

**Amateur Athletics:
Two Strikes against the Sweetheart Deal between Big-Time
College Sports and the Tax System^{1*}**

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Preface

The conference title assigned to this paper is simply “Amateur Athletics.” Because that is a broad subject indeed, some preliminary consideration of the scope of this assignment is necessary. Note first that the overall conference topic (“Colleges and Universities . . .”) sets some boundaries, putting the Little League World Series, the United States Golf Association Amateur Championship, and similar amateur athletic contests, beyond the scope of this paper.²

Even within the four-year undergraduate experience (or five, if we count the red-shirt year³—and in this context, we surely should), there are at least three subdivisions of athletic activity that require somewhat separate consideration, and involve increasing cause for concern about the soundness of the current tax treatment. The first, and least problematic, category is intramural athletics, in which teams of students from various houses, fraternities, or other affinity groups compete with teams of students representing other similar groups within the same university.

¹ I am grateful to John Colombo and Richard Kaplan for their helpful comments on an earlier draft of this essay.

² Many such non-collegiate amateur sporting events are now nationally televised, and produce significant revenue. The Little League World Series, for example, recently signed an eight-year contract with ESPN that will provide \$60 million over that period. Little League revenue totaled \$24.5 million in 2012 alone. See the Forbes Magazine web site at forbes.com/sites/bobcock/2013/08/26/little-league-reflecting-youth-sports-tv-demand-double-its-money-from-espn/. Naturally, this has led to commentary to the effect that Little League players should be paid. After all, child actors are paid for providing entertainment; why shouldn't child athletes? See www.sports.yahoo.com/news/mlb-is-it-time-to-pay-players-at-the-little-league-world-series-of-course-it-is-162419281.html. But this is for another article.

³ College athletes generally have four years of eligibility to compete in intercollegiate sports. However, they are liberally allowed to decline participation during one year (the “red-shirt” year, so called because they typically continue to practice with their teams if injuries do not prevent this, and, at least in some historic period, wore jerseys that indicated their nonparticipant status in that year). This privilege is frequently used in college football, leading to a common practice in which freshmen practice with their teams but do not play in that year, but maintain eligibility in the four following years.

These activities involve the use of some university resources—playing fields or courts, equipment, and usually one or more paid referees, along with some office support in creating and distributing schedules, compiling standings, and the like. A purist might observe that intramural sports are not strictly educational—they rarely involve any coaching or instruction—and so are not in pursuit of the exempt educational purpose of the university in a direct way. But that would be an unduly narrow view of exempt purpose. Students are not expected to spend every waking hour attending classes or studying; they have fuller lives, and not only may but should spend at least some time engaged in activities involving art, music, drama, and recreation, including athletics. Such activities make students healthier and happier, and are quite reasonably regarded as an integral part of normal student life.

Much the same could be said—though less convincingly—of the second category of college and university athletics. This category would consist of intercollegiate athletics—both of the “varsity” and “club” style⁴—that do not, and are not expected to, produce significant revenue, or at least not net income, after allowing for the often considerable costs of engaging in these sports. Traditionally, this “nonrevenue” category has consisted of virtually all intercollegiate athletics other than the football and men’s basketball programs at the highest tier of the college sports hierarchy—the group of programs that the National Collegiate Athletic Association has denominated as “Division I.”

Defense of nonrevenue intercollegiate athletics as within a university’s exempt purposes is somewhat more challenging than it is for intramural athletics. In light of the fact that few universities in the world (though most in the U.S.) engage in intercollegiate athletics at all, it is difficult to maintain that such activities are even a normal, much less a necessary part of the university student experience. And although nearly every U.S. college or university does engage in intercollegiate athletics at some level, relatively few students at

⁴According to University of New Hampshire (UNH) Athletic Director Marty Scarano, the main difference between the “varsity” and “club” classification is university funding. Although the level of competition may be commensurate with varsity athletics, because most of UNH’s funding goes to football, hockey, and basketball, many other sports are classified as “club” sports. Ryan Hartley, “Varsity Sports vs. Club Sports: It Comes Down to a Matter of Dollars and Cents,” *The New Hampshire* (Feb. 13, 2013), www.tnhonline.com/sports/varsity-sports-vs-club-sports-1.1390663.

each institution participate in any intercollegiate sports. Furthermore, those who do frequently find that participation in these activities diminishes rather than enhances their overall educational experience, if only because of the demands of time and energy imposed on the student-athlete.⁵

The lack of a compelling connection to the educational mission, together with the distinct possibility that nonrevenue intercollegiate athletics may in some cases reduce the value of the educational experience of the student-athlete, are troubling on many grounds. However, they are not ultimately troubling in terms of any issues posed by federal tax law. Although the relevant statute requires that organizations seeking exempt status pursue their charitable purposes “exclusively,” the Treasury Regulations implementing this provision have long interpreted this requirement to be satisfied as long as charitable purposes are primary.⁶

Thus, if nonrevenue intercollegiate athletics can be shown to be merely incidental activities of colleges and universities, and not primary, their presence on campus should not represent a threat to the institution’s qualification for exemption.⁷ In most cases, the incidental quality of nonrevenue sports would not be difficult to demonstrate. In the case of Duke University, for example, the array of intercollegiate teams includes twelve men’s teams and, equitably, twelve women’s teams.⁸ This is a considerable roster of teams for a relatively low-enrollment university.⁹ Nevertheless, the total expenditures for the athletics

⁵ The general NCAA guideline is that, during each sport’s defined season, up to twenty hours per week of the student-athlete’s time can be claimed by the team for practices, conditioning and related activities. This does not include travel time to games that are not staged on the student’s own campus, and also involves artificial time-accounting rules. For example, the athletic event itself is presumed never to exceed three hours, even if the event is a 36-hole golf tournament that may take more than eight.

⁶ Treas. Regs. §1.501(c)(3)-1(c)(1).

⁷ Public universities are not subject to the income tax because they are instrumentalities of state governments, rather than nonprofit corporations. Accordingly, they do not need to demonstrate that they primarily serve an exempt purpose (though they presumably could do so if they needed to). See Ellen P. Aprill, “*Excluding the Income of State and Local Governments: The Need for Congressional Action*,” 26 Ga. L. Rev. 421 (1992).

⁸ There are men’s and women’s teams in basketball, cross-country, fencing, golf, lacrosse, soccer, swimming, track and field, and tennis. In addition, there are men’s teams in baseball, football, and wrestling, and women’s teams in field hockey, rowing, and volleyball.

⁹ Duke has fewer than 7000 undergraduate students. “The Equity in Athletics Data Analysis Cutting Tool,” U.S. Department of Education (last visited Sept. 13, 2013), ope.ed.gov/athletics.

department—roughly \$78 million in the 2011-12 year¹⁰—is only a small fraction of the university’s overall budget (not including the Duke Health System) of over \$2.1 billion.¹¹ And while the total number of students at Duke who engage in intercollegiate athletics in any year runs to around 650, that is only about ten percent of the total population of undergraduate students.¹² Thus, even if intercollegiate athletics were determined to be unrelated to the exempt purposes of the university, it would seem that they were incidental, and did not constitute a primary purpose of the university.

Of course, if they are unrelated to the exempt purposes, the possibility arises that these activities might generate unrelated business income. But these sports are called “nonrevenue” sports for a reason. In most cases, they are not literally without revenue: spectators ordinarily pay small admission charges to watch athletic events in some sports within the nonrevenue category, such as soccer, baseball, and lacrosse games.¹³ And some television networks, in their continued quest to find the bottom of the public’s appetite for college sports, have begun televising many of these events, including the College World Series (men’s baseball), the counterpart tournament for women’s softball, the final three rounds of the NCAA Division I lacrosse tournament, and even regular season women’s basketball games, among many others.

So one is left thinking that the nonrevenue category is one to be watched; at any time, a sport may achieve a breakthrough level of popularity that will generate enough spectator interest—both live and on television—that it will need to be promoted to the “revenue sport” category. And the breakthroughs can be sudden: the University of Arizona baseball team, for example, had regular home gate receipts of \$69,000 in 2011—a non-trivial amount, to be sure, but barely enough to cover even a few scholarships for the play-

¹⁰ *Id.*

¹¹ Michael J. Schoenfeld, “Trustees Reappoint Brodhead, Approve Budget, Projects,” *Duke Today* (May 12, 2012), today.duke.edu/2012/05/trusteesmay2012.

¹² See note 7 above.

¹³ Practices with respect to admission charges in sports other than basketball and football vary widely. But at Duke University, charges in the range of five to ten dollars per ticket are the price of admission to the sorts of events noted in the text.

ers who received them.¹⁴ The box office boomed the following year, however, largely due to the construction of a new stadium: in 2012, Arizona's baseball team generated \$350,000 in home gate receipts, more than a five-fold increase in a single year.¹⁵

But even though Arizona went on to win the College World Series in that year, its athletic director denied that the sport generated significant net income.¹⁶ That claim is entirely plausible, because the scholarship, coaching, equipment and travel costs of fielding a 25-player team, and transporting them around the country to play its schedule, are considerable;¹⁷ generating revenue in the six-figure or even low-seven figure range would not likely be enough to make the sport profitable.¹⁸ And without profit, there would be no tax liability under the unrelated business income tax.

If the nonrevenue sports are put aside for the moment—subject to further review in the replay booth from time to time—we are left with the football and men's basketball programs at Division I universities. At the present time, there are 242 universities that compete in Division I football, and 340 universities that compete in Division I basketball.¹⁹

¹⁴ NCAA Division I permits 11.7 baseball scholarships per year. This means that a college can distribute partial and full scholarships totaling the value of 11.7 full scholarships per year. "College Athletic Scholarship Limits," (last visited Sept 18, 2013) scholarshipstats.com/ncaalimits.html.

¹⁵ Alicia Jessop, "University of Arizona Baseball: Making the College World Series . . . and Money," *Forbes On-Line* (June 13, 2012), <http://www.forbes.com/sites/aliciajessop/2012/06/13/university-of-arizona-baseball-making-the-college-world-series-and-money/>.

¹⁶ Arizona athletics director Greg Byrne has said: "It's not a big money-maker. We made a little bit of money on licensing from National Championship shirts" www.wildcat.arizon.edu/article/2012/08/greg-byrne-talks-facilities-olympics-college-world-series.

¹⁷ According to "The Equity in Athletics Data Analysis Cutting Tool," U.S. Department of Education, Duke reports spending over \$20 Million on all sports other than football or basketball in the 2011-2012 fiscal year. If an equal amount was spent on each of these sports, Duke would have spent around \$1.7 million on its baseball team alone.

¹⁸ For example, the Cal- Berkeley baseball team nearly got dropped from the roster of Cal teams in 2010 because of the substantial financial losses the team had incurred in the preceding years. It was estimated that the expense of conducting their baseball program was approximately \$1 million per year, but that it generated only \$180,000 in revenue. It has since been resurrected, as a result of a successful \$10 million fund-raising effort. See newscenter.berkeley.edu/2011/04/08/baseball-to-continue-at-cal/, and www.my.sportsdreams.com/youth-sports-fund-raiser-news.

¹⁹ "About the NCAA," National Collegiate Athletic Association (last visited Sept. 14, 2013), www.ncaa.org/wps/wcm/connect/public/ncaa/about+the+ncaa/membership+new. For football, Division I is divided into the Football Bowl Subdivision (FBS) and the Football Championship Subdivision (FCS). Unlike the FBS, the FCS plays a full post-season playoff to crown a national champion, and the FBS schools tend to spend more money on their football teams.

Even within this category, not all programs enjoy net income in any particular year.²⁰

However, the potential to achieve net income is present in all of these programs, and they raise similar enough issues to be considered as a group.

Following the discussion of big-time college athletics²¹ and its relation to the exempt purposes of a university, a quite separate argument will be considered, relating to the current rule contained in section 170(l) of the Internal Revenue Code, which allows eighty percent of contributions to universities that have the effect of giving the donor an opportunity to buy tickets to big-time college sports events. Because the domain of this rule is by its nature confined to big-time college sports, it was not necessary to explore its implications in the context of intramural or nonrevenue sports.

Strike One: Are Big-time College Athletics Related to a University's Exempt Purpose?

Having tightened the focus solely on the big-time sports of college football and men's college basketball, we can begin to consider one of the central questions in this field: Is pursuit of these sports within a university's exempt purpose? If the point of such an inquiry is to determine whether the university deserves exempt status, all the arguments in the preface can be mustered to support big-time athletics as well: many students participate, and a much larger number of students watch; colleges have always sought musicians to staff the orchestra, thespians to fill out the playbill, journalists to publish the student newspaper. Extracurricular activities are a part of campus life, and athletics not obviously less so than any other extracurricular activity. None of these activities is strictly necessary; but all contribute to the university community in their distinctive ways. And, in any event, there is the saving grace of the "primary" concept: in the aggregate, a university's budget will be dominated by the salaries of faculty and academic staff, construction and upkeep of

²⁰ Charles T. Clotfelter, Big-Time Sports in American Universities 95, 97 (2011); "2004-08 NCAA Revenues and Expenses of Division I Intercollegiate Athletics Programs Report," NCAA (Indianapolis, Aug. 2009), 8. Clotfelter cites *USA Today* Web site, financial data for 98 state universities, 2007-2008 fiscal year. An update to the site can be found at usatoday30.usatoday.com/sports/college/story/2012-05-14/ncaa-college-athletics-finances-database/54955804/1 with data for 227 public institutions.

²¹ Throughout this essay, the phrase "big-time" will be used to refer to football and men's basketball at Division I schools.

the laboratories, classrooms and dormitories, management of the university's endowment, and many other functions. Large universities have budgets that run into the billions of dollars, so athletics budgets that run into the tens of millions will not detract from the primary mission of the university.

Instead, the primary impact of a determination that engaging in big-time sports is not within the exempt purpose is, of course, that these activities may then imaginably be subject to taxation as unrelated business activities.²² And unlike fencing and volleyball, football and basketball can make enough money to cover their fully loaded costs, and still have a profit worth subjecting to an unrelated business income tax.

There would certainly seem to be a *prima facie* case for the argument that Division I football and basketball should be subject to the unrelated business income tax. They would seem to be a business, in that they are operated in a manner that appears to be designed to generate profit; they are regularly carried on; and they are unrelated to the purposes for which exempt status was granted to the college or university that houses the particular program. These are the elements of unrelated business subject to the tax under section 511(a) of the Internal Revenue Code,²³ and each seems satisfied by the facts presented by most big-time programs.

That this is so has been amply documented by others, and there is little point of rehearsing the full details here.²⁴ But it may be useful to summarize the main observations on these points. As to whether big-time sports are a business, one would note that they generate a tremendous amount of revenue, through the sales of tickets, of television and radio rights, and merchandise, especially apparel, related to the sports programs.²⁵ The athletic

²² IRC §511(a)(2)(B) imposes the unrelated business income tax even on public universities, despite their general exemption from federal income taxes.

²³ See also Treas. Regs. §1.513-1(a).

²⁴ Clotfelter, *supra*, note 20, at 94–107.

²⁵ Note that some merchandise is very directly related to the sports programs, e.g., replica jerseys with the names and numbers of particular players; shirts, etc., that carry legends like “Duke Basketball” or “2010 NCAA Basketball Champions;” and even, in Duke’s case, table-top models of Cameron Indoor Stadium, our local temple of basketball worship. It is also reasonable to assume that the Big-Time sports programs contribute to the market for more generalized university apparel and gifts. In Duke’s case, the full array of mer-

activities are heavily promoted through a variety of media, especially including television. The salaries of head coaches are routinely two to four times the salaries of the university president, and ten times or more the median salary of full-time faculty members.²⁶ (And when these are questioned, the usual defense is that the coach is “worth it.”) The games themselves are scheduled on dates and at times that are designed to maximize ratings for the broadcasts.²⁷ Tickets to the most popular big-time sports programs are allocated on the basis of seat licenses that are essentially auctioned off to would-be buyers—whether they have any relationship with the university or not—for whatever the market will bear.²⁸

Although the big-time sports contests are seasonal—from late August to the bowl games in early December for football, and from late October until early April for basketball—they are carried on in that seasonal way year after year, which is sufficient to meet the “regularly carried on” leg of the unrelated business income tax rules.²⁹ And, in truth, though the games are played during only the intervals noted, various other activities—recruiting of players, setting of schedules, sales of tickets, etc., go on year around.

The only leg of the three-legged UBIT stool that could be said to be seriously contestable would be the question of whether or not these activities are related to the broader educational enterprise housing them. Even as to this factor, the case for application of the unrelated business income tax seems clear. The “student-athletes” in these programs seem much more like athletes than students: they are selected primarily for their athletic ability

chandise can be viewed on the official athletics website of the university, goduke.com. The “.com” designation in itself seems an admission that some business is being transacted there.

²⁶ In 2011, Duke basketball coach Mike Krzyzewski received a salary of \$9.7 million. Steve Berkowitz, “Duke’s Krzyzewski Credited With \$9.7 Million in Pay for 2011,” USA TODAY Sports (May 16, 2013), <http://www.usatoday.com/story/sports/ncaab/2013/05/15/mike-krzyzewski-coach-k-duke-salary-pay-2011/2156231/>.

²⁷ Steve Eder, Richard Sandomir, and James Andrew Miller, “At Louisville, Athletic Boom Is Rooted in ESPN Partnership,” The New York Times (Aug. 25, 2013), <http://www.nytimes.com/2013/08/26/sports/at-louisville-an-athletic-boom-made-for-and-by-tv.html>.

²⁸ Clotfelter, Big-Time Sports in American Universities 99–103.

²⁹ This understanding of seasonal activities as being regularly carried on has been part of Congressional intent from the beginning, as explained in the legislative history of the Revenue Act of 1950, which created the unrelated business income tax: [I]f an organization owned a race track, this would not be considered an occasional activity even though the track was operated only a few weeks every year, since it is usual to carry on such a trade or business only during a particular season. H.R. Rep. No. 2319, 81st Cong., 2d Sess. 37, 109 (1950), 1950-2 C.B. 380, 458

rather than their academic ability; they devote huge amounts of time to their sports, especially during the primary seasons for their sport, but even in their respective off-seasons; they are ordinarily expected not to engage in other intercollegiate sports, and not to take classes at times that would conflict with times set aside for practices or games; they travel extensively during which they necessarily miss classes; they receive extensive “academic support” from athletic department staff that frequently blurs the line between tutoring and actually doing classwork on behalf of the students so “supported;” they have generally poor graduation rates, and rarely choose any of the more challenging major fields of study available on their campuses.³⁰

Coaches are hired for their ability to win games and fired for any shortcomings in that metric. Their incentive pay may include a nod toward the academic side of the university (for example, a bonus for achieving a particular graduation rate), but those incentives pale in comparison with the incentives to field successful teams. Studies of the bonus structure faced by coaches have found that the rewards for success on the field are approximately twelve times as large as the rewards for success in the classroom.³¹

Expensive facilities for training, practice, and the actual games, are built for, typically, the exclusive use of athletes in the big-time programs. At many universities, the student-athletes are even housed and fed in facilities that are separate from (and invariably in such cases, superior to) the facilities available to students who are not athletes in one of the big-time sports.

The Applicability of UBIT to College Sports: the Views of Congress, the IRS, and the Courts

But despite the seemingly tangential relationship between a university’s big-time sports programs and the educational institution whose name they share, all of the major sources of rules affecting the tax system—Congress, the Internal Revenue Service, and the

³⁰ In many universities, programs in “Recreation Management” or the like are available, and in many cases they are available primarily to scholarship athletes.

³¹ See Burton A. Weisbrod, Jeffrey P. Ballou, and Evelyn D. Asch, *Mission and Money: Understanding the University*, Cambridge University Press (2008), as cited in Clotfelter, *supra* note 20.

courts—have universally declared big-time sports to be sufficiently related to the educational enterprise to avoid the status of unrelated business activity.³²

This has been true from the very beginning—that is, from the date of enactment of the Revenue Act of 1950, which created the unrelated business income tax. Though big-time college sports are not specifically mentioned in the legislative language itself, the committee reports take considerable pains—one might almost say that they protest too much—to make it clear that Congress couldn’t even conceive of the new tax applying to college sports. The Ways and Means Committee and the Finance Committee seem to have agreed to use something of a zone defense of college sports, with the first specifically defending college football, and the latter college basketball³³:

Of course, [indeed!] 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.³⁴

And

Athletic activities of schools are substantially related to their educational functions. For example, 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.³⁵

The Internal Revenue Service did not immediately follow with its own pronouncements on the applicability of the unrelated business income tax to college sports, presumably because it did not feel that it needed to. It simply took no actions that would be inconsistent with the language of the legislative history, which sent a strong and unambigu-

³² Citations will follow in the specific paragraphs below.

³³ Their respective choices are a little odd, in light of the fact that college basketball was originally an urban sport, played in dank gymnasiums of Catholic high schools and colleges in New York, Philadelphia, and a few other cities. Football, in contrast, was of special interest to the fans of the big state universities of the West, Midwest, and South. In light of the malapportionment of the Senate in favor of states like Nebraska, Mississippi, and Oklahoma, one might have thought that football was their preferred sport. This reasoning presumably explains the misattribution of the two quotations in the text by the IRS in Rev. Rul. 80-296 (1980-2 C.B. 195, 196), which erroneously casts the House as the defender of basketball, and the Senate as the defender of football.

³⁴ H.R. Rep. No. 2319, 81st Cong., 2d Sess. 37, 109 (1950), 1950-2 C.B. 380, 458.

³⁵ S. Rep. No. 2375, 81st Cong., 2d Sess. 29, 107 (1950), 1950-2 C.B. 483, 505.

ous message that the IRS should not consider college sports as unrelated to the exempt purposes of the colleges that pursued those sports. Because the IRS did not attempt to assess any taxes on unrelated business income with respect to big-time athletics activities, the courts were not called on to make any determinations about the applicability of UBIT doctrines to this area. However, some older opinions could be found to support the idea that college sports were appropriately regarded as integral to educational experiences.³⁶

Occasionally, the IRS issued rulings regarding qualification for exemption by athletic support groups at a variety of levels of amateur sports: In Rev. Rul. 55-587,³⁷ the IRS ruled that an interscholastic body to oversee high-school athletic competition could qualify as a charitable organization. In Rev. Rul. 64-275,³⁸ the IRS ruled that a sailing school designed to train teams of athletes for international competition, including the Olympics, could also qualify as a charitable organization. And in Rev. Rul. 67-291,³⁹ the IRS ruled that an alumni organization that supported a college's "training table" for feeding members of athletics teams could qualify as a charitable organization. None of these organizations produced significant revenue, however, so no unrelated business tax issues were discussed in any of these rulings. And of course even if UBIT issues had been raised, the findings that the activities described did constitute exempt purposes would presumably have answered any questions about whether the IRS regarded these activities as related to exempt purpose.

Television and UBIT

During this time, the value of the rights to broadcast, and especially to televise some big-time sports events—especially college football bowl games and the NCAA basketball tournament—was growing. The 1979 basketball championship—featuring Larry

³⁶ See, e.g., *Dist. Of Columbia v. Shannon & Luchs Const. Co, Inc.*, 17 F.2d 219 (D.C. Cir. 1927). (This case involved the exercise of eminent domain to acquire property for a school athletic field. The Court summarized the case law on the subject, noting that: "[C]ourts . . . uniformly hold that physical culture and development is an integral part of our educational system")

³⁷ 1955-2 C.B. 261.

³⁸ 1964-2 C.B.142.

³⁹ 1967-2 C.B. 184.

Bird's Indiana State team playing Magic Johnson's Michigan State team—achieved a college-sports record single-game Neilson rating of 24.1, with a 38% audience share at its peak. This translated to a television audience of 18 million households—18 million households with a thirst for beer and soft drinks, a yen for pickup trucks, and a mighty appetite for fast food—at least in the judgment of the firms that decide to advertise their wares in this venue.

Perhaps spurred by this heightened attention, the IRS shortly thereafter ruled that television and radio revenue generated by college sporting events did not constitute unrelated business activity. In Rev. Rul. 80-296,⁴⁰ it opined, after a brief and very superficial analysis involving the facts of a college football bowl game, that:

[T]he educational purposes served by exhibiting a game before an audience that is physically present and exhibiting the game on television or radio before a much larger audience are substantially similar. Therefore, the sale of the broadcasting rights and the resultant broadcasting of the game contributes importantly to the accomplishment of the organization's exempt purpose.⁴¹

Really? The live audience and the television audience are “substantially similar? Consider a typical football weekend at a Big Ten or Southeastern Conference university (Ohio State, Florida, Penn State, Alabama, etc.). The fun for the students begins on Friday night, with a pep rally, maybe a bonfire, and certainly major partying. On Saturday morning, while the students are sleeping off their hangovers, the alumni begin to arrive in their SUVs and station wagons for the tailgating that will precede the game. The alumni often join with classmates arriving from different directions, creating hundreds of mini-reunions scattered over the massive acreage of the stadium parking lot. Then, as kickoff approaches, the students and alumni file into the stadium, along with faculty, staff, and members of the community whose relationship with the university may be less intimate, but who are nevertheless loyal fans, willing to pay hundreds of dollars for their season tickets.

The university president, and the deans of the graduate and professional units, will take their particularly desirable seats, along with trustees and other major donors, or peo-

⁴⁰ 1980-2 C.B. 195.

⁴¹ *Id.* at 4.

ple who are targets for such status. After the game, the partying will resume, with more or less festivity, depending on the outcome of the game. Not all of this activity is appealing or healthy, but it does all have some meaningful connection with the operations of the university.

Compare this with the experience of the television audience. That group will, in the case of a nationally televised game, number in the millions, of which only a small percentage will have even the most remote connection with the university. Most will not be even in the same state, much less the same zip code, as the host university. These viewers hope mostly to be entertained by the athletic display. Some may hope to be enriched, if they have wagers on the game with their on-line bookies in the Bahamas. Some may simply have nothing better to do. What they generally do not have is any interest in the educational enterprise that is associated with the universities whose student-athletes are on the field.

In a law-school examination situation, would we give a high grade to students who, after examining these facts, concluded: “Nope, no meaningful distinctions here; these audiences are ‘substantially similar’.” I think not. Defenders of big-time college sports defend their practices largely in terms of building their university communities—fostering “school spirit,” collective identity, and closer connections among and between the various constituent groups making up the university: students, administrators, trustees, and alumni, and perhaps as well people who operate businesses in the general vicinity of the university. None of that is going on in the national television audience. Rarely, if ever, would a university defend its sports programs on grounds that they serve to entertain a national audience of people who are largely strangers to the university community.

There may be one exception to this: university officials do sometimes mention that successful big-time sports programs may produce increased interest on the part of potential applicants for admission, which in turn may translate to an increase in applicant volume. The evidence on this is mixed, but the prevailing view seems to be that success does produce a modest (and transient) increase in applicant volume, but only for the very small

number of universities at the very pinnacle of achievement in football or basketball—literally only the teams that win a major bowl game, or make it to the Final Four ® of the NCAA basketball tournament.⁴²

So this effect is small, affects only a few universities, and even when present, may be a mixed blessing. If the marginal applications stimulated by athletic success are largely from students who are not well-qualified for admission to that university, there is little benefit at all.⁴³ But it is probably true that at least some of the marginal applicants are well enough qualified to be accepted, and perhaps enroll. However, if I were a provost, I would wonder whether it was necessarily a good thing that a few applicants whose interest in the university was based largely on its athletic success were displacing a similar number of applicants who were almost as well-qualified, and had been attracted to the university by its other qualities—qualities more closely associated with the things that universities claim to value.

Even if university officials do not take this view, being instead wholly pleased with application stimulation and other effects of the publicity generated by the success of their big-time sports programs, it is nevertheless the case that generating greater name recognition would not seem to be, in itself, sufficiently related to the university's exempt purposes to take an activity out of the range of the unrelated business income tax. After all, would manufacturing macaroni become a "related" business if the company making the pasta called itself the New York University Law School Macaroni Company, and featured pictures of Ronald Dworkin or Marty Lipton on its boxes, in the manner of Wheaties (The Breakfast of Champions)? Even if NYU Mac and Cheese became The Lunch of Power

⁴² Clotfelter, *supra*, note 20, at 145-46. One study Clotfelter cites does find an effect, albeit a very small and transient one, resulting from finishing in the top 20 in football, or making the round of sixteen in the basketball tournament. Devin G. Pope and Jaren C. Pope, "*The Impact of College Sports Success on the Quantity and Quality of Student Applications*," 75 Southern Economic Journal 750 (2009).

⁴³ One effect of increased applicant volume is that the apparent selectivity of the university may increase, as it accepts a smaller percentage of its fattened applicant pool. This may be slightly helpful; however, the US News methodology (as an example) weights acceptance rate as ten percent of the "selectivity score," which in turn is only fifteen percent of the overall score. Thus, acceptance rate is weighted at only 1.5% of the overall score.

Lawyers, it is doubtful that it would save macaroni manufacture from being regarded as a business unrelated to the exempt purposes of the university.

The Special Case of Advertising

One reason that it is important to distinguish between the live audience and the television audience is that the income produced by the attention of the television audience is largely advertising income.⁴⁴ Beginning in the late 1960s, the IRS developed a doctrine that an activity that may be within an organization's exempt purpose may also be viewed as a "content provider" (though of course that was not the lexicon of the time) of a sort that makes it an attractive platform for advertisers. When this situation arises, the IRS has argued, it is appropriate to view the advertising as a separate activity—one that is unrelated to the organization's exempt purpose, despite the fact that the underlying activity may be within its exempt purpose.

In the case of big-time college sports, the income does not come to the universities directly from the advertisers, but rather comes indirectly through the various television networks that sell the advertising opportunities in the market. Obviously, the magnitude of the available advertising revenue is the reason that networks are willing to pay substantial sums to the NCAA, or the various conferences, for the rights to televise big-time athletics contests. And the dollar amounts paid for advertising of college sports have grown in recent years to noteworthy levels. For example, it is estimated that the advertising revenue associated with the NCAA basketball tournament in 2013 exceeded one billion dollars!⁴⁵

⁴⁴ This may be changing. There are now special "networks" that operate by making games—such as all football games played by Big Ten schools—available only to subscribers who pay for the privilege of receiving these broadcasts through their regular cable or satellite television provider. In such an arrangement, the cable or satellite provider presumably keeps some of the subscription cost, and pays part of it to the conference that arranges the telecasts. There may be advertising sold in connection with these broadcasts as well, but at least a substantial part of the income received by the conference, and passed on to its member schools, would come from viewers, not advertisers. The impact of this will be considered below in the section of this essay on "Cable/Satellite Subscription Payments."

⁴⁵ "Kantar Media Releases March Madness Advertising Trends Report," Kantar Media (Mar. 6, 2013), <http://kantarmediana.com/intelligence/press/2013-march-madness-advertising-trends-report>.

Viewing the sale of television rights as implicitly advertising income has important implications for the application of the unrelated business income tax. First, as noted above, segregating the sale of advertising from the other aspects of an activity has been used, in effect, to require an independent justification of the relatedness of the advertising aspect; this means that it is possible that college sports could be exempt from UBIT because they are related to exempt purposes, while the sale of advertising opportunities might not be exempt, because it couldn't "borrow" the relatedness of the overarching activity.

Second, segregating an advertising element from the rest of the big-time sports elements would be much more likely to yield accounting results that would actually show unrelated business taxable income in substantial amounts. Even if the overall big-time sports picture for a university did not show an excess of revenue over expense (and it well might not, in light of the possibilities of generating deductions for major items like depreciation on stadiums and other facilities), the segregated business of televising college sports would likely show consistent, and large profits.⁴⁶ The television networks typically cover the costs of their operations themselves, so the amounts that are paid to the NCAA or the conferences, and then distributed to the universities, are nearly pure income

Finally, the magnitude of television, and its advertising revenue, has ballooned in recent years. It was virtually nil in 1950, when the unrelated business income tax provisions were first added to the code. It had grown considerably by 1980, when the IRS issued Rev. Rul. 80-296, but it was even then miniscule compared with today's dollar vol-

⁴⁶ One highly respected commentator disputes this, saying that even if big-time college sports were considered an unrelated business activity, the availability of deductions for program costs would likely wipe out any net income. See John D. Colombo, "*The NCAA, Tax Exemption and College Athletics*," ssrn.com/abstract=1336727 (2009). I disagree, and think that one of the purposes of the fragmentation rule was to split off the costs of the disaggregated activity—in this case, televising sporting events—from the overall activity. Indeed, if that is not the purpose, it is difficult to see any advantage in the fragmentation approach. This conference includes a presentation of a paper on the general subject of expense allocation in college and university UBIT disputes written by, um, John D. Colombo. Since that paper immediately precedes this one in the program, the accounting issues will presumably have been ventilated by the time a presentation is made on the current essay. Even in the worst case, however, I would note that Colombo concedes that some athletic programs would make money no matter how liberal the deduction rules might be; and I would note as well that the IRS has the power to amend the accounting rules to produce a better match of the actual expenses of televising sports with the revenue produced thereby.

ume. The continuing rise in the value of television rights continues to astonish: just when one thinks that one has gotten used to very large numbers, the numbers grow larger still. Writing in 1980, Richard Kaplan noted that the broadcast package for the NCAA basketball tournament had doubled in size over just the preceding two years.⁴⁷ How much was it back then? With the addition of a \$2,000,000 payment from the new Entertainment and Sports Programming Network (ESPN) for the rights to televise some early-round games, the total had grown to \$10,500,000.⁴⁸ A tidy sum, no doubt; but only about one percent of the sum paid for the rights to the most recent tournament.

The dramatic shape of this growth curve is important because it provides a powerful reason to re-examine conclusions reached earlier, on very different facts. Television barely existed in 1950, so no one in Congress could have imagined the revenue possibilities that would come to be more than sixty years later. By 1980, the IRS might have had a little more reason to think that growth in revenue was robust, and might continue. But no one in 1980 would likely have predicted a hundred-fold increase in television revenue over the following thirty or so years.⁴⁹

The amount of money at stake has had some predictable consequences. Schedules and game times, for example, used to be the province of the conferences primarily, with input from the athletics directors of the member schools. Increasingly, the dates and times of games are dictated by the networks that will be televising the events.⁵⁰ If it once seemed that sports teams were appendages of the universities they represented (or vice versa!), it now seems that they are increasingly the appendages of ESPN. So it is certainly worth asking: just how unrelated to higher education does televised big-time college sports have to get before we are ready to conclude that it should be subject to the unrelated business tax?

⁴⁷ Richard Kaplan, "Intercollegiate Athletics and the Unrelated Business Income Tax," 80 Colum. L.Rev. 1430, 1445 (1980).

⁴⁸ *Id.*

⁴⁹ Note that only a small part of this growth is attributable to inflation. The Consumer Price index was at 86 when the IRS issued the ruling in 1980, and has grown to about 230 today. So a multiplier of about 2.7 is the appropriate adjustment for inflation. Thus, instead of a hundred-fold growth, it may be more appropriate to speak of a real growth of more like a 35-fold magnitude. That is still huge growth.

⁵⁰ See Sandomir and Miller, *supra* note 25.

Before reaching any conclusions, a closer look at the relevant legal doctrines on segregation of advertising income from other aspects of a business conducted by a charitable organization is indicated. The law in this area stems primarily from *United States v. American College of Physicians*, a case involving the applicability of the unrelated business income tax to the income derived from selling advertising space in a publication of the College of Physicians entitled “*Annals of Internal Medicine*.”⁵¹ Decided in 1986, this case was the culminating event in a saga that went on for nearly twenty years.

In 1967, the Treasury promulgated a regulation that adopted a new approach to the unrelated business income tax.⁵² The Treasury was no doubt concerned that in the case of some mixed activities, where some exempt purposes existed, but where unrelated business activities were going on as well, aggregating the related business activities with the unrelated ones would produce accounting opportunities to offset unrelated business income with the expenses that were incurred in pursuit of business interests that were related to the organizations’ exempt purpose. Advertising was the chief target: the reasoning behind the regulation was that seeking (and finding) businesses that were interested in placing advertisements in publications of exempt organizations were businesses in themselves, and were businesses that had nothing to do with exempt purposes of the organization. Instead, they were about generating revenue.

This somewhat aggressive position of the Treasury was the object of criticism, but Congress came to the rescue with uncommon speed. In the Tax Reform Act of 1969,⁵³ it amended section 513(c) of the Code to specifically endorse this “fragmentation” approach to advertising income.

The facts of *American College of Physicians* illustrated the application of this theory. The publication involved was clearly within the exempt purpose of the College of Physicians: it carried articles describing research outcomes of interest to a wide range of practicing physicians. The articles were scholarly in nature, and were not designed to advance

⁵¹ 475 U.S. 834 (1986).

⁵² Treas. Reg. §1.513-1(b) T.D. 6939, 1968-1 C.B. 274.

⁵³ Pub.L. 91-172, 83 stat. 487.

the interests of any businesses that might have chosen to advertise in the journal. The case could have been a test case of the fragmentation approach, but after that approach was endorsed by Congress, such a challenge would presumably have had to be on Constitutional grounds, which the College of Physicians may have thought too high a bar.

Instead, what was at stake in American College of Physicians was the specific application of the fragmentation rule to advertising in a professional journal. The government took the position that all advertising in such journals was unrelated to exempt purposes; the College of Physicians disagreed, and the Supreme Court found for the College on this point. But having won that battle, the College went on to lose the broader war. The Court declined the IRS proffered *per se* rule, but upon examining the facts in the particular case, found that there was little or no editorial control over the content of the advertising, and that the particular ads in each journal issue could not be said to be in those pages for the purpose of advancing any charitable purpose of the College of Physicians.

The language of Justice Marshall's opinion suggests that if the College had, for example, limited advertisers (apparently mostly drug companies) to advertisements featuring new drugs, or only to advertisements that featured clinical findings that might have educational value for the physicians reading the journal, then the ads, and the revenue they produced, might have been found related to the exempt purpose of the College.⁵⁴ But of course this would have reduced the advertising opportunities significantly, so absorbing the unrelated business income tax was probably the more economically productive approach.

While the IRS enforcement pattern that is available on the public record—and indeed the text of the regulations themselves—suggests that the primary interest of the IRS was in print advertising in publications like the *Annals*, the text of section 513(c) is not so limited. At no point does it refer either to publications or advertising explicitly, but merely says, in relevant part:

⁵⁴ One pictures the ads as being of a more commercial sort: perhaps a picture of an unhappy-looking housewife, sitting at her kitchen table, staring into a cup of coffee, with text that reads: "Does she just have the blues, or is she suffering from a treatable medical condition?" Implicitly: Surely the latter, and here's just the drug she needs.

[A]n activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.⁵⁵

This is the sort of maddening draftsmanship that leads tax lawyers to say that resort to the code should only be undertaken in the event that the legislative history is unclear; and in this case, the legislative history is clear enough: Congress meant to endorse the IRS fragmentation approach, so that more-or-less free-standing, revenue-generating parts of an operation could be segregated for purposes of accounting for possible unrelated business income.

The precise targets were a matter of some debate. The House Report, while proposing language that was not limited to advertising income, mentioned only that in its report.⁵⁶ The Senate added an amendment that would have limited the scope of the provision to three activities specified in its report: advertising, “sales of drugs by a hospital pharmacy to persons other than hospital patients,” and “operation of a race track by an exempt organization.”⁵⁷ The Conference report adopted the House version, with minor wording changes to make it clear that “no part of it [the unrelated activity] is to be excluded . . . merely because it does not result in profit.”⁵⁸

The more general language of section 513(c) would seem to make clear that even if the revenue paid by broadcasters were not considered advertising, that would not bar application of the fragmentation principle. However, even if one were to take the narrow view that section 513(c) applied only to advertising income, it would seem that much of the broadcast and telecast income would qualify as such. Consider, for example, whether the result in *American College of Physicians* would have been any different if the College, instead of publishing the *Annals* itself, had arranged to have a third party publish the *Annals*, with the understanding that the third party would be allowed to sell advertising, and would pay most of the difference between its advertising revenues and its cost of publica-

⁵⁵ IRC §513(c).

⁵⁶ H.R. Rep. 91-413, reprinted at 1969-3 C.B. 232.

⁵⁷ S. Rep. 91-552, reprinted at 1969-3 C.B. 472.

⁵⁸ Conf. Rep. 91-782, reprinted at 1969-3 C.B. 653.

tion over to the College. Surely the injection of an intermediate agent into the production of the Annals would make little difference in the analysis.

This parallel version of the American College of Physicians facts is fairly close to what conferences and the NCAA have done with respect to big-time sports: they have agreed with CBS, ESPN, and others that those networks will be allowed to sell advertising that will be shown in connection with game broadcasts, with much of the net revenue derived from those sales being paid to the conferences or the NCAA. In fact, the recent creation of the Big Ten network indicates that business models involving even more direct sales of advertising are imaginable, and are in fact being pursued by some conferences.

But whether the advertising revenue is collected directly by a network owned by a conference or indirectly, though the medium of a more general broadcast network, it remains advertising revenue. To that extent, it could be subjected to a disaggregation analysis that would result in the recognition of substantial unrelated business taxable income.

Cable/Satellite Subscription Payments

To this point, no mention has been made of the fact that networks also receive revenue from a source other than advertising: payments from local television cable and satellite companies. The latter have contractual arrangements with subscribers under which monthly payments are made in exchange for delivery of a signal by cable or satellite into the viewers' homes. The basic rate for this service begins at around forty or fifty dollars per month, with add-ons for additional receivers, high-definition transmissions, optional programming, and other features. These subscription amounts come from the pockets of the viewers, and are more analogous to the purchase of a ticket than to advertising; just as is the case with payments for live admission to an event, they represent a payment from someone who wants to watch athletic contests. A possible inference from these facts might be that, to the extent that the funds that ultimately flow to universities are derived from subscription fees, rather than from advertising, they should be not be considered unrelated business taxable income under the fragmentation theory just advanced.

While such an inference is not facially unreasonable, it ignores the critical difference between live attendance and television viewing emphasized in the discussion above of the (defective) reasoning of Revenue Ruling 80-296: on-site viewing of events can be plausibly described as having something to do with community-building, providing social capital. Such a claim is not plausible in the case of a distant viewer who may have no connection with the universities represented on the field. Indeed, such viewers are normally not even able to select the particular games they would like to watch, except among the limited offerings that the networks that are part of that viewer's subscription provide from week-to-week. Unlike ticket buyers, the viewers at home are usually not even fans of the particular teams whose games are featured on any given day. The several million viewers of this year's regular-season football game of the century—the Alabama-Texas A&M game on September 14—were for the most part not enthusiasts of either school's athletic programs; they simply wanted to be entertained by what was expected to be an exciting football game, featuring players and coaches who had come to be nationally renowned.

I would therefore argue that the money whose source lies in subscription income from viewers is unrelated business taxable income for essentially the same reason that advertising income is: it is not derived from activities that have any reasonable relationship to the exempt purposes of the colleges and universities that ultimately receive the economic benefits that this business provides. The case may be marginally more difficult to sustain, because the case for UBIT treatment of advertising income draws support from Treasury Regulations, the Internal Revenue Code, and Supreme Court precedent. Subscription income is nevertheless conceptually similar to advertising income, in the sense that both come from sources too distant from the exempt purposes of a university to be considered related to those purposes.

Possible Defenses to Assertion of Unrelated Business Income Tax Liability?

The law on unrelated business income as it applies to big-time college sports contains a few other possibly relevant aspects that should be discussed, if only briefly. The first is the “sponsorship” controversy that swelled in the early 1990s, later to be quelled by

both a more generous view by the IRS, and by subsequent legislation on this topic. In 1991, the IRS issued technical advice to the effect that payments by commercial interests to support college football bowl games constituted unrelated business income.⁵⁹ Though identifying information was redacted, it was widely known that the particular bowls were the Mobil Cotton Bowl and the John Hancock Bowl, and the IRS position came to be known as the “Cotton Bowl ruling.”⁶⁰

This position created a backlash, and the IRS ultimately backed down.⁶¹ Congress secured a limited exemption for sponsorship gifts in section 513(i). It is possible to imagine that the sponsorship exemption could be used in lieu of some advertising as a means of avoiding unrelated business income if that concept were held to apply to television revenue generated by big-time sports. However, the rules of section 513(i) seem flatly inconsistent with the type of advertising commonly seen in telecasts of big-time sports. The prevailing preferences of advertisers are not of the general form of “This broadcast was brought to you by the generous contributions of Nike, Gatorade, Budweiser, and Ford Trucks.” Rather, those sponsors seem clearly to prefer to make a direct pitch about the desirability of their products. As Yogi Berra supposedly said, it’s hard to make predictions, especially about the future;⁶² nevertheless, it seems likely that advertisers and big-time sports would conclude that, if necessary, it was better to pay some amount of unrelated business tax than give up the opportunity to offer conventional advertising in connection with the broadcasts. Big-time sports have become one of the primary means of putting messages in front of young, especially male, audiences, and it seems unlikely that the unrelated business income tax would much deter advertisers from this mission.

Also to be noted is that the one attempt of the IRS to impose unrelated business taxes on advertising in connection with college sports was unsuccessful. In *National Collegiate Athletic Association v. Commissioner*,⁶³ the IRS sought to tax the advertising income generated by the magazine-like “program” published by the NCAA in connection

⁵⁹ Technical Advice Memorandum 9147007.

⁶⁰ Fishman & Schwarz, *Nonprofit Organizations, Cases and Materials*, (4th Ed. 2010), at 628.

⁶¹ *Id.*

⁶² But he also said that he never said a lot of the things he said, so who knows?

⁶³ 914 F. 2d 1417 (10th Cir., 1990).

with its annual Division I basketball tournament. Though the IRS prevailed at the Tax Court level,⁶⁴ that decision was reversed by the Tenth Circuit. One might well ask whether the IRS, having been rebuffed when it stuck a toe in these waters, can reasonably hope for better results if it were to jump in head first in the manner suggested in this essay.

There is every reason to think that it could get better results. Not only did the IRS win at the trial level in NCAA, but even the NCAA conceded that sale of the advertising was unrelated, and constituted a business.⁶⁵ The only missing element from a good UBIT case found by the court was that the activity was not “regularly carried on.”⁶⁶ This was barely debatable in the case of an annual three-week basketball tournament, but could hardly be debatable in the case of the regular seasons for college football and basketball, which extend, respectively, from August through January, and from October through April, of every year. If anything, the language of the opinion in this case supports the argument offered in this essay.

Finally, if one takes seriously the idea that big-time sports are conducted by amateur student-athletes, one must consider whether the general exemption from UBIT for activities conducted by unpaid volunteers might apply to big-time sports.⁶⁷ Without even going to the question of whether the student-athletes play “without compensation”⁶⁸ despite the fact that they receive scholarships that may be worth \$60,000 or \$70,000 (at private universities), one notes that the athletic contests inevitably involve a cadre of coaches, trainers, athletic directors and their staffs, numbering in the dozens. These individuals are clearly not volunteers, and in the cases of the head coaches and athletic directors, are typically the highest-paid employees of their institutions. This exemption would seem flatly unavailable in this context.

⁶⁴ 92 T.C. 456 (1989).

⁶⁵ 914 F.2d at 1421

⁶⁶ *Id.*, at 1424.

⁶⁷ IRC §513(a)(1).

⁶⁸ *Id.*

Prospects for Reform

Needless to say, universities are not likely to volunteer to declare unrelated business taxable income from televised big-time sports events, especially in light of the fact that Revenue Ruling 80-296 explicitly exempts such revenue from the tax. Further action from the IRS would be necessary to collect such a tax. Is this feasible?

It is certainly possible. The IRS does occasionally revoke earlier rulings, and in those cases it usually replaces them with new rulings that reflect more contemporary facts and current analysis. Revoking Revenue Ruling 80-296 would be a good idea, and entirely defensible both on grounds that it was defective *ab initio*, and on grounds that the truly stupefying infusions of revenue that big-time sports have begun to generate could not have been anticipated at the time that ruling was published. No changes in statutes or regulations would seem to be required to implement the view that television contracts generate unrelated business taxable income, since section 513(c) and its accompanying regulations already point to such a result, as argued above.

Is the IRS likely to revoke Revenue Ruling 80-296, and, if it does, is it likely to be able to sustain a position contrary to that ruling? As to the first, it certainly seems doubtful, especially in the short run. The IRS has limited political capital even in the best of times, and these are not the best of times. And the impetus for this action would presumably be initiated by the division with primary responsibility for exempt organizations, and that division is currently in a state of (largely undeserved) disgrace. So in the short run, do not expect this scenario to be playing out anytime soon at a big-screen sports bar near you.

But it may be worth bringing these arguments to the attention of the IRS, as part of a sustained campaign that might eventually lead it to reconsider Revenue Ruling 80-296. The revenue involved—unlike that which is at stake in most UBIT controversies—is substantial, and growing at a remarkable rate. It would seem that it would be healthy for both tax revenues and for colleges and universities themselves for the IRS to take a more realistic view of whether televised big-time sports are really related to the exempt purposes of a university.

If the IRS were persuaded eventually to take the view advocated here, it would probably be able to sustain that view in court, in view of strong Supreme Court precedent for disaggregation of advertising revenue from the otherwise exempt activity that provided the platform for it. Protecting this position from Congressional intervention offers a less sanguine prospect. Over a period of many years, whenever Congress is asked to back the IRS or big-time college sports, its choice has been emphatic, and the IRS has had to run for cover.

Just possibly, could that change? Maybe even Congress would balk at the world that we have seen develop in big-time college sports in recent years, and which we see growing worse every year. Coaches are being compensated at levels that must raise even a Congressional eyebrow or two. Scandals involving a wide array of truly disheartening moral failures—academic dishonesty, performance-enhancing drugs, illicit payments to players, even sexual favors offered to recruits—erupt with regularity in the world of big-time college sports. Maybe Congress would decide not to intervene, as long as it didn't see the IRS action as imperiling the basic idea of big-time sports? Maybe, though there is not much reason for optimism on this. It is somewhat more likely that this issue, if forced on Congress by the IRS, would prove to be the single thing on which the current Congress could quickly agree—but not in the direction advocated here!

Strike Two: The Eighty Percent Solution

High on any reasonable list of egregious violations of sound tax policy is the rule of section 170(l) of the Code. Under this provision, donors to college and university athletics programs can deduct 80% of the amount contributed even if the donor “receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event”⁶⁹ This rather strange rule represents the culmination of an entertaining, but ultimately dispiriting, dispute between athletics boosters and the IRS that be-

⁶⁹ Section 170(l)(2)(B).

gan in 1984, with the publication of Revenue Ruling 84-132.⁷⁰ That ruling examined a hypothetical situation in which a donor received, for a contribution of \$300 per year—a comically small amount by today’s standards—the right to purchase a season football ticket in a “preferred” location between the two forty yard lines. The ruling also hypothesized that there was a waiting list of potential donors who sought this privilege. Under the circumstances, the IRS rather easily concluded that the ticket-access privilege had “significant value,” and that the donor could therefore deduct no part of the payment unless he could show that his donation exceeded the value of the ticket-access privilege.⁷¹ (Implicitly, this would be exceedingly unlikely in a situation in which would-be donors were on a waiting list to be allowed the privilege.)

This was nothing more than a straightforward application of the well-established doctrine of disallowance of “gifts” that involved *quid pro quo* values returned to the donor as part of the exchange. This principle was most authoritatively established by the Supreme Court in *Hernandez v. Commissioner*,⁷² a case decided a few years after the ruling itself. Although the IRS has decided, for reasons never fully disclosed, not to enforce *Hernandez* as to the actual facts that gave rise to it,⁷³ there can be little doubt that the *quid pro quo* doctrine was and is good law. Although it was decided after the IRS had issued its ruling on athletic ticket privileges, the IRS had had some previous success in establishing this doctrine. In *United States v. American Bar Endowment*,⁷⁴ the government had argued that amounts paid to the Endowment as premiums for life insurance policies were in no part deductible, despite the fact that the policies were priced at a level that allowed the Endowment, a charitable entity, to make a profit on the sales. The premiums were nevertheless at amounts not exceeding the cost of similar insurance available to the policyholders through commercial insurance companies, so no deduction was allowed. Although the

⁷⁰ 1984-2 C.B. 55.

⁷¹ *Id.*, at 56.

⁷² 490 U.S. 680 (1989).

⁷³ The case involved payments for “auditing services” provided by the Church of Scientology. The IRS announced its intention to allow deductions for such contributions in Rev. Rul. 93-73, 1993-2 C.B. 75, notwithstanding its successful outcome denying such deductions in *Hernandez*.

⁷⁴ 4 Cl. Ct. 404 (1984), 53 AFTR 2d 84-942.

final result in this case was not determined until the Supreme Court decided it in 1986,⁷⁵ the IRS had won the first round with the Claims Court decision which was announced on January 31, 1984; the IRS issued its ruling later that year.⁷⁶

The theory behind the ban on deductions of *quid pro quo* transactions is eminently reasonable: the charitable donation deduction is meant to reflect true donations, not exchanges of more or less equal value. If the latter were deductible, why wouldn't deductions be allowed for the payment of hospital bills by patients, or the payment of tuition by students? The IRS has gotten this right, and so has the Supreme Court, generally by wide margins.⁷⁷

Despite the soundness of its position, the IRS responded to the firestorm of criticism of Revenue Ruling 84-132 by suspending it later in the same year.⁷⁸ Its announcement offered no new opinion on the merits, but simply indicated that the IRS would hold hearings on the question before finally deciding its position. A bit over a year later, the IRS, to its credit, stuck by its guns, and ruled again that contributions conditioned on the grant of seat privileges were not deductible.⁷⁹

Several bills were introduced in Congress later in 1986 to reverse this result, and a provision to that effect was included in the House bill that became the Tax Reform Act of

⁷⁵ United States v. American Bar Endowment, 477 U.S. 105 (1986).

⁷⁶ This case has a complicated procedural history, which can be briefly summarized as follows: both the Endowment and individual policyholders were parties to a consolidated case involving the IRS claims that the Endowment enjoyed unrelated business income from the sale of the insurance, and that the policyholders were entitled to no deductions for any part of their premiums. The Endowment prevailed at the Claims Court level, while the taxpayer/policyholders did not. The court of Appeals for the Federal Circuit affirmed the result as to the Endowment, but reversed as to the taxpayers/policyholders. 761 F.2d 1573 (Fed. Cir., 1985). However, this result was not announced until after the IRS had issued Rev. Rul. 84-132. Ultimately, the Supreme Court decided this case for the government on all points: the premiums were unrelated business income to the Endowment, and were not deductible by the taxpayer/policyholders.

⁷⁷ The single dissent in American Bar Endowment was by Justice Stevens, and related to the UBIT issue rather than to the *quid pro quo* gift issue. 477 U.S. 119. Hernandez was more complicated, with Justice O'Connor and Scalia dissenting on the only issue in that case, the charitable deduction. The dissenting opinion by Justice O'Connor emphasized the inconsistent treatment by the IRS of payments for religious benefits. 490 U.S. 704.

⁷⁸ Announcement 84-101, 1984-45 I.R.B. 21.

⁷⁹ Rev. Rul. 86-63, 1986-1 C.B. 88.

1986.⁸⁰ However, the provision was dropped in conference, and the IRS position survived for a time.⁸¹ But in the next major tax act, the Technical and Miscellaneous Revenue Act of 1988⁸² (which really was a major act, despite its diffident title), Congress overruled the IRS, adding section 170(l) to the Code.⁸³ Pointedly flexing its muscles, Congress even added a rather unusual provision allowing refund claims by anyone who lost his or her deduction due to this frolic of the IRS' during the previous four years, even as to tax years for which the statute of limitations on adjustments would otherwise have expired.⁸⁴ Congress meant not merely to overrule the IRS, but to obliterate any trace effects of the IRS attempt to rein in this abusive practice.

There is very little explanation of what Congress was thinking, which is sometimes evidence that it wasn't. Because it was added as an amendment, no "reason for change" appeared in any committee report. However, a Joint Committee explanation did the best it could:

The proposal would eliminate otherwise unavoidable valuation controversies between the IRS and many individual taxpayers as to the proper treatment of payments to college athletic scholarship programs.⁸⁵

Indeed, valuation controversies are not unimaginable under some circumstances. If a college sports program announced to its boosters that very generous donors would be rewarded with the opportunity to acquire good seats to football and/or basketball games, some donors might give large gifts, and then argue that they did so because of their large hearts, and that they could have given less and gotten similar favors. They might point to other donors who got good seats for smaller contributions, arguing that anything over the smallest donation that yielded good-seat privileges was deductible. The IRS might then need to evaluate the precise quality of the seats of the two donors, to assure that they were

⁸⁰ See Conrad Teitell, "Philanthropy and Estate Planning," (column), 128 Trusts and Estates 58, 61 (1989) for a description of the legislative response to Rev. Rul. 86-63.

⁸¹ Id.

⁸² Pub.L. 100-647, §6001, 102 Stat. 3683 (1988).

⁸³ This provision was added as subsection (m), of section 170, but later renumbered as subsection (l).

⁸⁴ This provision was added by the Senate, and adopted by the Conference.

⁸⁵ Description of Proposed Amendment to H.R. 4333 as Amended, Joint Committee on Taxation, July 13, 1988, JCX-15-88, at 15.

in fact comparable—that, for example, end-zone seats weren’t being compared to sideline seats. These questions can get difficult, as the controversies over valuation of “skybox” seats for purposes of section 274 of the Code have shown.⁸⁶

But it would not seem generally to be in the interest of universities to structure their seat privilege policies this way. Seekers of seats, or better seats, want to know what it takes to get them. Vagueness on this question would be annoying, and no university wants to annoy alumni and friends who are trying to give it money. It is possible that some booster organizations might attempt some subterfuge, in which the precise dollar amount wasn’t published, but could be whispered by the manager of the organization⁸⁷ to alumni and friends who call seeking this information. However, the IRS should be able to penetrate such a ruse fairly easily. It would observe that many contributions were of exactly the same amount, the presumptive minimum; it could also simply ask the university to tell it what that number is, or to state officially that no such number existed—a statement which would, if false, be a felony.

At Duke, there is no ambiguity. Football tickets are available without any special contribution, because Duke’s football team has a long history of mediocrity, or worse. Basketball tickets, on the other hand, are a scarce and valuable resource. There are some breaks for faculty and other insiders, but a fan with no current connection to the university must make an annual contribution of \$7000 to be entitled to buy two season basketball tickets, the purchase of which will incur an additional charge of \$2000 or more, depending on the location of the tickets. Valuation of the seat privileges would not seem to be difficult under these circumstances, which are common among big-time sports.

Prospects for Reform of the Eighty-Percent Rule

. . . are dim. This defective rule entered the Code via an Act of Congress, and it

⁸⁶ See Richard Schmalbeck and Jay Soled, “*The Cultural Symbolism of the Deductible Skybox*,” 126 Tax Notes 1524 (2010).

⁸⁷ At Duke we call this organization the Iron Dukes. It is a subdivision of our athletics department, staffed by university employees. Most colleges that participate in big-time sports have a counterpart organization.

will require an Act of Congress to repeal it, or otherwise reform it. Given Congress' track record of extraordinary generosity toward big-time sports, this seems very unlikely. But it is barely possible to imagine that a Congress that is desperately interested in ways to find revenue without increasing tax rates might be persuaded that the revenue gain associated with such a change would be compelling. As is the case with the unrelated business income tax, this is an issue whose dollar value has increased greatly over the years since the addition of this rule to the Code. The numbers could be significant. If 100 universities are able, as Duke is, to effectively charge \$3500 per seat for a seat license, and those universities have on average 20,000 seats that are attractive enough to command that premium, the collective amount contributed would be in the vicinity of \$7 billion. Eighty percent of that is \$5.6 billion, and the revenue loss associated with that, assuming an average marginal tax rate of 35%, is about \$2 billion. An amount in this range is not going to pay off the national debt, but if these back-of-the-envelope calculations are reasonably realistic, the amount at stake is not trivial. And this would seem to be a conservative estimate: at the top end, at a place like Ohio State, which has had both football and basketball teams in the top ten in recent years, and has indoor and outdoor stadiums that seat roughly 20,000 and 100,000, respectively,⁸⁸ the assumption of 20,000 seats being the subject booster programs is very conservative indeed. Also, the amounts at stake seem to be growing at impressive rates (remember the quaint \$300 amount mentioned in the 1984 ruling). That means that the revenue loss associated with this defective rule will be growing as well, making a ten-year revenue estimate for repeal of section 170(l) a potentially eye-catching number. It would seem at a minimum to be a large enough number that it might well finance a few other miscellaneous, revenue-losing proposals that members of Congress might wish to make, but only if they could be done on a revenue-neutral basis.⁸⁹ So there is some hope.

⁸⁸ Ohio Stadium seats 102,329; Schottenstein Arena seats 18,809.

⁸⁹ A Finance Committee Staff Report issued on June 13 listed (on page 8) repeal of the eighty percent rule as among the options for reform that should be considered.

Is There a Third Strike?

There are other tax issues associated with college sports, but none rise to the level of importance of the two that have been the primary subject of this paper. There is, of course, always the issue of the faulty accounting for gifts in kind, which are deductible at their fair market value, rather than at their adjusted basis.⁹⁰ This is on a par with the eighty-percent rule described above, in that both rules lack any reasonable defense as a matter of tax policy or accounting. However, this rule is not particularly implicated by big-time sports. While gifts to booster clubs could presumably be made in the form of, say, appreciated stock, they are probably made in this form infrequently, if only because the specific target number required to obtain seat licenses makes gifts in kind somewhat awkward.

One might also question whether the use of tax-exempt financing to construct stadiums should be permissible, since section 501(c)(3) bonds may not be used for facilities that are constructed for the purpose of generating unrelated business income.⁹¹ However, the main argument as to unrelated business income in this essay has been that revenue from television might be unrelated business income, even if the live audience has a sufficient nexus to the educational purposes of the university that it may avoid the UBIT category. That more narrow UBIT argument would seem to have some chance of success, but that argument effectively concedes that the live audience is not generating unrelated business income. If that's the case, then the stadiums, which house the live audience, would continue to be eligible for tax-exempt financing.

Finally, there are questions about accounting for unrelated business income in the case of mixed-use facilities on university campuses. The basketball arena may be used to stage rock music concerts, or NBA exhibition games; the golf course may be open to the public at regular market rates; or, most famously, the hockey rink may be rented out for

⁹⁰ Treas. Reg. §1.170A-1(c).

⁹¹ IRC §145(a)(2)(A).

ice shows.⁹² Broadly, the problems in this area can run in either of two directions. Most commonly, the problem is that both the regulations and case law may be excessively generous in allowing allocated deductions against the gross unrelated business income, resulting in little or no income, and hence little or no revenue.

A variant on this pattern seems to have emerged recently, at least in the eyes of the IRS. It believes that in some cases, activities that are *related* to the exempt purpose of a university are being classified as unrelated business activities, because these related activities generate losses that can be used to absorb the otherwise taxable unrelated business activity.⁹³ A hotel adjacent to the campus, for example, might be operated primarily for university business, but categorized as an unrelated business activity by the university in order to use its net losses in this way.

While these are significant issues, they have less to do with big-time athletics than with more general questions about tax accounting in complex institutions that conduct both exempt and nonexempt programs. There is also a separate paper being prepared on these issues for this conference, so the better course seems to be to defer to that paper for a fuller discussion of these issues.

Conclusions

The purpose of this essay is not to destroy big-time college sports. If that were the purpose, it would be completely pointless. Big-time sports are deeply and widely popular; they are not going away. But they are also unmistakably commercial, at least in some aspects. While the on-campus aspects of college sports may have some connections, however remote, with the educational purposes of the institution that sponsors them, the televised programming associated with college sports has no substantial connection to those purposes. When the broadcasting of college sports was largely local, and the revenue de-

⁹² See *Rensselaer Polytechnic Institute v. Comm'r*, 732 F.2d 1058 (2d Cir., 1984).

⁹³ IRS officials alluded to this problem during the ABA Tax Section meeting in Washington on May 10, 2013. See (much less famous) remarks of Lois Lerner, session on IRS activities with respect to charitable organizations.

rived from it quite modest, it may have been appropriate to ignore the tangential connection to exempt purpose. But as the broadcasting of college sports has gone national, and begun to produce prodigious amounts of revenue, it no longer makes sense to ignore the fact that it is generating unrelated business income for the participating universities.

In 1980, the IRS made a mistake, even in light of the facts known at the time, in ruling that television revenue was related to exempt purpose. But as the revenue has grown a hundred fold in the years since, it has become clear that a reevaluation of this mistake is increasingly needed. The doctrine of disaggregating advertising revenue provides a plausible hook for the unrelated business income tax, but in fact any revenue from the sale of television rights has the same basic qualities: it furthers no educational purposes, and cannot be considered related to the university's reason for exemption.

And when Congress added section 170(l) to the Code twenty-five years ago, it made a mistake. It too may have misjudged the significance of the deduction it was authorizing in declaring eighty percent of "contributions" made to purchase seat licenses was deductible, but that significance has become clearer as big-time sports have grown ever more big-time in the years since. There is now a substantial revenue loss associated with this provision, and the provision has no convincing rationale. Congress should review the rule, and close this loophole.

In all likelihood, neither of these changes would very much change the big-time sports landscape. They would reduce, but not hugely, the financial benefits of engaging in big-time sports. They might result in a world in which the best coaches were paid only twice as much as the presidents of the institutions that employed them. Staffs might be reduced, so that a particular assistant coach would have to be responsible for coaching both the wide receivers *and* the tight ends. These changes would not be catastrophic; indeed, they would barely return big-time sports to the status they enjoyed twenty years ago.

What they would do is to improve the coherence and fairness of the federal income tax. College sports are successful enough without the sizable subsidies that the current

rules provide them. While college sports have powerful friends, who will probably successfully resist the reforms suggested in this essay, it is nevertheless a battle worth fighting.

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