the overall education of the athlete given the amount of time they consume, and so forth.

There are substantial counterarguments, however. Even if one views the "in furtherance of" language in the Treasury Regulations as incorporating a "functionally related" concept, the IRS has consistently ruled over many decades that college athletics are, in fact, functionally related to educational programs of universities.[107] For the IRS to claim otherwise at this stage would require overturning decades of rulings, not to mention court cases approving the IRS position. The arguments regarding the commercialization of college athletics may also be specious; after all, universities spend millions on high-tech laboratories in engineering and hard sciences that benefit only a few graduate students studying under a particular professor. Further, students in the fine arts often put in as much or more practice time as athletes to the equal detri-

103. *See NCAA Response*, *supra* note 2, at 17–18 (reporting that 53 percent of then Division I-A football programs and 28 percent of Division I basketball programs had revenues in excess of expenses in 2004–05).

104. *See* Steve Wieberg & Steve Berkowitz, *NCAA, Colleges Pushing the Envelope with Sport Marketing*, USA TODAY, Apr. 2, 2009, http://www.usatoday.com/sports/college/2009-04-01-marketing-cover_N.htm.

105. *E.g.*, *id.* Although my conclusion in this Section is that the commerciality doctrine does not provide the IRS with much ammunition for attacking the NCAA's exempt status, if the NCAA continues to unabashedly exploit the commercial side of college athletics and continues to issue statements apparently condoning a more commercialized approach to revenue opportunities, the ability of the IRS to use the commerciality doctrine as a potential exemption attack certainly will increase. After all, it doesn't take a rocket scientist to plaster the commercial activity label on college athletics when the NCAA itself is talking about how to better exploit commercial opportunities. Moreover, as the analysis in this Section shows, courts have been more willing to pull exemption from entities based on the "commercial hue" of their primary activities than perhaps the IRS Regulations or rulings warrant. In short, if the NCAA "keeps it up" on the commercial exploitation front, I might well change my conclusion in a year or two, and more importantly, the IRS might find the NCAA a tempting commerciality target.

106. *See infra* text accompanying notes 138–40.

107. *See infra* text accompanying notes 138–46 (discussing the "substantially related" issue under the UBIT).

ment of their broader education, yet no one suggests that we should pull tax exemption from Juilliard.

Moreover, if one accepts the proposition that "in furtherance of" includes a situation in which commercial revenues subsidize charitable outputs (the basis of the IRS's "commensurate-in-scope" rulings), then the case for attacking exemption on commerciality grounds becomes virtually impossible. Both the NCAA and universities conducting Division I football and basketball programs claim that profits from such programs are used to expand opportunities for students (particularly women) in nonrevenue sports as well as provide billions of dollars in scholarship aid.[108] The NCAA itself claims to use profits from the major revenue-producing sports to advance eighty-eight competitions and tournaments in twenty-four different nonrevenue sports.[109] Assuming this is true, the "commensurate-in-scope" analysis outlined above would protect the exempt status of both the NCAA and the universities conducting big-time athletic programs, because profits from the "commercial" activity (men's football and basketball) are being used to subsidize what are clearly charitable activities (nonrevenue sports).

4. *Public Universities*

Unlike private universities and the NCAA, which rely for their federal income tax exemption on Code § 501(c)(3), public universities generally are exempt from federal income tax either under the broad constitutional doctrine of intergovernmental tax immunity,[110] or else under Code § 115, which exempts the income of States or "any political subdivision thereof" derived from "the exercise of any essential governmental function."[111] Accordingly, the § 501(c)(3) doctrines discussed above that

108. *NCAA Response*, *supra* note 2, 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 . . . .").

109. *Id*. at 22 ("In furtherance of its tax-exempt missions, the NCAA sponsors 88 championships in 24 sports.").

110. For an overview of the constitutional doctrine, see RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 13.9 (4th ed. 2007). Professors Rotunda and Nowak opine that the immunity of state government from federal taxation may be vastly narrower than IRS interpretations:

> The principles of federalism, regardless of whether those principles are derived from the structure of the Constitution or the Tenth Amendment, do not restrict the federal power to tax the activities of state and local governments, or persons or entities who deal with those governments, so long as the tax does not discriminate against state and local governments in a way that impairs their sovereignty.

Id.

111. I.R.C. § 115 (2006). Despite what it says, § 115 generally applies only if the organization in question is an entity separate from state government but carrying out essential government functions. If the organization involved is not a separate entity but rather simply a part of state government, the IRS takes the position that § 115 does not apply, but that the organization in question is nevertheless exempt under the general doctrine of intergovernmental tax immunity. *See supra* note 110. Thus whether § 115 applies to a particular public university depends on how the IRS views its organizational structure. *See, e.g.*, Letter from the IRS to the University of Texas System 3 (Mar. 20, 1984),

would apply to the NCAA and private universities probably would not apply to public universities that did not seek exemption under § 501(c)(3)—for example, § 4958, which applies an excise tax to excessive salaries paid by a charitable organization to its management, applies only to organizations exempt under § 501(c)(3).[112] As a result, whatever options the IRS might have for withdrawing exemption from the NCAA and private universities engaged in Division I athletics are even more limited (perhaps virtually nonexistent) when it comes to public universities.

5. *Summary*

The above analysis indicates that withdrawing tax exemption from either the NCAA or the individual universities that conduct Division I football and basketball programs is a near impossibility under current law. Both the NCAA and the universities involved in big-time college athletics have a clear prima facie charitable purpose as educational institutions (and, in the case of the NCAA, advancing amateur athletics). The limitations on exempt status that might conceivably apply to college athletic programs (private inurement/intermediate sanctions, private benefit, and commerciality), moreover, simply do not provide much legal support for withdrawing exemption from the entities involved.

IV. APPLYING THE UBIT TO THE NCAA AND COLLEGE ATHLETICS

Withdrawing tax exemption from the NCAA or universities running high-profile basketball and football programs is not the only tool available to the IRS with respect to taxing revenues from Division I college athletics, however. As noted above, since 1950 the Code has provided that revenues from a regularly carried on trade or business that is not

http://research.uthscsa.edu/osp/forms/UT_IRStaxstatusletter.pdf ("Based on the information submitted, we conclude that section 115 of the Code does not apply to the income of the University System and its component institutions because they are not organizations established separately from the State. . . . [W]e conclude that the University System and its component institutions are not subject to federal income taxation [under the doctrine of intergovernmental immunity] because they are agencies within State's government.").

For a thorough discussion of § 115 and its quirks, see Ellen P. Aprill, *The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Governmental Affiliates*, 23 J. CORP. L. 803 (1998).

112. I.R.C. § 4958 applies by its terms only to "an applicable tax-exempt organization," which in turn refers to an organization exempt under § 501(c)(3) or (c)(4). I.R.C. § 4958(c)(1)(A), (e); *see* Lawrence M. Brauer et al., *An Introduction to I.R.C. 4958 (Intermediate Sanctions)*, in IRS EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM FOR 2002, http://www.irs.gov/pub/irs-tege/eotopich02.pdf.

The one exception may be the private benefit doctrine, discussed in the text at notes 63–81, *supra*. According to Ellen Aprill, the IRS has applied the private benefit concept in determining if an organization qualifies for exemption under § 115. Aprill, *supra* note 111, at 816–17. If, however, the public university is simply considered part of state government and therefore exempt under the general doctrines of intergovernmental tax immunity, even the private benefit doctrine appears inapplicable. *See id*.

"substantially related" to an organization's exempt purpose will be subject to taxation, roughly as though it were carried on in a separate corporate enterprise.[113] Thus even if current legal rules make withdrawal of exempt status from the NCAA or certain universities engaged in Division I football and basketball exceedingly difficult, one might argue that at least the revenues from these programs can and should be taxed under the UBIT.

The landmark legal analysis applying the UBIT to college athletics was written twenty-eight years ago by my colleague, Richard Kaplan.[114] Despite its age, the article's analytical approach and conclusion questioning whether college athletics should be exempt from the UBIT are as valid today as they were in 1980. Nevertheless, developments in both the structure of college athletics and legal precedent demand some updating of Professor Kaplan's work, and reveal that although it is somewhat more plausible for the IRS to apply the UBIT to Division I football and basketball revenues, serious legal hurdles exist. Moreover, even if the UBIT applies to big-time college athletics, it may well be a paper tiger: it is likely that when rigorous cost accounting methods are applied to the revenues and expenses involved, coupled with some perfectly legal creative overhead allocations that data indicate almost certainly are used by charities to offset any income otherwise taxable under the UBIT, no profit will be left that would actually be subject to taxation. Both of these issues are discussed below.

A. The Legal Analysis

As noted in Part II.B., the UBIT applies to tax net income from (1) a trade or business (2) that is regularly carried on, and (3) is not substantially related to the exempt organization's accomplishment of its exempt purpose. For purposes of this analysis, the fragmentation rule permits the IRS to test individual revenue streams (such as football revenues) that might otherwise be viewed as simply a part of an overall business enterprise (e.g., part of a collegiate athletics program).

The first two requirements for applying the UBIT (the trade or business and the "regularly carried on" requirements) are not terribly controversial. "Trade or business" is defined for UBIT purposes as "any activity which is carried on for the production of income from the sale of goods or the performance of services."[115] There is little doubt that most Division I football and basketball programs meet this test; as noted above, the NCAA in its response to Chairman Thomas stated that 53 percent of then Division I-A football programs and 28 percent of Divi-

113. *See* I.R.C. §§ 511–513.

114. Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430 (1980).

115. I.R.C. § 513(c); *see also* Treas. Reg. § 1.513-1(b) (as amended in 1983).

sion I basketball programs have revenues that exceed expenses.[116] But profit in an accounting sense is not strictly necessary; even programs that fail to make a profit would be considered a trade or business if they are carried on "for the production of income," which often is signified by being substantially self-funding (i.e., the program supports itself by generating its own revenue).[117]

"Regularly carried on" generally is measured by comparing the "frequency and continuity" of the activity in question with how the activity is conducted by commercial counterparts.[118] Activities do not have to be conducted throughout the year to be "regularly carried on"; IRS Regulations make clear that "seasonal" activities will be regularly carried on if that is the commercial norm and the exempt organization conducts those activities during a "significant portion of the season."[119] These tests would seem to be met by major college athletics. Both football and basketball are "seasonal" activities that are carried on in a manner that is similar to the commercial (i.e., professional) product. College football games are played once a week from late August through November, with the "Bowl Season" running the last two weeks of December and the first week of January.[120] The NFL plays games once a week beginning in the August "pre-season" through December, with playoffs in January.[121] The two are therefore quite comparable. The college basketball season, on the other hand, is both significantly shorter than the pro season (late November through March for college; early November through early June for pro, including the tournaments/playoffs in both cases) and has significantly fewer games (about thirty or so for college teams, not counting the NCAA playoffs; eighty-two for the pros not counting the playoffs).[122] Still, the analog is close enough (five months versus eight months) and games are conducted with sufficient regularity in the season that the "regularly carried on" requirement almost certainly will be met for this purpose.[123]

One exception may be college football bowl games and tournaments. Though I would argue that the opinion is just flat-out wrong in its

116. *NCAA Response*, *supra* note 2, at 17–18.

117. *See* Kaplan, *supra* note 114, at 1442–43 (discussing "program-generated revenues" in collegiate athletics). Obviously, programs that make no profit have little to worry about even if they are subject to the UBIT, because no tax would be due in any event.

118. Treas. Reg. § 1.513-1(c)(1).

119. *Id.* § 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.").

120. NCAA, http://www.ncaafootball.com (follow hyperlinks under "Schedules" to view respective Division schedules) (last visited Nov. 10, 2009).

121. NFL, Schedules, http://www.nfl.com/schedules#week (last visited Nov. 10, 2009).

122. CBS Sports, NCAA College Basketball, Schedules, http://www.cbssports.com/collegebasketball/schedules (last visited Nov. 10, 2009); NBA, Master Calendar, http://www.nba.com/mastercalendar/masterCalendar.html (last visited Nov. 10, 2009).

123. *See* Kaplan, *supra* note 114, at 1449 (reaching a similar conclusion).

analysis, the Tenth Circuit essentially held in 1990 that the NCAA men's basketball tournament was not "regularly carried on" for purposes of taxing the advertising revenue that resulted from the sales of advertising in the NCAA tournament commemorative programs.[124] The court seemed to compare the NCAA's sale of advertising for its tournament to the sales of advertising by sports magazines such as *Sports Illustrated*, which of course occur year-round, rather than seasonally.[125] The problem is that 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. Though the IRS announced it would not acquiesce in the Tenth Circuit's decision,[126] that case stands as a fairly significant impediment to applying the UBIT to college tournament and bowl game revenues, whether at the NCAA level or the individual college/university level.

Nevertheless, the meat of the UBIT question really is the last requirement: that of being "substantially related." It is on this question that the bulk of the argument ensues. According to the regulations, an activity is "substantially related" to an exempt purpose when the activity has a "causal relationship to the achievement of exempt purposes," other than simply supplying income to use on charitable activities.[127] In other words, the activity must be functionally related to the entity's charitable purpose, not just be a revenue source. Moreover, in applying the "substantially related test," the IRS has generally taken a fairly narrow view of an organization's charitable purpose.

For example, in the case of hospitals, the IRS and courts have defined a hospital's charitable purpose as providing health care *to patients of the hospital*, not providing health care generally (even though the IRS

124. NCAA v. Comm'r, 914 F.2d 1417, 1425–26 (10th Cir. 1990).

125. "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* . . . ." *Id.* at 1425. The court should have read Professor Kaplan's article (which was written well before this case was decided). As he pointed out, though the regulations state that "intermittent" activities that occur infrequently will not be subject to the UBIT, such activities are taxed if they demonstrate "the competitive and promotional efforts typical of commercial endeavors." Kaplan, *supra* note 114, at 1450 (quoting Treas. Reg. § 1.513-l(c)(2)(ii) (1975)). I am hard-pressed to find significant differences in the promotional efforts undertaken by the NCAA for its basketball tournament (and the accompanying commemorative program) and the NFL for the Super Bowl (and its accompanying commemorative program). Both are hyped beyond belief by commercial, cable, and satellite television, as well as the usual talking heads on ESPN and other sports programs. The 2007 NCAA Final Four basketball tournament commemorative program was 104 pages, with advertising from such well-known commercial entities as Cingular, Coca-Cola, Pontiac, DiGiorno, Enterprise Rent-a-Car, The Hartford, Lowe's, State Farm, and Anheuser-Busch; the 2007 Super Bowl commemorative program was 240 pages, with ads by similar well-known commercial entities (Coors, instead of Anheuser-Busch; Pepsi, instead of Coca-Cola; Cadillac, instead of Pontiac; etc.). Both commemorative programs are on file with the author.

126. I.R.S. Action on Decision 1991-15 (July 3, 1991), 1991 AOD LEXIS 50.

127. Treas. Reg. § 1.513-1(d)(2) (as amended in 1983). Again, those not steeped in tax policy (and even those who are) may question why profits from a business activity that are used to expand charitable outputs should be taxed at all. For a not-altogether-satisfying answer, see the discussion of the policies behind the UBIT *infra* text accompanying notes 176–80.

stated in Revenue Ruling 69-545 that "the promotion of health" for the general community is a charitable purpose).[128] Thus the IRS and courts have held that sales of pharmaceuticals by a hospital-owned pharmacy result in unrelated income when the sales are to the general public, but sales to patients are considered "substantially related."[129] Similarly, sales of science books by an art museum gift shop are considered taxable, because they do not advance the museum's mission to educate the public about art, even though the science books almost certainly are educational in a general sense.[130] Sales of art reproductions or even greeting cards with pictures of the museum's collection, on the other hand, are considered substantially related because this activity "stimulat[es] and enhanc[es] public awareness, interest, and appreciation of art."[131] In the college/university setting, the regulations state that a university that invites professional theater groups and symphony orchestras to campus does not have to pay the UBIT on revenues from ticket sales for those events, because "the presentation of such drama and music events contributes importantly to the overall educational and cultural function of the university."[132]

Applying this test to college athletics would result in two different analyses, one for the NCAA and one for colleges engaged in Division I football and/or basketball. Given the IRS's narrow view of an organization's charitable purpose in analyzing unrelated businesses, the NCAA presumably would need to show that the revenues derived from Division I football and basketball (primarily the television rights fees) are "substantially related" to its charitable purpose of *promoting amateur athletics*. With respect to colleges/universities, the analysis would be slightly different. In these cases, the revenues from major college athletics presumably would have to be substantially related *to the education of students*, just as the sales of pharmaceuticals must be related to treating patients in the hospital setting. Moreover, the fact that revenues from these programs support the respective charitable purpose in question is not sufficient to escape the UBIT—in other words, neither the NCAA nor individual universities could claim that the UBIT is inapplicable to Division I sports revenues because these revenues support other athletic programs.[133]

128. Rev. Rul. 69-545, 1969-2 C.B. 117, 118.

129. Carle Found. v. United States, 611 F.2d 1192, 1199–1200 (7th Cir. 1979); Rev. Rul. 68-374, 1968-2 C.B. 242, 243–44.

130. Rev. Rul. 73-105, 1973-1 C.B. 264.

131. Rev. Rul. 73-104, 1973-1 C.B. 263, 264.

132. Treas. Reg. § 1.513-1(d)(4)(iv) ex. 2.

133. Using revenues from an unrelated business to support charitable activities does not exempt the unrelated business itself from taxation. *See supra* note 27 and accompanying text. The fact that revenues are used to support other charitable programs, however, may be a major factor in a charity avoiding a complete loss of tax exemption due to the conduct of a substantial commercial business. See *supra* text accompanying notes 83–99 for a discussion of this point.

How the UBIT analysis comes out in each of these cases is arguable. Critics of big-time college athletics point to the increasing commercialization of these programs as evidence that they are not "amateur" athletics at all, but rather thinly disguised minor leagues for the pros, organized to produce maximum entertainment revenues.[134] Under this view, the NCAA's exploitation of media revenue for these programs hardly advances "amateur" athletics; rather, it is akin to the NCAA deriving revenues from licensing broadcasts for a professional football or basketball team, which almost certainly would be unrelated to the charitable purpose of promoting amateur athletics (remember that the fact the money received may be used for other charitable purposes is irrelevant to the legal analysis).

On the college/university side, the critics also note that Division I football and basketball programs serve only a tiny number of students who essentially are sequestered from the normal academic life of the university,[135] that the practice time involved and the increasing length of

134. *See, e.g.*, KNIGHT FOUND. COMM'N ON INTERCOLLEGIATE ATHLETICS, A CALL TO ACTION: RECONNECTING COLLEGE SPORTS AND HIGHER EDUCATION 13 (2001), http://www.knightcommission.org/images/pdfs/2001_knight_report.pdf [hereinafter *Knight Commission*]. This report states:

> At the heart of these problems is a profound change in the American culture of sports itself. At one time, that culture was defined by colleges, high schools, summer leagues, and countless community recreational programs. Amateurism was a cherished ideal. In such a context, it made sense to regard athletics as an educational undertaking. Young people were taught values ranging from fitness, cooperation, teamwork and perseverance to sportsmanship as moral endeavor.
>
> All of that seems somehow archaic and quaint today. Under the influence of television and the mass media, the ethos of athletics is now professional. The apex of sporting endeavor is defined by professional sports. This fundamental shift now permeates many campuses. Big-time college basketball and football have a professional look and feel—in their arenas and stadiums, their luxury boxes and financing, their uniforms and coaching staffs, and their marketing and administrative structures. In fact, big-time programs have become minor leagues in their own right, increasingly taken into account as part of the professional athletics system.

Id.; *see also* WALTER BYERS WITH CHARLES HAMMER, UNSPORTSMANLIKE CONDUCT: EXPLOITING COLLEGE ATHLETES 346 (1998) ("[T]he NCAA constitutional restriction prevents direct dealings between the commercial, for-profit world and the athlete. This is not about amateurism. This has to do with who controls the negotiations and who gets the money."). *See generally* WILLIAM G. BOWEN & SARAH A. LEVIN, RECLAIMING THE GAME: COLLEGE SPORTS AND EDUCATIONAL VALUES 316–17 (2003) (discussing why reform in amateur athletics has been "difficult to achieve," including television revenues and dreams of "winning big" in each new season); JAMES L. SHULMAN & WILLIAM G. BOWEN, THE GAME OF LIFE: COLLEGE SPORTS AND EDUCATIONAL VALUES 5–18 (2001) (discussing the rise of college sports and the transformation "from student clubs to highly professionalized athletic departments," including the public's interest in sports, the institution of regulations and rules of engagement, and "collective institutionalization" under the NCAA and conferences); Erin Guruli, *Commerciality of Collegiate Sports: Should the IRS Intercept?*, 12 SPORTS L.J. 43 (2005); Amy Christian McCormick & Robert A. McCormick, *The Emperor's New Clothes: Lifting the NCAA's Veil of Amateurism*, 45 SAN DIEGO L. REV. 495 (2008).

135. *See Knight Commission*, *supra* note 134, at 14–15 ("Big-time athletics departments seem to operate with little interest in scholastic matters beyond the narrow issue of individual eligibility. . . . The historic and vital link between playing field and classroom is all but severed in many institutions."); *see also* Kaplan, *supra* note 114, at 1458–59 (discussing the consequences of college athletics that take "a major commitment of the student's time").

the seasons is detrimental to a student's education,[136] and that graduation rates are "abysmal."[137]

The contrary arguments, of course, are that despite the commercialization of big-time college athletics, these programs still involve amateurs, at least to the extent that one defines amateur as a person who does not get paid for his or her athletic performance. Thus the NCAA can legitimately claim that even with their commercial hue, Division I football and basketball involve promotion of "amateur" athletics. Universities would similarly argue that these programs perform an educational function for students, teaching the value of teamwork and how to deal with both success and failure in specific endeavors.[138] Although these programs may benefit a relatively tiny number of students, universities can legitimately respond that many very expensive laboratories maintained on campus directly benefit an even smaller segment of students (typically, the graduate assistants of the professors running the lab). They also point to the "community-creating" benefits, including enhanced contributions from donors (though at least one empirical study finds such benefits elusive, at best).[139] Given that the Treasury Regula-

136. *See Knight Commission*, *supra* note 134, at 27 ("The length of playing, practice and postseasons must be reduced both to afford athletes a realistic opportunity to complete their degrees and to enhance the quality of their collegiate experiences."); Kaplan, *supra* note 114, at 1458–59 (discussing the "dubious" educational practices that universities engage in to ensure their athletes' eligibility); *see also* BOWEN & LEVIN, *supra* note 134, at 280–83 (discussing lengths of the "playing season"—including the "traditional segment," the playing season ending with the NCAA championship; and the "non-traditional segment," the rest of the playing season—and the "off-season," and suggesting such reforms as shortening seasons, controlling what happens in the non-traditional segment, and making working out during the off-season voluntary); SHULMAN & BOWEN, *supra* note 134, at 69–70 (discussing the time commitments made by college athletes and noting that "athletes are spending more time than many of their peers on activity other than classwork" and that even students involved in other "'extracurriculars' finished much higher in the class, on average, than students in general").

137. *Knight Commission*, *supra* note 134, at 15 ("Graduation rates for athletes in football and basketball at the top level remain dismally low . . . . Graduation rates for both were already abysmal."); *see also* BOWEN & LEVIN, *supra* note 134, at 125–27; SHULMAN & BOWEN, *supra* note 134, at 261–62.

138. *See generally* BOWEN & LEVIN, *supra* note 134, at 27–35 (discussing the founding principles and educational values of the Ivy League, New England Small College Athletic Conference (NESCAC), and University Athletic Association (UAA)). For example, NESCAC colleges agreed that one main reason to establish the conference was "*to advance their values*." *Id*. at 31. The NESCAC's founding principles state, "The program in intercollegiate athletics is to be kept in harmony with the essential educational purposes of the institution. . . . Competing players are to be representative of the student body." *Id*. Among the UAA's founding principles is the notion that "athletics is integral to the overall educational process of the institution and should be conducted in a manner consistent with the institution's central academic mission." *Id*. at 35.

Besides the conferences' own principles and values, proponents of college athletics argue that "[p]articipation in varsity sports is also said to prepare young people for leadership roles in later life," and that "strong intercollegiate programs . . . 'build campus spirit and community.'" *Id*. at 244.

139. *See* Frank, *supra* note 101. After discussing previous empirical studies of the link between college athletics and alumni giving, *see id*. at 20–24, Frank concludes:

> The most forceful conclusion that can be drawn about the indirect effects of athletic success is that they are small at best when viewed from the perspective of any individual institution. Alumni donations and applications for admission sometimes rise in the wake of conspicuously successful seasons at a small number of institutions, but such increases are likely to be both small and transitory. More to the point, the empirical literature provides not a shred of evidence to

tions acknowledge that paid-admission performances in the arts are substantially related to student education,[140] consistency would demand similar deference to paid-admission performances in athletics.

Perhaps the biggest impediment to applying the UBIT to Division I football and basketball revenues at this time, however, is the legal precedent involved. These precedents go back as far as the UBIT itself: the House Ways and Means Committee report on the UBIT legislation straightforwardly stated that "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;"[141] later, the same report stated that "income 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."[142] Probably in part because of this legislative history, the IRS has ruled several times in many different contexts that college athletics are an "integral part" of the educational program of a university (and therefore clearly "substantially related" to a university's educational program).[143] Although the IRS briefly considered attempting to tax the revenues from the sale of broadcast rights to college football bowl games in 1977, the Service quickly reversed itself and ultimately issued two formal rulings that such revenues were not subject to the UBIT.[144] Since then, the IRS has basically given up on any attempts to tax revenues associated with college athletic programs, with the exception of revenues that the IRS considered nothing more than payments for advertising, such as "sponsorship" payments that are now

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suggest that an across-the-board cutback in spending on athletics would reduce either donations by alumni or applications by prospective students.

Id. at 33.

140. *See supra* note 132 and accompanying text.

141. H.R. REP. NO. 81-2319, at 37 (1950).

142. *Id*. at 109.

143. *E.g*., Rev. Rul. 67-291, 1967-2 C.B. 184 (finding that an organization that subsidized a "training table" for coaches was tax exempt because the athletic program was an "integral part" of the educational activities of the exempt university in question); Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-296, 1980-2 C.B. 195 (stating that broadcast revenues from college bowl games were not taxable, as "[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"); *see also* NCAA v. Comm'r, 914 F.2d 1417, 1421 (10th Cir. 1990) (challenging only the advertising revenues from the NCAA men's basketball tournament as not subject to the UBIT); Kaplan, *supra* note 114, at 1454–55 (summarizing the differing legal standards between courts' test for whether an activity "'contributes importantly' to a university's educational function" and IRS regulations and rulings that consider "the size and extent of an activity in relation to its claimed educational contributions").

144. Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-296, 1980-2 C.B. 195; *see also supra* note 143. Professor Kaplan gives a more extensive history of this episode, noting that the public Revenue Rulings were preceded by numerous private rulings holding that such revenues were not subject to the UBIT. These private rulings apparently were the result of successful lobbying efforts by Southern Methodist University, Texas Christian University, and the University of Kansas that got the IRS to reverse its intent to treat such revenues as taxable under the UBIT. *See* Kaplan, *supra* note 114, at 1431.

regulated by statute.[145] Whether these precedents are supported by the policy rationales for the UBIT is considered in more detail below,[146] but for the IRS to reverse course and now take the position that big-time college athletic programs are subject to the UBIT would require the agency to overturn almost sixty years of precedents stating just the opposite—a highly unlikely scenario.

B. The Paper Tiger Problem

Even if the IRS chose to ignore the long precedential history and was successful in applying the UBIT to Division I football and basketball revenues, a serious question exists as to whether such a course of action would make any difference to individual institutions and/or accomplish any of the reformers' goals. Put simply, even if the UBIT applied to big-time college athletics revenues, there may be no net revenue to tax after applying normal cost accounting methods to these revenues, including allocating general overhead expenses. Moreover, although subjecting Division I athletics to the UBIT would result in some disclosure regarding the finances of those programs as a result of the required filing of the now-public Form 990-T, the scope of that disclosure would be nowhere near what reformers believe is needed. Again, we should examine this issue for both the NCAA itself and for individual colleges/universities that undertake athletic programs.

With respect to the NCAA, it is unclear whether application of the UBIT would actually result in any tax impact. As noted above, the IRS has the ability under the UBIT to "fragment" revenues for UBIT purposes. Thus the IRS might attempt to apply the UBIT to, say, only the NCAA men's basketball tournament revenues or football licensing revenues. But the NCAA does not keep these revenues; instead, it distributes them to member schools after deducting its expenses. Under standard tax doctrine, the distribution of these revenues to member schools likely would be a deductible business expense (the "fee" that the NCAA must pay to member schools in exchange for the right to market their athletic "product" during the year, akin to a publisher agreeing to pay an author current royalties[147]). The result is that there likely would be little or no "profit" subject to tax under the UBIT even if it applied.

145. In 1991, the IRS issued two Technical Advice Memoranda that held that "sponsorship fees" paid by a business to a college, university, or independent bowl association were taxable because they represented essentially nothing more than payments for advertising. 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. Congress responded to this initiative by amending the UBIT rules to eliminate "corporate sponsorship payments" from UBIT. 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).

146. *See infra* Part V.B.

147. *See* I.R.C. § 162. Although a distribution of profit from a taxable corporation to shareholders is not a deductible business expense, the NCAA's distributions to member schools are essentially

For example, in its 2006 Form 990 (the latest available as of this writing), the NCAA reported total program service revenue of approximately $584 million.[148] While the Form 990 does not break this revenue amount down by sport, it does show that $512 million came from television rights fees and another $66 million from "championships," with the balance from miscellaneous items.[149] One could safely assume that the vast bulk of this revenue, therefore, is generated by Division I football and basketball, probably mostly from the CBS Television contract for the Division I men's basketball tournament. If the UBIT applied to this revenue, however, the NCAA would get to deduct all its regular business expenses directly attributable to the income and an appropriate portion of its overhead in order to determine its taxable income. The NCAA Form 990 shows program service expenses of $548 million, much of which is distributions to member schools.[150] That would leave $36 million in program service revenue, but the NCAA also incurred about $24 million in management/administrative expenses.[151] That means that "net" program service revenue (i.e., the NCAA's operational profit) might be as little as $12 million—a "profit" that could easily be erased completely by simply increasing the distributions to member schools.[152] Thus the likelihood that the NCAA would actually pay any tax under the UBIT is remote; minimal tax planning could easily insure that the NCAA has no net business revenues to tax.

With respect to individual universities operating big-time athletic programs, the picture is similar. Although 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

payments to those schools for the rights to negotiate broadcast contracts, license memorabilia, and so forth on an annual basis, and therefore almost certainly would meet the test of § 162 as an "ordinary and necessary" business expense. Or put another way, the payments to member schools are not a return on members' equity ownership in the NCAA, but payments for the exploitation of property rights owned by those members. Moreover, the NCAA could probably re-arrange its legal relationships with members to make itself essentially an agent collecting a fee for its work, with the underlying payment "owned" by the member institutions. This arrangement would result in only the "fee" being taxable to the NCAA in any event, because only the "fee income" would be "owned" by the NCAA.

148. *Form 990 Filing*, *supra* note 14, pt. I.

149. *Id*. pt. VII, l. 93.

150. *Id*. pt. I, II.

151. *Id*. pt. I. It is likely that not all of this expense reasonably could be allocated to Division I football and basketball revenues; the NCAA conducts many other programs in nonrevenue sports, and therefore at least a portion of this expense must be allocable to those other sports. It is also likely, however, that not all the revenue is attributable to Division I football and basketball (for example, the lower-tier football championship is also shown on television). Moreover, at least some of the expenditures of the NCAA are probably directed almost exclusively at big-time athletics: the infractions enforcement, for example, almost always involves major football or basketball programs. Thus the points in the text should be taken as a rough starting point. What is clear is that whatever taxable income would be left to tax under the UBIT is miniscule in comparison to the revenue stream, and even that remainder could fairly easily be "wiped out" with proper tax planning.

152. The NCAA also reported interest income of $12 million; interest income, however, is not subject to the UBIT. I.R.C. § 512(b)(1).

world. Walter Byers, the former Executive Director of the NCAA, notes:

> The accounting variables in college athletics make it difficult if not impossible to know whether a big-time sport pays for itself, much less whether it generates net receipts to finance the deficit sports. Actual cost accounting, in the sense of a hard-nosed business analysis, isn't done. In past times as today, through university-approved accounting techniques, many big-ticket items are shunted off athletics department budgets to be paid by student fees, donated booster/alumni funds, other departments of the university, or state appropriations. Capital expenditures for buildings or permanent equipment as well as the maintenance and upkeep of facilities may be in the university's overall accounts and current operating budget, with fractional accounting charges to athletics.[153]

James Shulman and William Bowen conclude that if capital costs are properly accounted for, no program would show an actual net profit for accounting purposes: "What can be said with confidence is that taking account of the imbedded capital costs of athletic facilities would surely reverse any appearance of financial 'profit' associated with even the most successful big-time program."[154]

Even if there were some profit left over after properly accounting for the capital costs and other direct costs of operating football and basketball programs, charities in general have shown remarkable ability to "zero out" any net income from unrelated business activities. In 2004, for example, charities exempt under IRC § 501(c)(3) reported *gross income* from unrelated business activities of $5.5 *billion*, but ended up paying only a total of $192 million in tax, an effective rate of about 3.5 percent.[155] A recent story in the *Chronicle of Philanthropy* surveyed ninety-one large charities filing UBIT returns; the authors noted that 51 percent of the charities reported zero or negative taxable income and were able to reduce $419.1 million of gross income into a collective $3 million deficit after allocating deductions and overhead.[156] The NCAA and universities conducting big-time college athletics hardly are less sophisticated, and have even greater opportunities for aggressive cost allocation given the large capital investments and overhead costs of running their athletic programs.

Accordingly, it is highly likely that if the IRS applied the UBIT to individual football or basketball program revenues (either at the NCAA or university level), it would find no net profit from these programs to tax after factoring in depreciation on athletic facilities and a reasonable

153. BYERS WITH HAMMER, *supra* note 134, at 221.

154. SHULMAN & BOWEN, *supra* note 134, at 250.

155. Margaret Riley, *Unrelated Business Income Tax Returns, 2004*, IRS STATISTICS OF INCOME BULLETIN, Winter 2008, at 76, 96.

156. Peter Panepento & Grant Williams, *A Question of Calculation: Many Charity Businesses Manage to Avoid Paying Federal Taxes*, CHRON. PHILANTHROPY, Feb. 7, 2008, at 33, 33.

apportionment of overhead. As a result, I doubt that the general counsel of, say, the University of Michigan would cower much in the face of a threat by the IRS to apply the UBIT to Michigan's football program.

On the other hand, subjecting Division I athletic revenues to the UBIT could have some salutary effect even if no tax is due. At the very least, such an action would be a declaration that these programs no longer serve primarily an educational purpose and hence would publicly embarrass those who maintain that big-time college athletics are an inherent part of the educational enterprise. Bringing these activities within the ambit of the UBIT also would require that the NCAA and participating universities apply rigorous cost accounting methodologies that, from the sources cited above, appear to be lacking today.[157] Moreover, under changes made to the tax laws in 2006, UBIT returns on Form 990-T are subject to public inspection,[158] meaning that the often-impenetrable finances of athletic programs would be subject to some measure of disinfecting light.

Nevertheless, the disclosure available under Form 990-T would hardly be what reformers think is needed. Form 990-T is a classic tax form;[159] reporting would be limited to the overall revenues and expenses from the particular unrelated business activity (football and/or basketball, as opposed to the revenues and expenditures of the athletic department as a whole). Accordingly, the form would not provide data on individual coaches' salaries, what money is paid where, expenditures that are not business expense deductions, or other potential disclosures relating to student-athletes' academic progress. As a result, what would be disclosed in the 990-T is far short of what reformers have called for in other contexts.[160]

Given the legal difficulties explained above in applying the UBIT to college athletics and the fact that whatever disclosure would come from the UBIT route would be very limited in scope, the reform movement is likely to be sorely disappointed by whatever benefits might accrue from a strategy of subjecting big-time college athletics to the UBIT.

V. THEORY, POLICY, AND SOME REGULATORY ALTERNATIVES

The above analysis indicates that current law presents a number of hurdles for the IRS either to revoke (or threaten to revoke) tax exemption for the NCAA and/or colleges and universities engaged in Division I athletics, or to tax Division I football/basketball revenues via the UBIT. Proponents of using the tax laws to better regulate college athletics,

157. *See, e.g.*, BYERS WITH HAMMER, *supra* note 134, at 221.
158. Pension Protection Act of 2006, Pub. L. No. 109-280, § 1225, 120 Stat. 780, 1093 (amending I.R.C. § 6104(d)(1) (2006)); *see also* I.R.S. Notice 2007-45 (May 29, 2007), http://www.irs.gov/pub/irs-drop/n-07-45.pdf.
159. A copy of the form is available from the IRS at http://www.irs.gov/pub/irs-pdf/f990t.pdf
160. See *infra* Part V.C.3 for a discussion of disclosure issues.

therefore, probably need a more nuanced approach than simply asking the IRS to strip tax exemption from the NCAA or to apply the UBIT to university athletic programs because college athletics no longer adheres to the ancient Greek ideal.

The next logical question to ask, therefore, is whether the current law set forth above accurately reflects some core theory or policy concerning tax exemption and the application of the UBIT. Put another way, are the legal impediments to challenging the tax exemption of the NCAA, or the application of the UBIT to athletic program revenues, consistent with the underlying reasons for granting tax exemption in the first place, or applying the UBIT? If so, such a conclusion would suggest that current tax law should be left alone, and those who would attack the tax status of college athletics as a method of furthering reform goals should find a different approach. If not, it suggests that the current tax-favored status of big-time college athletics is an "exception" to normal tax policy relating to nonprofit organizations and we should forthrightly recognize it as such. Concluding that athletics is an exception to general tax theory, moreover, means that the decision to continue tax-favored treatment is simply a public policy question, not a core tax policy issue, and that Congress could easily consider special conditions on continuing tax-favored treatment to advance whatever public policy goals are appropriate without damaging any core tax policies.

This Part of the Article, therefore, proceeds as follows. First it considers whether college athletics should be immune from taxation under various theories of tax exemption and the rationale for the UBIT. This Section concludes that big-time college athletics does *not* fit any of the theoretical explanations for tax exemption and *does* fit within the rationales for applying the UBIT. As a matter of tax theory, therefore, the revenues from these programs (whether at the NCAA or college level) should be taxed. Having concluded that no theoretical or base tax-policy rationale exists to justify excluding college athletic revenues from taxation, the Article then turns to a brief examination of some potential policy responses. While I leave the question of what the exact scope of regulation should be to a future article by experts in college sports law and management, I note that tax law has in the past employed three kinds of regulation that might be peculiarly appropriate to college athletics: (1) requiring revenues from certain athletic programs (e.g., football and basketball) to be spent on specific policy goals, such as other educational or athletic opportunities; (2) imposing expenditure limits, such as salary caps on coaches; and (3) requiring additional disclosure via the Form 990.

A. The Theories of Tax Exemption and College Athletics

The major problem with our system of tax exemption for charities is that there is no clearly defined underlying theory for why we grant tax exemption to the broad range of organizations that claim charitable status.[161] Over the past thirty years, several tax policy experts and tax academics have posited a number of different theories to justify charitable tax exemption. Though each takes a somewhat different overall approach, a common theme of virtually all these theories is that charities supply some sort of good or service, or "way of doing things," that is not replicated in the private market or by government—some kind of public good or quasi-public good that otherwise would not exist.[162] The "good" supplied might be a specific item not available from the private market (e.g., symphonic music) or something as diffuse as a "nonprofit ethic" that takes a different (and presumably unique) approach to providing something that might otherwise be available in the market.[163] For example, a nonprofit hospital might approach patient care in a different manner than a for-profit one, even though the services provided (e.g., a heart bypass) are ultimately the same.

So, for example, the classic "quid pro quo" theory of exemption posits that tax exemption is a rough "quid pro quo" to charities for doing things that otherwise would become the burden of (and paid for by) government.[164] The "community benefit" theory broadens this approach by justifying tax exemption not just for specific items done by charities that the government might otherwise have to pay for, but rather to all sorts of "good things" done by charities that are not otherwise being done by the private market or government directly, or which differ in some significant way from similar services provided by the market or government.[165] Several theories of exemption (the "contract failure" theory of Henry Hansmann,[166] the "risk compensation" theory of Nina Crimm,[167] and the

161. *See, e.g.*, *Overview of the Tax Exempt Sector: Hearing Before the H. Comm. on Ways & Means*, 109th Cong. 57 (2005) (statement of Professor John D. Colombo, University of Illinois College of Law), *available at* http://waysandmeans.house.gov/hearings.asp?formmode=view&id=2604; JOHN D. COLOMBO & MARK A. HALL, THE CHARITABLE TAX EXEMPTION 4 (1995); FISHMAN & SCHWARZ, *supra* note 21, at 75–96 (listing various theories); Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 397–98 (1997).

162. *See* COLOMBO & HALL, *supra* note 161, at 5–6.

163. *Id.*

164. *See id.* (discussing how nonprofits "do good" for society); *id.* at 22–23 (noting the distinction between tax-base and subsidy rationales for charitable tax exemption); FISHMAN & SCHWARZ, *supra* note 21, at 76; Atkinson, *supra* note 161, at 403–04.

165. *See* COLOMBO & HALL, *supra* note 161, at 63; FISHMAN & SCHWARZ, *supra* note 21, at 76; Atkinson, *supra* note 161, at 403–04.

166. *See* Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 72–75 (1981) (proposing an efficiency rationale that suggests charitable tax exemption is a capital subsidy that compensates for nonprofit organizations' struggles to build capital, because of the nondistribution constraint, when nonprofits better serve the public than their for-profit analogs).

"donative theory" that I constructed with Mark Hall[168]) are based explicitly on economic theory, again focusing on the role of charities in supplying goods or services not available in the private market. Several other theories would grant tax exemption essentially as a reward for enhancing our pluralistic society. Thus Rob Atkinson justifies exemption as a reward for altruism, which should be encouraged in its own right;[169] Evelyn Brody opines that exemption is a compromise in which government largely keeps its hands off this "third sovereign" (which is doing things that the "real" sovereign is not);[170] and David Brennen theorizes that exemption should reward diversity in its broadest sense.[171] Finally, one theory (offered by Boris Bittker and George Rahdert) bases exemption on the fact that charitable organizations simply do not fit our normative definitions of the tax base and thus are excluded essentially as a matter of administrative convenience.[172]

Despite the multiplicity of theories justifying tax exemption, big-time college athletics appears to fail under all of them. College athletics is not something one would expect the government to provide in the absence of a private provider; thus there is no legitimate claim by college

167. *See* Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 424–25 (1998) (proposing that "tax exemption is a non-volatile expected return to compensate rational charitable organizations for undertaking the provision of 'inherently risky' public goods and services" and that determining if a nonprofit organization should be tax-exempt "requires taking into account an organization's evolution, the need to maximize inter-generational utility, and the application of dynamic gamesmanship theory").

168. COLOMBO & HALL, *supra* note 161, at 99–113 (explaining that exemption is justified to provide public support to organizations that supply goods or services that are not supplied by the private market or government and that the public desires—as signaled by their significant donations to support these entities).

169. Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 617–19 (1990) (proposing that tax exemption is a reward for altruism—the decision to relinquish profits—and that nonprofit organizations can be tax-exempt even if their income funds consumption by people other than those controlling the organization because "[t]he metabenefit of altruistic production" is a desirable policy goal).

170. Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 585 (1998) ("For all its imprecision, tax exemption keeps government out of the charities' day-to-day businesses, and keeps charities out of the business of petitioning government for subvention."); *see also* Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947, 952–53, 986 (2005) (arguing that the income of charities should not be part of the normative tax base because such income is dedicated to the betterment of the "community" and "the community" itself is not taxable—doing so would be like having the government tax itself, because government exists to improve the welfare of the community).

171. David A. Brennen, *A Diversity Theory of Charitable Tax Exemption—Beyond Efficiency, Through Critical Race Theory, Toward Diversity*, 4 PITT. TAX REV. 1, 23–24 (2006) (discussing the economic and non-economic benefits of tax exemption for nonprofit organizations and noting that "the charitable tax exemption allows for diversity and experimentation that often lead to production of undiscovered values").

172. Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 307–16 (1976) (discussing how traditional income measurement theory under the IRC cannot be applied to nonprofit organizations and how calculating these organizations' net income would be difficult, complicated, and confusing, and that taxing such income would in effect be a tax on the beneficiaries of the organization who are often too poor to pay tax themselves).

athletics to exemption under the traditional quid pro quo approach. The widespread commercialization of Division I football and basketball means that these "goods" almost certainly would be supplied absent exempt status (one cannot imagine that the NCAA men's basketball tournament, which garners $1 billion in television rights fees, would not be supplied in some fashion absent the grant of tax exemption to universities and the NCAA). Thus the economic explanations of exemption offered by Hansmann, Crimm, and Colombo and Hall would not apply because each of them is based on the assumption that neither the government nor the market will supply the goods or services without exemption as an incentive to do so.[173]

One might be able to argue that Division I football and basketball have a unique "ethic" or approach to competition that is available only because these programs operate in the nonprofit environment, thus justifying exemption under the "community benefit" theory or one of the other "pluralism-enhancing" theories such as those offered by Atkinson, Brody, or Brennan. But frankly that argument seems specious. Indeed, one is hard-pressed to identify any significant changes in the structure or operation of big-time football and basketball programs that would be made if they were run via for-profit subsidiaries of the sponsoring universities. For example, one cannot imagine that the salaries for coaches, capital investment in facilities, recruiting costs, advertising costs, racial or economic backgrounds of players, etc., would be substantially different if these programs were unabashedly for-profit as opposed to being run as a "division" of a charitable organization. In addition, these programs hardly fit the classic pluralism ideal or advance diversity in any signifi-

173. One might argue that my own donative theory (which concluded that activities supported in substantial part by donations should be eligible for tax exemption) supports exemption for college athletics because these programs are funded in substantial part by donations from athletic boosters. A wealth of evidence suggests, however, that these so-called donations are largely nothing more than purchases: payments for seating preferences, parking, and special individual perks (such as a seat on the team plane for away games). *See* Brad Wolverton, *Key Senator to Question Tax Treatment of Booster Clubs*, CHRON. HIGHER EDUC., Oct. 5, 2007, at 38, *available at* http://chronicle.com/free/v54/i06/06a03501.htm. Indeed, virtually all university grants-in-aid programs have a "price list" of benefits available to donors at specific donation levels. The "Tide Pride" brochure describing ticket preferences at the University of Alabama based upon various donation levels is typical in this regard. *See* University of Alabama, Tide Pride 2006, http://www.rolltide.com/fls/8000/files/tidepride/2006tidepridebrochure.pdf?DB_OEM_ID=8000 (mailing to University of Alabama football boosters).

In 1986, in fact, the IRS determined that "donations" to college athletic programs that carried with them the right to ticket preferences and other individual perks were not deductible under the general rule that a payment is not a donation when the payment is in return for a tangible quid pro quo. Rev. Rul. 86-63, 1986-1 C.B. 88. In 1988, however, Congress overturned the IRS determination by statute, providing that 80 percent of such donations are deductible in any event. I.R.C. § 170(*l*) (2006). I have previously opined that so-called "donations" that are in fact quasi-purchases (a category in which I put most athletic donations as well as "donations" that in effect purchase a naming opportunity for the donor, such as a named professorship or building) should not be deductible and should not count as "donations" for purposes of my donative theory of exemption. *See* John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 661–62 (2001).

cant sense: they benefit a relatively tiny number of elite athletes at only a handful of schools[174] and arguably exploit those athletes, rather than benefit them. Finally, big-time college athletics revenues clearly do fit the normative tax base: payments for tickets sold, television and other media rights fees, advertising, and so forth are absolutely no different from or harder to calculate than these same revenues flowing to professional, for-profit sports.

What this analysis shows is that there is no inherent theoretical reason to exempt Division I football or basketball revenues from taxation. These programs do not themselves provide any special good or service that would not be supplied in a taxable environment nor any special ethic or way of doing things that differs substantially from for-profit sports entertainment. Their revenues and expenses would easily fit our normal tax rules. Whatever one's favorite theory of exemption may be, therefore, Division I football and basketball simply do not belong inside it.

B. UBIT Theory and College Athletics

Although none of the available exemption theories support tax exemption for big-time college athletics, these programs are not conducted in stand-alone entities. Even the NCAA does many other things than simply negotiate media contracts for Division I football and basketball games.[175] As noted at the very beginning of the Article, tax exemption is applied to entities, not to individual activities of entities. Hence the fact that tax exemption theory would not support exemption for big-time college athletics if these programs were conducted in stand-alone entities does not complete the analysis, because these programs generally are not conducted in that manner. Rather, as noted in Part III, the activities are conducted in entities that almost certainly qualify for exemption because of the other things they do (education for universities; supporting nonrevenue athletics for the NCAA). Nevertheless, the UBIT was enacted precisely to handle this kind of situation: that is, to tax revenues from commercial activities undertaken by an otherwise exempt charity. Thus a second important theoretical question is whether the rationales for applying the UBIT apply to Division I football and basketball programs—that is, does the theory behind the UBIT support the long precedential history of not applying the UBIT to college athletics, or does the theory suggest that this precedential history is wrong?

174. *See* JOHN S. & JAMES L. KNIGHT FOUND., REPORT OF THE KNIGHT COMMISSION ON INTERCOLLEGIATE ATHLETICS 21 (1999), http://www.knightcommission.org/images/pdfs/1991-93_KCIA_report.pdf (describing the problems with athletics as "most apparent within major athletics programs and are concentrated most strongly in those sports for which collegiate participation serves the talented few as an apprenticeship for professional careers").

175. *See infra* notes 190–91 (discussing the NCAA's support of a variety of nonrevenue sports and sponsorship of championships in those sports).

Unlike tax exemption per se, we have a better theoretical base for the application of the UBIT. As explained earlier in the Article, the traditional justifications for the UBIT are protecting the corporate tax base and avoiding "unfair competition" between charities and for-profit service providers.[176] With regard to the latter, I have previously pointed out that economists almost uniformly have rejected the notion that charities engage in "unfair competition," at least if one defines that term as some sort of predatory pricing or predatory market entry or expansion.[177] Instead, protecting the corporate tax base remains the most compelling of the traditional justifications.[178] To this, however, one might add two additional policy concerns: (1) limiting the extent to which the attention of charitable managers is diverted from their core charitable mission to for-profit empire building,[179] and (2) promoting economic efficiency by avoiding situations in which charities are tempted to run commercial businesses simply because they can avoid the tax that would be collected on these activities were they conducted in for-profit form.[180] Giving Division I football and basketball revenues a pass under the UBIT clearly offends the corporate tax base protection and diversionary concerns, while the economic efficiency issue is at best a wash.[181]

176. Treas. Reg. § 1.513-1(b) (as amended in 1983) ("The primary objective of adoption of the [UBIT] was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the non exempt business endeavors with which they compete."). *See generally* FISHMAN & SCHWARZ, *supra* note 21, at 376–79 (discussing the history and policy behind the UBIT, including considerations of loss of revenue and unfair competition).

177. Colombo, *supra* note 22, at 529–46; *see also* Michael S. Knoll, *The UBIT: Leveling an Uneven Playing Field or Tilting a Level One?*, 76 FORDHAM L. REV. 857, 891 (2007) (questioning whether there is any economic advantage at all to a nonprofit engaging in a commercial business).

178. *See* Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 622 (1989) (arguing that repealing the UBIT would shrink the corporate tax base and cause tax-exempt nonprofit organizations to buy corporate businesses through debt-financed acquisitions, and also noting that "[t]he UBIT is far more important in protecting the corporate income tax base than it is in raising revenue directly"); *see also* Colombo, *supra* note 22, at 529–34.

179. *See* Burton A. Weisbrod, *Modeling the Nonprofit Organization as a Multiproduct Firm: A Framework for Choice*, *in* TO PROFIT OR NOT TO PROFIT 47, 54 (Burton A. Weisbrod ed., 1998) (permitting charitable organizations to engage in extensive commercial activities will erode the core differences between charitable management and for-profit management); Colombo, *supra* note 22, at 534–35.

180. *See* Colombo, *supra* note 22, at 538–41; Hansmann, *supra* note 178, at 614–17 (arguing that repealing the UBIT would cause managerial inefficiency because nonprofit organizations do not have stockholders and therefore have less incentive to maximize their revenues or minimize their costs than for-profit entities, and would also cause poor diversification of nonprofit organizations' investment because "nonprofits would have a strong incentive to abandon the current practice of investing in a broad range of common stocks and to pursue instead a strategy of investing in firms that the nonprofits can completely own").

181. Professor Ethan Stone has suggested that an alternative view of the UBIT is that the legislation was more a political statement (warning?) by Congress intended to keep charities operating in the traditional charitable sphere, rather than expanding to activities not traditionally considered charitable. Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1475 (2005). Under this conception, one might argue that college athletics, being a traditional activity of exempt educational institutions, should not be subject to the UBIT. And, in fact, the original statement in the House Committee report excluding college athletics from the UBIT would appear to support this view. *See supra* note 141 and accompany-

The "protecting the corporate tax base" issue is straightforward, though some additional explanation might help explain the concept. In our tax system, business income is always taxed at least once. In the traditional corporate form, the income actually is taxed twice: once to the corporation and then again if the income is distributed to a shareholder. In the case of a partnership or proprietorship, the income is taxed once to the individual partner or proprietor.

Though it may come as something of a surprise to many people, our tax laws forbid either individuals or corporations from "zeroing out" their income via deductions for charitable contributions.[182] For example, Newman's Own, the corporation set up by Paul Newman to manufacture and sell salad dressings and other food items, pays taxes on its profits despite the fact that Newman's Own gives all those profits to charity. Accordingly, if a charitable organization were permitted to carry on a business enterprise without taxation, the public fisc would lose the tax revenue that otherwise would be paid on the business profits, even though the profits might all be used to subsidize other charitable activity. Tax base impairment is the concern that presumably led to the famous (to tax policy folks) quote by Representative John Dingell, Sr. during the debates on the UBIT: "Eventually all the noodles produced in this country will be produced by corporations held or created by universities . . . and there will be no revenue to the Federal Treasury from this industry. That is our concern."[183] Similarly, if we assume that big-time college athletic programs would be carried on even in taxable form (e.g., inside a taxable subsidiary of a university), permitting revenues from these programs to escape taxation impairs the general tax base.[184]

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ing text. A counterargument, however, would be that the recent commercialization of Division I athletics has taken it out of what one might identify as the traditional charitable sphere. The very public angst over coaches' salaries, graduation rates, and the athletic "arms race" in general would support the notion that college athletics is now seen as a case of charities expanding into an area not traditionally reserved for charitable activity.

182. Individuals cannot deduct more than 50 percent of their adjusted gross income for charitable contributions (and in some cases, that amount is limited to 30 percent of AGI); corporations cannot deduct charitable contributions in excess of 10 percent of their taxable income. I.R.C. § 170(b) (2006). Therefore, even if a corporation gives all its profits to charity (like Newman's Own), it would owe taxes on 90 percent of that profit. Similarly, individuals would have to pay taxes on at least 50 percent of their net income even if they handed all of it over to charity. See *supra* note 25 for further discussion of this point.

183. *Revenue Revision of 1950: Hearings Before the H. Comm. on Ways & Means*, 81st Cong., 2d Sess. 580 (1950) (remarks of Rep. John D. Dingell, Sr.).

184. As noted above in the text at notes 147–60, some question exists as to actually how much tax revenue would be gained by subjecting big-time college athletics to taxation, because it is likely that only a few of these programs would show a taxable profit after applying rigorous tax-accounting policies to their income and expenses. Nevertheless, the point in the text is valid: from a tax-theory standpoint, allowing an activity that would be carried on in taxable form to escape the corporate income tax means that the corporate tax base has contracted to some degree. Or put another way, no one would suggest that U.S. automakers should be exempt from tax simply because they haven't made any taxable profit in the past few years. Whatever the current reality, the theoretical tax base should include operations by auto manufacturers, and the potential for future profit cannot be ignored.

The "diversion" problem is also obvious. Did Alabama hire Nick Saban or Kentucky hire John Calipari for their respective contributions to the educational environment at the universities in question, or did they do so simply because they wanted to win at football/basketball? Is the rise in Division I football and basketball coaches' salaries in general attributable to a race among universities to provide the best educational environment for athletes, or is it more likely attributable to an "arms race" to win?[185] Are the millions of dollars poured by universities into athletic training facilities and stadiums improving the educational environment of student-athletes? Across the country, university administrators spend countless hours and significant dollars dealing with the fallout of recruiting violations—hours and dollars not being spent on academic programs.[186] These issues illustrate why big-time college athletics may be the *best* example of how a significant commercial activity diverts the attention of charitable management from their core charitable program to the needs of the commercial business.

Finally, there is the question of economic efficiency. When we forego taxes on revenue-producing economic activity, we give charities an incentive to engage in such activity simply because they can avoid taxes in doing so, rather than because they are more efficient at doing so.[187] Without some mechanism like the UBIT, therefore, charities would likely expand into economic activities that they have no management expertise in, and therefore would run poorly. Our tax policies, at least, should not encourage this behavior.

185. *See generally Knight Commission*, *supra* note 134, at 16–19 (discussing colleges' "ever growing 'arms race' of spending and building to reach impractical financial goals"). The report also notes that colleges often do not profit from their "big-time" basketball and football programs:

> There is a tangible downside to this arms race for most schools, that is, for the majority whose big-time programs are less successful and cannot pay for themselves. They must siphon funds from general revenue to try to keep up with the Joneses. Pursuit of success in this context jeopardizes not only the universities' moral heritage but also their financial security.

Id. at 19.

186. A recent example is the mess that former basketball coach Kelvin Sampson produced for the University of Indiana. Sampson was finally forced out of his job after recruiting violations, but not before the University engaged in its own extensive investigation of Sampson's activities and paid a $750,000 buyout. *See Sampson Forced Out at Indiana*, N.Y. TIMES, Feb. 23, 2008, at D3, *available at* http://www.nytimes.com/2008/02/23/sports/ncaabasketball/23indiana.html?ref=sports; David Woods, *Sampson to Keep Coaching as Indiana Investigates*, USA TODAY, Feb. 16, 2008, http://www.usatoday.com/sports/college/mensbasketball/bigten/2008-02-15-indiana-probe_N.htm.

187. For example, assume that a charity invests $1000 in Starbucks, Inc. by buying its stock and receives a $100 dividend. In order to pay that $100 dividend, Starbucks has to earn a profit of approximately $154, on which it will pay taxes at 35% (35% of $154 equals a tax bill of $54, leaving $100 to distribute). Put another way, Starbucks must earn a 15.4% pre-tax return in order to give its shareholders a 10% after-tax return. If a charity could operate Starbucks' business without paying taxes, it would earn that same 15.4%, or a 5.4% premium solely as the result of its tax exemption, not because of any operational efficiencies. This "tax arbitrage" is what led Henry Hansmann to opine that something like the UBIT was necessary to prevent charities from acquiring for-profit businesses simply to earn a premium rate of return. Without such a limitation, charities would be inclined to operate coffee shops even though their management (presumably selected for their dedication to charitable mission, rather than operational efficiency in coffee shop management) might well be lousy at running coffee shops. *See* Hansmann, *supra* note 178, at 614–17.

While college athletics seems to suffer from some glaring inefficiencies,[188] the efficiency factor is ultimately a mixed bag. College athletics arguably is not the paradigm case of charitable economic inefficiency (e.g., a charity operating a BMW dealership simply because it can avoid the taxes on it and earn a higher rate of return, even though the charity's management has no expertise in car sales and therefore will likely be bad at it) because whatever economic inefficiencies exist are offset at least to some degree by the fact that big-time college athletics earns its significant revenues *largely because of its association with the sponsoring universities*. A professional minor league for the NBA, for example, likely would not be able to sell its tournament rights for billions of dollars as is the case with the NCAA men's basketball tournament. In effect, big-time college sports earn a premium return in part because of their educational affiliation. Sports fans who would never attend a AAA minor league baseball game will gladly fork over whatever ESPN wants to tune into the broadcast of their alma mater playing Duke in the NCAA men's basketball tournament. Thus managerial inefficiencies in college athletics are offset, perhaps completely, by "branding efficiencies" that provide a greater return on investment than would be the case if the product were divorced from the sponsoring educational institution. Accordingly, college athletics is not a paradigm case of needing the UBIT to combat economic inefficiency by charities.

Nevertheless, even if the economic efficiency criterion is a wash, college athletics clearly violates the tax base protection and diversion rationales for the UBIT. Excepting these revenues from the UBIT therefore violates two of the three core rationales for having such a tax. Ergo, on balance the rationales for having the UBIT would not support exempting college athletics from its grasp.

C. Exploring Some Regulatory Alternatives

Sections A and B of this Part demonstrate that despite the current law favoring no taxes on athletic revenues, in fact there is no valid *tax policy* reason to except big-time college athletic revenues from taxation. This observation in turn means that the tax-favored treatment of Divi-

188. For example, my colleague, Steve Ross, who is an expert in sports law at Penn State's law school, notes that universities routinely permit coaches to breach their coaching contracts without penalty; in the professional sports world, however, coaches are typically subject to buyout clauses that impose economic penalties for breach. An arguable result of this behavior in the collegiate world is that colleges overpay for the services of top coaches by not insisting on (or not enforcing) substantial buy-out penalties if a coach wishes to leave for a different (and presumably "better") job. Similarly, because student-athletes cannot be paid market rates, universities must compete for "athletic labor" using back-door incentives such as TV exposure, expensive training facilities and so forth. This situation, of course, has led the NCAA to promulgate extensive rules governing even the minutiae of athletic recruiting and whole "compliance departments" inside athletic programs to ensure the rules are followed. *See, e.g.*, Theresa Tiso, *More Paperwork, No Less Cheating*, CHRON. HIGHER EDUC., Apr. 22, 2005, at A55.

sion I football and basketball programs should be viewed as a "special exception" to general tax policy and continuing this tax-favored treatment is simply a public policy, rather than a tax policy, decision. Put another way, one should view exemption for organizations conducting big-time athletic programs much like tax policy experts view the deduction for home mortgage interest or any number of tax credit provisions (such as the low income housing tax credit, or tax credit for hybrid automobiles): they are not part of the tax laws because of any theory of income taxation, but rather are simply a congressional choice to use the tax code to effect certain public policy outcomes, and therefore should be properly constructed and limited to advance those policy outcomes. Accordingly, there is no reason Congress should not attach special rules regarding continuing this tax-favored treatment for college athletics to effect broader public policy goals.

Because I am a tax professor and this Article is intended to be a discussion of the tax exemption/UBIT aspects of college athletic revenues, I will leave extended discussion of potential congressional regulation of college athletics to the sports law and sports management experts. But I think it is appropriate to highlight briefly some regulatory approaches that have been used within the tax system in other areas that might be of particular interest in the debate over regulating Division I football and basketball programs in the context of tax exemption. Note that because of the "paper tiger" problem discussed above in Part IV, the approaches discussed below likely would need to be structured as requirements for continued tax exemption of the entity operating the sports (or, for public universities, continued eligibility to receive deductible contributions under § 170[189]), rather than requirements for escaping the UBIT (i.e., the sanction for failure to comply would be loss of tax-exempt status for the entity itself, not just the taxability of big-time athletic revenues), because the threat of applying the UBIT might well turn out to be not a very powerful behavioral incentive (or, in the case of disclosure, might not cover the items that are part of the reform agenda).

189. As explained in the text accompanying notes 110–12, *supra*, public universities technically are not exempt under § 501(c)(3), but rather are exempt either as a part of state government under the broad principle of intergovernmental tax immunity, or else as an "instrumentality" of state government engaged in an essential government function (e.g., education) and exempt under I.R.C. § 115. In the case of public universities, therefore, Congress cannot simply "revoke" their exempt status for failure to comply with conditions relating to athletic programs; as a part of state government, presumably there would be constitutional limits on such an action. Congress could, however, make exemption of athletic revenue from the UBIT subject to such conditions because public universities *are* subject to the UBIT. *See supra* note 13. Congress could gain considerable additional leverage by making donations to public universities deductible only if the university complied with whatever athletic program restrictions it chose to enact (in other words, universities operating athletic programs not in compliance with whatever rules Congress might choose would not be eligible to receive deductible donations under § 170 of the Code).

1. The Use of Athletic Program Revenues

In its response to Chairman Thomas, the NCAA often stressed the fact that revenues from Division I football and basketball are used to support athletic opportunities in nonrevenue sports.[190] The NCAA argues that it uses revenues from the men's basketball tournament to support competitions in a variety of nonrevenue sports;[191] individual universities claim that revenues from football and basketball support other nonrevenue sports, particularly athletic opportunities for women.[192] My observation here is simple. If we view enhancing athletic opportunities as a valid public policy goal, then it would be perfectly appropriate for Congress to *require* that a certain percentage of revenues from revenue-producing sports such as football and basketball be used to expand nonrevenue athletic opportunities, rather than simply hoping that such action occurs. In short, we should demand legal accountability: if a major reason we choose to let exempt organizations operate highly commercialized athletic programs is because the proceeds support noncommercial athletic opportunities, we should say so specifically and clearly, and enact some minimum standard of subsidization to ensure that this policy is pursued appropriately.[193]

Limitations on the use of money are used all the time in tax law to qualify for specific tax benefits. So, for example, charities can issue tax-exempt bonds under Code § 145, but only if 95 percent of the proceeds are used for charitable purposes and the proceeds do not benefit non-exempt entities.[194] Section 4942 requires private foundations to spend at least 5 percent of their asset value per year on charitable programs or face an excise tax penalty.[195] I have suggested in previous writing that charities should be forced to prove that they spend a minimum amount (based upon the average rate of return from government securities) from commercial activities to subsidize charitable outputs in order to remain

190. *NCAA Response*, *supra* note 2, at 7 ("It should be pointed out that colleges and universities apply the 'tax subsidy' to offer a broad range of athletics participation opportunities for hundreds of thousands of young men and women at more than a thousand institutions.").

191. *Id.* at 22 ("Less than half of the funds from the Division I Men's Basketball Championship is distributed based on appearances in the tournament. Most of the funds are distributed based on the number of sports sponsored and the number of athletics scholarships awarded to all student-athletes on an institutional basis.").

192. *Id.* at 7–9.

193. My view here is consistent with my position regarding tax exemption for nonprofit hospitals. Some commentators believe that exemption for nonprofit hospitals is appropriate because nonprofit hospitals "do things differently" than for-profit hospitals; for example, some empirical research indicates that nonprofit hospitals are more likely to offer important, but unprofitable, health care services. I have suggested that if this is the case, it is perfectly appropriate to use tax exemption as a means of encouraging the private production of services that are otherwise not available from the for-profit sector, and hospitals should be required to show exactly what services they provide that fit in this category and how much they spend on them. *See, e.g.*, John D. Colombo, *Federal and State Tax Exemption Policy, Medical Debt and Healthcare for the Poor*, 51 ST. LOUIS U. L.J. 433, 456 (2007).

194. I.R.C. § 145(a)(2)(B) (2006).

195. *Id.* § 4942; *see* FISHMAN & SCHWARZ, *supra* note 21, at 608–11.

eligible for tax exemption.[196] Any of these approaches could easily be adapted to revenues from big-time college athletic programs.[197] Thus Congress might require, for example, that universities conducting Division I football or basketball programs must spend at least 5 percent of their total investment in these programs (or 5 percent of the annual revenues from these programs) to support nonrevenue athletic opportunities or other clearly academic activities. If a particular university could not afford to do this, then its solution would be to "downgrade" its athletic programs from Division I and "de-commercialize" football and basketball so that this limitation would not apply to them.

2. *Expenditure Limits*

The 2001 Knight Commission report highlighted the "arms race" nature of big-time college athletics, resulting in the meteoric rise of coaching salaries and huge capital investments in stadiums.[198] Accordingly, Congress might consider targeted expenditure limits, such as capping coaches' salaries or limiting annual expenditures on recruiting or sports facilities as a condition to exemption for universities operating Division I football and basketball programs.[199] As with expenditure requirements, there are certainly precedents for expenditure limits on exempt organizations: for example, § 501(c)(3) itself limits exempt organizations' lobbying activities to an "insubstantial" amount and prohibits such organizations from engaging in any activities relating to a political campaign.[200] Several of the excise tax provisions applicable to exempt organizations penalize certain kinds of expenditures, including excess business investments, "jeopardizing investments," political activity expenditures, and others.[201] The Senate considered limits on executive and board compensation for charitable organizations as part of the charitable reforms

196. Colombo, *supra* note 97, at 351–52.

197. On the other hand, one should recognize that expenditure requirements of the type discussed above (e.g., a requirement that a university (1) earn and then (2) spend a certain "rate of return" on the investment in major athletic programs on other charitable outputs) might have little or no effect on profitable programs that already use revenues from football and basketball to subsidize other sports, but rather would (perhaps perversely in the minds of some) have the most impact on programs that either barely break even on major sports or actually lose money on them. In my view, there is nothing wrong with telling a university that consistently invests money in a money-losing commercialized athletic program that it either needs to find a way to be successful enough with that investment to produce revenues to subsidize other charitable outputs or else it needs to liquidate that investment and use the money in some other way (e.g., leave Division I and restructure its programs into "noncommercial," less-expensive versions). But I am sure that the president of Rutgers (see discussion below) would feel differently.

198. *See supra* note 185.

199. This approach presumably would not work with the NCAA, because the vast majority of its "expenditures" each year are simply distributions to member schools to share revenues generated by the NCAA from commercial exploitation of college athletics; one presumably would not want to limit such revenue sharing.

200. I.R.C. § 501(c)(3). If they so desire, charities other than churches can elect under § 501(h) to use a mathematical expenditure limit test for compliance with the lobbying limitation.

201. *Id.* §§ 4943–4945.

enacted in 2006, although ultimately these provisions were not included in the final legislation.[202] Another highly publicized case of expenditure limits outside the tax law area occurred recently when President Obama announced compensation limits for top executives of financial institutions receiving money from the federal Troubled Asset Relief Program.[203]

Difficulties certainly exist with this approach. For example, there is considerable dispute in the charitable community itself over whether salaries for executives and employees should be lower than in the for-profit sector.[204] The arguments pro and con are fairly simple. On one hand, some assert that keeping charitable management salaries below those of the for-profit sector helps ensure that managers retain the "special ethic" of charities as serving their constituents rather than making a buck. The counterargument is that such limitations artificially condemn charities to hiring "second rate" management because they will be unable to compete with for-profit firms for the top managerial talent. As I often ask my students in my exempt organizations class, would you rather undergo quadruple bypass surgery with a heart surgeon who makes $1 million a year or one whose salary has been artificially limited to $50,000 per year? Compensation limits also may be unworkable in practice; commentators generally agree that the limit on deductibility for executive compensation in the for-profit business world contained in § 162(m) has been completely ineffective, largely because performance-based compensation such as stock options is disregarded.[205]

Nevertheless, college athletics may be a particularly suitable case for expenditure limits, particularly with respect to recruiting budgets and coaches' salaries and perks. Because there are so many non-economic, non-charitable reasons to prize football or basketball success, there are few incentives for most schools to adequately police whether they are getting value for money from these expenditures. The scandal concerning Rutgers University Athletic Director Robert Mulcahy and the virtually unchecked spending inside the Rutgers athletic department is only one of the more recent sordid tales in this regard.[206] In addition, one can

202. *See infra* note 204.

203. *See, e.g.*, *Obama Sets Executive Pay Limits*, CNN, Feb. 4, 2009, http://www.cnn.com/2009/POLITICS/02/04/obama.executive.pay/index.html.

204. For an overview of this debate, see FISHMAN & SCHWARZ, *supra* note 21, at 232–37. As Fishman and Schwarz note, the Senate Finance Committee in 2004 circulated a discussion draft of proposed reforms in the nonprofit sector that included limits on executive compensation. The Panel on the Nonprofit Sector issued a response to these proposals in 2005 which opposed compensation caps. Final legislation passed by Congress in 2006 as part of the Pension Protection Act did not include any compensation limitations.

205. *Id*. at 236.

206. The Rutgers mess was chronicled in a series of investigative reports by the *New Jersey Star-Ledger*, available at http://blog.nj.com/ledgerarchives/rutgers_stadium/ (last visited Nov. 10, 2009). The Rutgers situation spawned internal investigations by Rutgers as well as the state government, all of which painted a picture of an athletic department completely "out of control," spending or committing to spend vast amounts of money ostensibly to keep its football program competitive with other Division I programs.

certainly sympathize with the view that Congress should not approve Ohio State's command of a private fleet of jet planes so that coaches can "show love" to Terrelle Pryor (a recent football recruit) by watching him play in a high-school basketball game.[207]

3. *Disclosure Requirements*

A very different (and perhaps preferable) regulatory approach to defined limits on spending or use of revenues is to require more expansive disclosure regarding a number of aspects of the operation of college athletics. Additional disclosure, in fact, is something the IRS could implement on its own, without congressional approval, although some congressional action would be necessary to extend these reporting requirements to public universities, which generally are not required to file Form 990 (the reporting form required from § 501(c)(3) organizations).[208]

The lack of transparency in athletic department operations has been a consistent theme of reformers and has led to well-documented cases of abuse. As mentioned, one of the most notorious recent cases involved Rutgers University, where (in an attempt to keep Rutgers football competitive with other Division I football programs) the athletic department under then-Director Robert Mulcahy essentially "ran wild," entering into no-bid contracts with outside firms and committing the University to expenditures (such as for an extensive stadium renovation) that it ultimately could not afford.[209]

In response to cases like the Rutgers fiasco, college athletics "watchdog" groups such as the Coalition on Intercollegiate Athletics (COIA) and The Drake Group have pushed for expanded disclosure on a number of fronts. With respect to finances, Lindsey Luebchow, writing in the Higher Ed Watch Blog, has recommended greater financial disclosure along with academic disclosure.[210] Luebchow notes:

207. *See* Henry Gola, *Terrelle Pryor Timeline*, ESPN.COM, Mar. 19, 2008, http://sports.espn.go.com/ncaa/recruiting/football/news/story?id=3300355 (chronicling the recruitment of Pryor). On February 1, 2008, "Pryor expects Ohio State coach Jim Tressel and Michigan coach Rich Rodriguez at his basketball game against East Allegheny. He has already hosted Penn State coach Joe Paterno, LSU coach Les Miles and Oregon coach Mike Bellotti." *Id.*

208. *See* INTERNAL REVENUE SERV., INSTRUCTION FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 5 (2008), http://www.irs.gov/pub/irs-pdf/i990.pdf [hereinafter *Instructions for Form 990*]. Charities other than churches with gross revenues in excess of $25,000 per year are required to file Form 990 annually. This filing requirement would encompass the NCAA and all private universities engaged in college athletics. Public universities, however, generally are not required to file Form 990 because they are governmental units and thus are exempt from tax under § 115 of the Code, rather than § 501(c)(3) (although even public universities are subject to the UBIT and must file a UBIT return when appropriate). Accordingly, some congressional action would be necessary to extend reporting requirements to public universities that otherwise are not required to file a Form 990.

209. *See supra* note 206.

210. Posting of Lindsey Luebchow to the Higher Ed Watch Blog, College Sports Reform: Opening Up the Budget Books, http://www.newamerica.net/blog/higher-ed-watch/2008/college-sports-reform-spending-5441 (July 29, 2008, 22:44 EST) [hereinafter *Opening Up the Budget Books*].

> Under the Equity in Athletics Disclosure Act, which Congress passed in 1994 to expose differences in collegiate spending on men's and women's sports, the federal government currently requires colleges that receive federal student aid and have intercollegiate sports programs to submit an annual report on athletic participation, staffing, revenue, and expenses. The financial disclosure requirements, however, are vague, allowing each college to craft its own definition of what's included in aggregate revenue and expenses. As a result, the federal athletics spending data is not comparable from school to school, making it essentially useless. The NCAA also collects revenue and expense data from each college, but reports the numbers only in aggregate.[211]

Accordingly, she calls for colleges to "break down the data to reveal how much revenue their athletics programs receive from the sports teams themselves ('generated revenue') and how much the colleges provide to the programs ('allocated revenue')" and to "detail how much the schools spend on coaching salaries by team and on facilities."[212] COIA agrees that financial aspects of athletic programs need greater transparency and disclosure.[213]

The scope of recommended disclosure, however, goes well beyond financial matters. The college athletic reform groups also want disclosure on academic matters affecting student-athletes. Specifically, the Drake Group has proposed that universities be required to disclose

> a student's academic major, academic advisor, courses listed by academic major, general education requirements, electives, course grade point average (GPA) and instructor—without revealing the names of individual students. In addition, TDG requests that average SAT and ACT scores for revenue producing sports teams be reported along with those of athletes in nonrevenue sports, and scholarship students in the symphony orchestra, band, and other extra-curricular activities. Similar comparisons should be made regarding independent studies taken, grade changes by professors, and classes missed because of extracurricular demands.[214]

In 2008, the IRS completed a substantial revision to Form 990. The revisions significantly increased the level of financial disclosure required of exempt organizations and thus likely will provide significant detail on

211. *Id.*

212. *Id.*

213. THE COAL. ON INTERCOLLEGIATE ATHLETICS, FRAMING THE FUTURE: REFORMING INTERCOLLEGIATE ATHLETICS, Proposed Reform 4.1 (2007), *available at* http://www.neuro.uoregon.edu/~tublitz/COIA/FTF/FTFtext&appendix.htm ("The Athletic Department's budgets, revenues and expenditures should be transparent and aligned with the mission, goals and values of the institution. The University President should take the lead to ensure that fiscal reports, including dash board indicators as listed in the 2006 NCAA Presidential Task Force report, are issued annually and made available to the campus faculty governance body.").

214. The Drake Group, The Drake Group Proposals, http://thedrakegroup.org/proposals.html (last visited Nov. 10, 2009); *see also Opening Up the Budget Books*, *supra* note 210.

the compensation of Division I basketball and football coaches (at least at private universities),[215] but nothing in the revisions implements any kind of special disclosure concerning athletic program operations or expenditures or disclosures regarding the academic program for student-athletes of the nature recommended by The Drake Group, Luebchow, or COIA. In fact, Schedule E to Form 990, which is required for exempt schools (and deals mostly with the school's nondiscrimination policies), is essentially the unchanged information formerly required in Schedule A of the "old" Form 990.[216] This is in stark contrast to what the IRS did with tax-exempt hospitals, where a whole new disclosure form (Schedule H to Form 990) was added so that the IRS could gather data on the exact operations of nonprofit hospitals and whether those operations justified exempt status.[217] Schedule H, for example, not only mandates reporting on a number of issues relating to nonprofit hospital expenditures, but also circumscribes what accounting methods can be used to generate the reported numbers.[218]

One could well imagine the IRS embarking on a "Schedule-H-like" project for exempt organizations that conduct or perform services with regard to Division I athletic programs. Like Schedule H's requirements for reporting community benefit expenditures by hospitals, a substantially revised Schedule E could require detailed accounting of athletic expenditures using standardized accounting methods as well as the academic information suggested by the reform groups. In particular, if we believe that a major public policy reason for continuing exemption for organizations involved in Division I athletics is that revenues generated by big-time football and basketball programs are used to subsidize other athletic opportunities, a thorough accounting of where the money goes based upon standardized reports in a schedule to Form 990 would go a long way toward determining whether this conception is really true. Moreover, public disclosure of the details of athletic department operations in a standardized format should promote transparency and help avoid situations, like that at Rutgers, in which athletic departments oper-

215. The revised form requires substantial disclosure of compensation levels and details for directors, officers, trustees, "key employees," and the five highest compensated employees not part of the first four categories in Part VII of the core form, with additional details provided on Schedule J. For more specifics on the reporting requirements, see *Instructions for Form 990*, *supra* note 208. Because of their high compensation levels and responsibility for large programs within the university, Division I football and basketball head coaches likely will fall under either the "key employee" definition or fall within the group of five most highly compensated employees outside the other groups. Note, however, that public universities generally are exempt from the Form 990 filing requirements. *See supra* note 208.

216. *Instructions for Form 990*, *supra* note 208, at 2.

217. *See, e.g.*, INTERNAL REVENUE SERV., FORM 990 REDESIGN FOR TAX YEAR 2008: SCHEDULE H, HOSPITALS—HIGHLIGHTS (Dec. 20, 2007), http://www.irs.gov/pub/irs-tege/highlights_schedule_h.pdf.

218. *Id.* Schedule H, for example, requires an exempt hospital to provide detailed information on the costs of charity care, Medicaid shortfalls, and other "community benefit" expenditures, as well as information on charity care policies, joint ventures, and other business activities.

ate with essentially zero university or public oversight. One suspects that the Rutgers situation would not have spiraled out of control had the university been required to file a detailed public disclosure form on athletic department expenditures and athletes' academic progress each year.

Finally, the Form 990 disclosure route likely would be far superior to disclosure that would be available if Division I football and basketball were deemed subject to the UBIT. First, a Form 990 approach could be comprehensive, requiring disclosure of all the financial aspects of athletic operations, rather than simply the revenues and expenses of the football/basketball programs (which are the likely UBIT targets). Second, a Form 990 approach could tailor disclosure to the specific issues surrounding college athletics, rather than relying on a "one-size-fits-all" UBIT reporting form that is essentially a business tax form, not a disclosure form per se. Finally, a Form 990 approach could require disclosure regarding student-athlete academic progress and other academic issues that would not be part of the UBIT reporting form.

VI. SUMMARY

Current tax exemption and UBIT law makes intervention by the IRS in the college athletics world difficult. Even if we view Division I football and basketball as nothing more than commercial minor leagues for the pros, the NCAA and individual colleges and universities almost unquestionably meet the current legal tests for tax exemption because of their other activities. Though it is somewhat more plausible that the IRS could tax revenues from Division I football and basketball programs under the UBIT, the arguments for applying the UBIT are far from legal "slam dunks," and pursuing this route would require the IRS to abandon a significant body of legal precedent. Moreover, even if the IRS were successful on the UBIT front, a serious question exists as to whether subjecting athletic revenues to the UBIT is a sufficient stick to induce reform: once colleges/universities and the NCAA started accounting for these programs as for-profit businesses, one could expect that any *taxable* profit would quickly disappear and that subjecting these programs to the UBIT would largely end up being a paper tiger. While imposing the UBIT would provide some level of public disclosure, the disclosure provided would be far less than, and inferior to, the kinds of specialized disclosure favored by athletic reform groups.

On the other hand, the various tax theories underlying tax exemption and the UBIT do not support exempting big-time football and basketball revenues from taxation. These programs are not consistent with underlying theories of exemption, and in fact are perfect examples of why commercial revenues of charities should be subject to taxation. There is no general tax policy reason to exempt these revenues from tax; accordingly, Congress would be completely justified in attaching special limitations on the continuation of tax-favored status for entities conducting or providing services for college athletics as a means of furthering public policy goals outside of the tax field. These special limitations could take the form of mandating particular use of revenues, limiting expenditures (particularly coaches' salaries and recruiting expenditures), and/or mandating increased disclosure, all of which have current analogues in the Code or IRS procedure. Whether and to what extent these special limitations in fact make good public policy with respect to college athletics is a debate I will leave to my colleagues in sports law and management; from the standpoint of tax policy, big-time college athletics per se has no claim to tax-favored treatment.