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COLLEGIATE ATHLETICS AND THE UNRELATED BUSINESS INCOME TAX: OLD ASSUMPTIONS AND NEW DIRECTIONS FOR AN ISSUE OF CHARITABLE TAX EXEMPTIONS

Roni A. Elias*

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* Vice Chair, International Judicial Affairs Committee, American Bar Association; Florida A&M University College of Law, J.D. 2015.
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INTRODUCTION

College sports are popular and valuable commercial products, which generate revenue through the sale of tickets, broadcast rights, and licensed merchandise. At the center of this commercial product is the concept of the "student athlete," a young person who pursues extracurricular athletic competitions while attending college. To a great extent, college sports are popular and valuable because spectators enjoy watching athletes who are presumably motivated by the love of their university and the love of the game–and not by any financial or commercial motives.

The ideal concept of the student athlete is becoming increasingly difficult to maintain. College sports generate an ever-increasing amount of revenue every year. In 2010, the National Collegiate Athletic Association ("NCAA"), the major entity that regulates and organizes college sports, signed a 14-year contract for the broadcast rights to its annual men's basketball tournament that will produce a total of $10.8 billion in revenue for its member colleges and universities.[1] Two years later, the entity that administers college football's postseason playoff system signed a 12-year contract for broadcast rights to a few postseason games each year for $5.64 billion.[2] Meanwhile,

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[1] Brad Wolverton, *NCAA Agrees to $10.8-Billion Deal to Broadcast its Men's Basketball Tournament*, CHRONICLE OF HIGHER EDUCATION (Apr. 22, 2010), http://chronicle.com/article/NCAA-Signs-108-Billion-De/65219/.

[2] Jerry Hinnen, *ESPN Reaches 12-Year Deal to Air College Football Playoffs*, CBS SPORTS (Nov. 21, 2012), http://www.cbssports.com/collegefootball/eye-on-college-football/21083689/espn-reaches-12year-deal-to-air-college-football-playoffs.

stories about academic fraud[3] and other rule-breaking violations[4] have undermined the presumption that collegiate athletics are merely an avocation for student athletes. An ever-increasing number of observers see collegiate athletics as nothing more than a big business that is in tension with the educational purposes of universities.

The tension between the ideal and the reality of collegiate athletics has been heightened by recent litigation, which challenges the legality of the "amateur ideal" that animates collegiate athletics.[5] This litigation threatens to change the structure and conception of college athletics and will perhaps eliminate the current ideal of the student athlete. There are many consequences of this litigation for the operations of collegiate athletic departments and even for the structure of university operations. However, one potential consequence has not drawn immediate attention: the effect of these fundamental changes on the taxation of the enormous income derived from collegiate athletic programs, especially football and men's basketball.

Currently, under the broad tax emption provided by IRC Section 501(c)(3), such income is exempt from taxation because it is treated as "substantially related" to a university's educational mission.[6] This exemption is premised on certain ideas that are bound up with the idealized model of collegiate athletics. The most important of these presumptions is the idea that athletics are an aspect of a university's educational mission.

The recent and pending litigation about college athletics threatens the viability of this idea and therefore threatens one of the crucial foundations of the tax exemption for income from collegiate athletics. At the core of the legal challenges to the university's athletic model is the contention that collegiate

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[3] *See generally* Jack Stripling, *Widespread Nature of Chapel Hill's Academic Fraud Is Laid Bare*, CHRONICLE OF HIGHER EDUCATION (Oct. 23, 2014), http://chronicle.com/article/Widespread-Nature-of-Chapel/149603/.

[4] *See generally* Lynn Zinser, *U.S.C. Sports Receive Harsh Penalties*, N.Y. TIMES (June 10, 2010), http://www.nytimes.com/2010/06/11/sports/ncaafootball/11usc.html?_r=0.

[5] Patrick Vint, *Ranking the NCAA's 5 Biggest Legal Battles, from Least to Most Threatening*, SB NATION (Mar. 20, 2014), http://www.sbnation.com/college-football/2014/3/20/5528032/ncaa-lawsuits-obannon-kessler-union.

[6] I.R.C. § 501(c)(3).

athletics are a business and that the relationship between the "student athlete" and the university is primarily a commercial one, which should be governed by the ordinary legal rules applying to any other commercial relationship. Interestingly, in defending against these challenges, entities associated with collegiate athletics, especially the NCAA, have essentially conceded this point.[7] Consequently, regardless of how the challenges to the established model are resolved, the litigation process has provided a substantial basis for challenging the premises behind the tax exemption.

This article examines how the emerging changes in the structure and concept of collegiate athletics may affect the tax-exempt status of the income generated by "big time" college sports. Part I of this article reviews the business of college sports and how that business fits into the educational missions of colleges and universities, both in theory and in practice. Part II reviews the law governing taxation of the business activities of tax-exempt charitable and educational institutions, such as colleges and universities; this part also includes a brief background of the tax law that could be affected by changes to the concept of collegiate athletics. Part III discusses the application of these taxation rules to universities and their business operations that are collateral to their educational mission. Part IV discusses how these taxation rules have traditionally been applied to income generated by collegiate athletics; it reviews important, recent developments in the current litigation challenging the collegiate athletics model and how those developments affect the established approaches to taxing income from collegiate athletics. This article concludes by considering ways in which the law governing taxation of income from collegiate athletics may develop in the future.

I. THE BUSINESS OF COLLEGE SPORTS

College sponsorship of student athletic competition did

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[7] Gary T. Brown, *Is College Sports a Big Business?*, NCAA NEWS ARCHIVE (Aug. 29, 2005), http://fs.ncaa.org/Docs/NCAANewsArchive/2005/Association-wide/is%2Bcollege%2Bsports%2Bbig%2Bbusiness%2B-%2B8-29-05%2Bncaa%2Bnews.html.

not begin until the twentieth century. Collegiate athletics began in the middle of the nineteenth century as an informal social activity for students. The first collegiate athletic competition occurred in 1852, when Yale and Harvard competed in rowing.[8] After the Civil War, universities began to encourage their students to play the new sport of football.[9] Football was seen as a means to develop the moral character of students because its combative nature, acting as a salutary substitute for the discipline and rigor of military service.[10] Thus, in the beginning, collegiate athletics were intended to be an element of the educational process for a thoroughly well-rounded student.

The popularity of collegiate athletics among students and spectators alike fueled its rapid growth and prompted efforts towards national organization and standardization of practices and policies governing collegiate athletic competition. In 1905, the presidents of 62 colleges and universities founded the NCAA for the principal purpose of creating a uniform set of rules to regulate intercollegiate football.[11] As a voluntary membership organization, the NCAA has rapidly grown; today, the NCAA includes approximately 1,100 schools and regulates intercollegiate athletic competitions in approximately two dozen different sports.[12] Despite this growth, the NCAA remains founded on the principle that inspired the creation of intercollegiate athletics in the nineteenth century. Specifically, that participation in athletic competition is a crucial aspect of the education of young men and women.[13] According to its current

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[8] *Great Moments in Yale Sports*, YALE ALUMNI MAGAZINE (Mar. 2001), http://web.archive.org/web/20121114113135/http://yalealumnimagazine.com/issues/01_03/sports.html (last visited Nov. 4, 2015).

[9] GEORGE M. FREDRICKSON, THE INNER CIVIL WAR: NORTHERN INTELLECTUALS AND THE CRISIS OF UNION 222-24 (1993).

[10] *Id*.

[11] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 7 F. Supp. 3d. 955, 963 (N.D. Cal 2014) (finding basic factual matters regarding the history and structure of the NCAA and college athletics stipulated by the parties), *aff'd in part*, *vacated in part* 2015 WL 5712106 (9th Cir. 2015).

[12] *Id*.

[13] Myles Brand, President, NCAA, State of the Association Speech at the NCAA Convention in Indianapolis: The Principles of Intercollegiate Athletics (Jan. 7, 2006), http://fs.ncaa.org/Docs/NCAANewsArchive/2006/Association-

constitution, the NCAA seeks to "initiate, stimulate and improve intercollegiate athletics programs for student athletes and to promote and develop educational leadership, physical fitness, athletics excellence and athletics participation as a recreational pursuit."[14]

The NCAA establishes rules governing athletic competition among its member schools.[15] These rules apply to almost every conceivable aspect of the life of student athletes, from the rules of the competition on the playing field to the smallest detail of their lives on campus.[16] As outlined in the NCAA constitution and bylaws, these rules set forth guidelines and restrictions for recruiting high school athletes, establish academic eligibility requirements for student athletes, and impose limits on the number and size of athletic scholarships that each school may provide.[17] The rules even prescribe the kind and amount of food that can be given to athletes as a part of the meal plans included in their athletic scholarships.[18]

The NCAA is subdivided into three primary divisions – Divisions I, II, & III. A school is placed in a division based on the number of sports they sponsor, the amount of money they offer in athletic scholarships and financial aid, and the competitiveness of the programs in those sports.[19] In football, Division I is further divided into two subdivisions, the "Football Championship Subdivision," for smaller football programs, and

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[14] NCAA 2015-2016 DIVISION I MANUAL art. 1, § 1.2(a) (Aug. 1, 2015), http://www.ncaapublications.com/productdownloads/D116.pdf (last visited Nov. 4, 2015).

[15] *O'Bannon*, 7 F. Supp. 3d at 963.

[16] *See id*. at 963-64, 971-72.

[17] *See* NCAA 2015-2016 DIVISION I MANUAL art. 2, *supra* note 14.

[18] Michelle Brutlag Hosick, *Council Approves Meals, Other Student-Athlete Well-Being Rules: New Model Provides Unlimited Student-Athlete Meals and Snacks*, (Apr. 15, 2014), http://www.ncaa.org/about/resources/media-center/news/council-approves-meals-other-student-athlete-well-being-rules.

[19] *O'Bannon*, 7 F. Supp. 3d at 963-64.

the Football Bowl Subdivision, for the most well-known and competitive programs, such as the University of Michigan, the University of Southern California, and Ohio State University.[20]

At the core of all NCAA division and subdivision rules is the principle of amateurism. NCAA rules strictly prohibit athletes in member schools from receiving any compensation in connection with their participation in collegiate athletics.[21] NCAA athletes cannot endorse commercial products or sell autographs, they cannot accept payments from fans or alumni or other "outside sources," and they certainly cannot be paid for their services by the schools for which they perform.[22] In the view of the NCAA (and, presumably, in the view of its member institutions), amateurism is the key to making sure that athletic competition is an aspect of the educational experience and that it does not become the primary or absolute reason for the student athlete's association with a college or university. In other words, a commitment to amateurism in athletic competition is what assures that collegiate athletics have an educational purpose. As the NCAA includes on its website:

> Amateur competition is a bedrock principle of college athletics and the NCAA. Maintaining amateurism is crucial to preserving an academic environment in which acquiring a quality education is the first priority. In the collegiate model of sports, the young men and women competing on the field or court are students first, athletes second.[23]

To assure that the provision of athletic scholarships does not compromise principles of amateurism, the NCAA imposes strict rules to define the amount and nature of the benefits that can be awarded through athletic scholarships. Most fundamentally, these rules prohibit member institutions from giving student athletes financial aid based on athletic ability that exceeds the cost of tuition, room and board, and course-related books.[24]

Thus, the foundational concept of collegiate athletics and

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[20] *See id*. at 964.

[21] *Id*. at 971.

[22] *Id*. at 971-72.

[23] NCAA, *Amateurism*, http://www.ncaa.org/amateurism (last visited Nov. 4, 2015).

[24] *O'Bannon*, 7 F. Supp. 3d at 971.

the NCAA rules are premised on the idea that athletic competition is merely an extracurricular activity for full-time students. However, the financial realities of collegiate athletics suggest that it is far more than a pastime for students-- it is a big business, generating billions of dollars in revenue for colleges and universities. The most prominent collegiate athletic programs generate well over $100 million dollars in annual revenues.[25] In the most recent year for which data is available, the University of Oregon generated over $196 million in annual income from its athletic programs, including income from ticket sales, trademark licensing for souvenirs, and the sale of broadcast rights.[26] Nineteen other schools earned over $100 million dollars annually.[27]

Notwithstanding the enormous revenue generated by collegiate athletics, the NCAA and its member schools steadfastly insist that collegiate athletics are not a business but rather just another aspect of the process of educating students. According to an NCAA publication:

> [Former] NCAA President Myles Brand said intercollegiate athletics, and higher education in general, have business elements that must be adroitly addressed. Bills must be paid, salaries have to be provided and difficult personnel decisions must be made, Brand said, but similar decisions face other nonprofit enterprises that rely on major revenue streams. 'College sports may be a business with respect to the revenue side of the equation,' he said, 'but it is a nonprofit focused on the values of higher education with regard to expenditures.'[28]

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[25] *NCAA Finances*, USA TODAY, http://sports.usatoday.com/ncaa/finances/ (last visited Nov. 4, 2015).

[26] *Id*.

[27] *Id*.

[28] Gary T. Brown, *Is College Sports a Big Business?*, NCAA NEWS ARCHIVE (Aug. 29, 2005), http://fs.ncaa.org/Docs/NCAANewsArchive/2005/Association-

In Brand's view, which persists today, the revenue generated by football and men's basketball is sought only as a means of funding other educational projects, chiefly the so-called "non-revenue" sports, such as lacrosse or field hockey.[29] Indeed many, if not most, collegiate athletic departments do no better than break even or operate at a loss.[30] Thus, the income generated from collegiate athletics are just the way that schools are able to pay for the educational experience of collegiate athletics for all of the student athletes in a school. This understanding of how collegiate athletics departments work is designed to preserve the idea that collegiate athletics are integrated into the overall educational mission of the university.

In a wide variety of recent cases, current and former student athletes have sued the NCAA, its member institutions, or both, challenging the legality of the NCAA model, especially its strict requirements of amateurism and its prohibitions on any compensation for student athletes beyond their athletic scholarships.[31] In these cases, the plaintiffs have alleged violations of antitrust law by the NCAA and its members. According to the plaintiff's theory, the NCAA's amateurism rules are an unlawful restraint of trade that prevents student athletes from deriving full market value for their services and intangible property rights associated with their athletic performance.[32]

In the most well known of these cases, *O'Bannon v. National Collegiate Athletic Association*, the plaintiffs were a group of current and former college student athletes. These athletes challenged "the set of rules that bar student athletes from receiving a share of the revenue that the NCAA and its member schools earn from the sale of licenses to use the student athletes' names, images, and likenesses in videogames, live game telecasts, and other footage."[33] In response to this challenge, the NCAA maintained, "that its restrictions on student athlete compensation are necessary to uphold its educational mission

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[29] *See id*.

[30] *Id*.*; see also NCAA Finances*, *supra* note 25.

[31] Vint, *supra* note 5.

[32] *See id*.

[33] *O'Bannon*, 7 F. Supp. 3d at 963.

and to protect the popularity of collegiate sports."[34]

Thus, these legal challenges threaten the fundamental premise behind the idea that college athletics are an aspect of the educational process and not an independent business operation. As this idea is essential to the justifications for the tax exemptions for revenue generated by collegiate athletics, this litigation has the potential to change understanding of the relationship between college athletics and the educational mission of the university. A change in this relationship could alter the entire analysis as to whether, and to what extent, income from collegiate athletics are exempt from taxation. In order to more fully understand how this change in analysis could occur, it is necessary to examine the background and nature of that exemption.

II. EXISTING LAW GOVERNING THE UBIT OF 501(C)(3) ORGANIZATIONS

Section 501 of the Internal Revenue Code (the "Code") provides an exemption from income tax for certain organizations, including corporations organized by an act of Congress as an instrumentality of the United States, charitable trusts, and a variety of organizations that serve charitable and public purposes.[35] Section 501(c)(3) specifically includes educational institutions and amateur sports organizations in its list of organizations that serve charitable purposes, public purposes, or both:

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) . . . .[36]

This tax exemption does not extend to "unrelated

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[34] *Id*.

[35] I.R.C. § 501 (2010).

[36] *Id*. § 501(c)(3).

business income."[37] Sections 511-513 of the Code provide for the imposition of tax at standard corporate tax rates on the "unrelated business income" of an organization that is otherwise exempt from taxation under Section 501.[38] This tax is known as the "unrelated business income tax" or "UBIT." The UBIT applies to income earned by a tax exempt organization that: (1) comes from a "trade or business" as that term is used in Section 162 of the Code,[39] (2) is "regularly carried on,"[40] and (3) is not "substantially related" to the accomplishment of the organization's exempt purpose.[41]

As with any legislation, the statutes establishing the UBIT were enacted for a variety of reasons. A couple of those reasons are important to understanding how the UBIT has developed and, in particular, are important to understanding how it will develop to apply to the changing dynamics of college athletics. These reasons relate to the concerns prompted by the commercial activity of tax-exempt organizations.

One such concern was the risk of unfair competition. In the legislative history associated with the UBIT in 1950, there is extensive discussion of how tax law could be applied to prevent charitable organizations from competing unfairly with for-profit enterprises.[42] Such unfair competition could occur if exempt organizations were able to use the economic advantages associated with their tax exemptions to undercut their commercial rivals on prices.

Another significant concern at the time of UBIT inception was how to permit the tax exemption for charitable organizations without eroding the tax base-- specifically the tax

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[37] *Id*. § 501(b).

[38] *Id*. §§ 511-13.

[39] *Id*. § 513(a); Treas. Reg. § 1.513-1(b).

[40] I.R.C. § 512(a); Treas. Reg. § 1.513-1(c).

[41] I.R.C. § 513(a); Treas. Reg. § 1.513-1(d).

[42] *See, e.g.*, H.R REP. No. 2319, 81st Cong., 2d Sess. 36 (1950); S. REP. No. 2375, 81st Cong., 2d Sess., 28 (1950); Henry Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 613 (1989); Donald L. Sharpe, *Unfair Business Competition and the Tax on Income Destined for Charity: Forty-Six Years Later*, 3 FLA. TAX REV. 367, 385-86 (1996); 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, 1488-90 (2005).

base of commercial activity by profit-making organizations.[43] One aspect of this concern arises from the possibility that charities could earn an unwarranted premium on their investments by purchasing and running a business directly, rather than by purchasing stock as a passive investor. Thus, a nonprofit organization could "capture" a financial return premium if it could conduct a business directly and avoid the corporate tax that otherwise would be paid.[44] This was not merely a hypothetical concern. There is evidence that precisely this kind of activity was occurring before the enactment of the UBIT. In a famous example, New York University operated the Mueller Macaroni Company,[45] along with "a piston ring factory, and a chinaware manufacturing operation. Other colleges and universities owned enterprises manufacturing automobile parts, cotton gins, and food products, and operated an airport, a street railway, a hydroelectric plant, and a radio station."[46]

Yet another reason for adopting the UBIT was to prevent the use of charitable organizations as accommodation partners in tax-shelter transactions, especially leasebacks and bootstrap acquisitions.[47] At the time of the UBIT legislation, there was substantial anecdotal evidence that charities were being used in these kinds of transactions.[48] One concern with these activities was that they would cause a diversion of managerial resources away from serving the charity's exempt purpose. Such a diversion would damage both the charity's ability to accomplish the purpose that justified its exemption, and it could harm economic efficiency overall because non-experts would be managing business enterprises that could be managed more

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[43] H.R. REP. No. 2319, 81st Cong., 2d Sess. 39 (1950); *See* Stone, *supra* note 42 at 1491, n.55; Sharpe, *supra* note 42, at 393.

[44] Hansmann, *supra* note 42, at 610.

[45] C.F. Mueller Co. v. Comm'r of Internal Revenue, 190 F.2d 120 (3d Cir. 1951).

[46] Susan Rose- Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 STAN. L. REV. 1017, 1017 n.2 (1982).

[47] Stone, *supra* note 42, at 513-18.

[48] *Id*. at 1519.

effectively by others.[49]

As noted above, the UBIT applies to income earned by a tax exempt organization that: (1) comes from a "trade or business" as that term is used in Section 162 of the Code,[50] (2) is "regularly carried on,"[51] and (3) is not "substantially related" to the accomplishment of the organization's exempt purpose.[52] There is little controversy or question about how to apply the first condition for application of the UBIT. An income-generating activity constitutes a "trade or business" for UBIT purposes when it is a profit-making activity that involves the sale of goods or services.[53] In meeting this first condition, "profit-making" is the crucial concept; the activity cannot be taxed unless it was undertaken for the primary purpose of generating income or profit.[54] The Internal Revenue Service ("IRS") has recently relied more heavily on the "profit motive" factor to disqualify money-losing ventures from UBIT analysis.[55] Most important is whether the organization is engaging in the activity for the purpose of making a profit and with a reasonable expectation of eventually making a profit, even if the activity does not generate a profit in the short-term.[56]

The second condition in applying the UBIT is similarly

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[49] *See* Hansmann, *supra* note 42.

[50] *Id*. § 513(a); Treas. Reg. § 1.513-1(b).

[51] I.R.C. § 512(a); Treas. Reg. § 1.513-1(c).

[52] I.R.C. § 513(a); Treas. Reg. § 1.513-1(d).

[53] Treas. Reg. § 1.513-1(b).

[54] *See*, *e.g*., United States v. Am. Bar Endowment, 477 U.S. 105, 110 n.1 (1986) (holding that the "taxpayer's primary purpose for engaging in the activity must be for income or profit" in order for the UBIT to apply); Prof'l Ins. Agents v. Comm'r of Internal Revenue, 726 F.2d 1097, 1102 (6th Cir. 1984) (finding that the "existence of a genuine profit motive is the most important criterion for . . . a trade or business.").

[55] *See* FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS ¶22.03 at 22-8 (2002, supp. 2013); BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 638- 40 (10th ed. 2011).

[56] For the purposes of the UBIT, an activity can show losses for many years and still be "for-profit." For example, a charitable organization might undertake a real estate development project, which loses money in the short term but which leads to an eventual net profit upon sale of the land and buildings in the future. *See* Treas. Reg. § 1.183-2(a).

straightforward. "Regularly carried on" means that the business is conducted with the same "frequency and continuity" as an analogous for-profit business.[57] For example, if a charity operated a restaurant on a year-round basis, it would be considered as an activity that was "regularly carried on" because restaurants operated by for-profit entities are open year-round. But, if a charity operated a food booth for two weeks per year at a local fair, that activity would not be characterized as "regularly carried on."[58] Applying these principles, a court ruled that the NCAA did not engage in a "regularly carried on" business when it sold advertising in game programs during its annual basketball tournament.[59] This was because the for-profit business of selling advertising in sports publications is a year-round enterprise.[60] However, by the same token, even an activity carried on for a very short period can be characterized as "regularly carried on." If a charity operated a Christmas tree lot in November and December, that business likely would be "regularly carried on" because commercial Christmas tree lots operate for the same period of time.

Determining whether an activity is "substantially related" to an organization's exempt purpose is far more problematic. According to the applicable regulations, a trade or business is substantially related to an organization's exempt purpose when it bears a "causal relationship" and "contribute[s] importantly" to the accomplishment of that purpose.[61] IRS rulings and cases stand for the proposition that the business activity must be tied directly to how the charity executes its exempt purpose; it is not enough that the activity be related to that purpose in some abstract or indirect way. For example, with respect to art museums, which are exempt as "educational" organizations, the IRS has held that the sale of art and art-related materials at a museum gift shop are "related" but that the sale of

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[57] Treas. Reg. § 1.513-1(c)(1).

[58] *Id*. § 1.513-1(c)(2).

[59] *See* NCAA v. Comm'r of Internal Revenue, 914 F.2d 1417, 1421-22 (10th Cir. 1990).

[60] *See id*.

[61] Treas. Reg. § 1.513-1(d)(2).

science books is an unrelated trade or business.[62] Thus, for an art museum, a sales activity is not unrelated trade or business if it involves the promotion of knowledge and appreciation of art, but is unrelated if it involves education about non-art matters.

Courts have agreed with this approach. In *Carle Foundation v. United States*,[63] the Seventh Circuit held that pharmacy sales by an exempt hospital were "related" when the sales were made to patients, but not when the sales were made to the general public. This is because selling medications to hospital patients has a "causal relationship" and "contribute[s] importantly" to the exempt purpose of treating the hospital's own patients, but selling medication to non-patients lacks the same close connection.[64]

The application of these three requirements is complicated by the "fragmentation rule," which is codified in Section 513(c).[65] This rule generally permits the IRS to subdivide income-producing activities in various ways for the purpose of determining whether they involve unrelated business income that should be subject to taxation. According to the regulations, the fragmentation rule provides:

> Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are 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.[66]

This rule has been applied in a number of contexts. As noted above, it was applied to analyze the business of an art museum gift shop[67] and the business of pharmaceutical sales by a hospital.[68] It has also been applied to the business of

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[62] Rev. Rul. 73-105, 1973-1 C.B. 264.

[63] Carle Found. v. United States, 611 F.2d 1192 (7th Cir. 1979).

[64] *See id*.

[65] I.R.C. § 513(c) (2011).

[66] Treas. Reg. § 1.513-1(b); *see generally* HILL & MANCINO, *supra* note 55, at ¶22.02; HOPKINS, *supra* note 55, at 643.

[67] Rev. Rul. 73- 104, 1973-1 C.B. 263; Rev. Rul. 73-105, 1973-1 C.B. 264.

[68] Treas. Reg. § 1.513-1(b).

publishing a periodical so that the income from the sale of advertising in the publication is analyzed separately from the income of selling the publication itself.[69] This varied application demonstrates the flexibility of the rule. Activities can be fragmented by product (an art museum's sale of books about art is separated from the sale of science books[70]) or by customer (a hospital's sale of medication to the general public is separated from its sale of medications to its patients[71]).

III. APPLICATION OF EXISTING UBIT RULES TO UNIVERSITY ACTIVITIES

There is an established body of law outlining the analysis of when and how the UBIT can be applied to various businesses operated by universities. These cases demonstrate that the analysis of university-sponsored business activities can be quite variable and can lead to apparently divergent results. To a great extent, this diversity of decision-making may be a product of the fact that the established law permits great flexibility in how an income-producing activity can be defined and how it can be related to the university's exempt purpose of providing education.

One prominent university-related case addressed the "regularly carried on" requirement. In *NCAA v. Commissioner*, the Tenth Circuit held that the UBIT did not apply to income derived from the sales of advertising in a souvenir program sold at a NCAA men's basketball tournament.[72] According to the Tenth Circuit, neither the tournament itself, nor the sale of program advertising were "regularly carried on" because the

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[69] United States v. Am. Coll. of Physicians, 475 U.S. 834 (1986) (holding that the advertising sales were subject to the UBIT because commercial advertisement sales in a medical journal could be separately tested under UBIT due to the fragmentation rule).

[70] Rev. Rul. 73-105, 1973-1 C.B. 264.

[71] Treas. Reg. § 1.513-1(b); *see also* I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 8, 1996) (finding that the use of university-owned golf course by students and staff is a related business but that use by alumni and guests is not related).

[72] NCAA v. Comm'r of Internal Revenue, 914 F.2d 1417 (10th Cir. 1990).

tournament was conducted for only a three-week period, once a year.[73] In reaching its conclusion, the *NCAA* Court found the relevant commercial analogue to be monthly or weekly sports magazines, such as *Sports Illustrated*, which also sold advertising aimed at sports fans.[74]

Other rulings involving college and university activities have focused on the "substantially related" requirement. In its regulations, the IRS uses an example concerning income from a student performance as an illustration of when an activity is substantially related.[75] In its example, the IRS takes the position that the sale of tickets for a public performance should be characterized as a related activity because teaching students how to perform in front of an audience is a necessary component of performing arts training and it is at the core of a university's educational purpose.[76] A similar theory is applied to the business of selling tickets to the public for athletic events.[77]

The IRS has concluded that a business activity is not "substantially related" if it does not have a direct connection to a formal educational program. For example, many colleges and universities offer travel tour programs offered to alumni through their alumni associations.[78] These programs will generally fail to meet the "substantially related" requirement unless they are part of a substantial formal educational program.[79] In 2000, the IRS finalized regulations on tour activities and indicated that a test focusing on al of the facts and circumstances surrounding such programs will be used to determine whether individual tours are in compliance with the "educational content" standard.[80] For example, if a university offers a "summer camp" to the general

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[73] *Id*. at 1424-26.

[74] *Id*.

[75] Treas. Reg. § 1.513-1-(d)(4)(i) ex. 1.

[76] *Id*.

[77] *See, e.g*., Rev. Rul. 80-296, 1980-2 C.B. 195. There are, of course, good reasons to question this conclusion. While students in a performing arts program are receiving training specifically designed to prepare them for a professional career in the performing arts, the same is not true for participation in sports programs. By all accounts, college sports are extracurricular activities that has a role to play in education, but it is not considered to be part of a "pre-football" or "pre-basketball" course of study.

[78] *See* Rev. Rul. 78-43, 1978-1 C.B. 164.

[79] *Id*.

[80] Treas. Reg. § 1.513-7(a).

public in an area of educational instruction, then the summer camp is generally considered "substantially related."[81]

The IRS has also ruled on the question whether the UBIT applies to income earned from the use of university facilities. Apparently following the same analysis as applied to hospital pharmacies, the IRS has held that use of university facilities, such as recreational facilities by students, faculty, and staff is "substantially related" to the university's exempt purpose; but use by the general public, including alumni, is not.[82] With respect to events held in university facilities, there must be a close connection between the event and the university's educational mission. Thus, a professional symphony orchestra performance in a university's performing arts center could be characterized as an integrated part of the university's purpose to provide a performing arts education.[83] However, the same conclusion cannot be said of a popular music concert held in a basketball arena, or a professional soccer game held in a football stadium, and especially not when those events are commercially indistinguishable from similar events in non-university facilities.[84]

There are numerous exceptions to the general rules governing the application of the UBIT. Listing all of them would be unproductive for the purposes of this article. However, there are some specific exceptions that apply to university

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[81] Rev. Rul. 77-365, 1977-2 C.B. 192.

[82] *See, e.g.*, Treas. Reg. 1.513-1(d)(4)(iii) (applying analysis to dual-use facilities in general); Rev. Rul. 78-98, 1978-1 C.B. 167 (finding that income from general public's use of ski facilities owned by exempt school and otherwise used for physical education classes was UBIT); I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 8, 1996) (finding that the use of a university golf course by students and staff is a related business but that the use by alumni and guests is not related).

[83] *See, e.g.*, I.R.S. Gen, Couns. Mem. 39,862 (Jun. 3, 1991) (ruling that income generated by the use of a multipurpose facility for rock concerts, professional basketball games and similar events aimed at general public audience is not "substantially related"); *see also* I.R.S. Tech. Adv. Mem. 91-47-008 (Nov. 22, 1991).

[84] I.R.S. Tech. Adv. Mem. 91-47-008 (Nov. 22, 1991).

operations. These exemptions may shed some light on how to analyze changes in college athletics programs, which could subsequently change the application of the UBIT to the income derived from those programs.

I.R.C. Section 513(a)(2) provides an exception from the UBIT for an activity carried on "primarily for the convenience of members, students, patients, officers or employees."[85] The test for applying this exception is factually oriented, and the IRS has not provided any meaningful guidance on how to draw the line between an activity that qualifies for this exception and one that does not.[86] The convenience exception has broad application in the university context, having been applied to activities as diverse as the sale of toothpaste to students by a university bookstore as well as income from parking garages on university property.[87]

The complexity of the interaction between the fragmentation rule, the "substantially related" rule, and the convenience exception is nicely illustrated in the context of the university bookstore. The IRS stated in 1994 published guidelines:

> The sale to students, officers and employees of books, supplies, and other items that are necessary for courses at the institution is an activity substantially related to the institution's educational purposes. Thus, the sale of books that are required or recommended for courses at the institution and general school supplies such

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[85] I.R.C. § 513(a)(2) (2012). The exception is limited to 501(c)(3) organizations and public universities which are subject to the UBIT by virtue of I.R.C. § 511.

[86] *See* HILL & MANCINO, *supra* note 55, at ¶22.03[2] (asserting there is "little guidance exists as to what constitutes a convenience-type activity."); HOPKINS, *supra* note 55, at 707.

[87] As a general rule, however, regardless of what kinds of activities are covered by the convenience exception, the fragmentation rule suggests that the exception applies only to income derived from students, faculty, and staff who are involved in the activity, not from income derived from the general public. *See* Rev. Rul. 78-98, 1978-1 C.B. 167 (income from general public's use of ski facilities owned by exempt school and otherwise used for physical education classes was UBIT); I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 08, 1996) (holding that the use of a university golf course by students and staff is related but that the use by alumni and guests is not related).

> as notebooks, paper, pencils, typewriters, and athletic wear necessary for participation in the institution's athletic and physical education programs, does not constitute unrelated trade or business. Similarly, educational purposes are served by the availability of other materials that further the intellectual life of the campus community. In general, the sale to students, officers, and employees of an institution of books, tapes, records, compact discs, and computer hardware and software (whether or not required for courses) is considered an activity substantially related to educational purposes.[88]

In this guideline, the fragmentation rule is applied in various ways that demonstrate how the convenience exception will work. First, the analysis uses the rule to distinguish sales of "related activity" items, such as books and educational supplies, from the sale of other items, such as toothpaste, toiletry articles, or apparel. Under this approach, "[e]xcepted merchandise may include toiletry articles, wearing apparel or novelty items bearing the institution's insignia, and other items such as candy, cigarettes, newspapers and magazines, greeting cards, photographic film, cameras, radios, and television sets or other appliances."[89] At the same time, the guidelines also invoke the fragmentation rule to reach the conclusion that sales to alumni do not qualify for the convenience exception and "the sale of multiple computers, in a single year, to a single student or the sale of a computer to someone who is not a student, officer or employee of the institution may result in unrelated business

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[88] I.R.S. COLLEGE AND UNIVERSITY EXAMINATION GUIDELINES, ANNOUNCEMENT 94-112; 1994-37 I.R.B. 36 at 342.(13)(2) (1994), http://www.federaltaxissues.com/docs/IRS-announce-94-112.pdf (last visited Nov. 3, 2015).

[89] *Compare id*. (finding that the sale of a wide range of items to students, officers and employees of an institution are substantially related) *with* Rev. Rul. 81-62, 1981-1 C.B. 355 (finding that sales of heavy appliances by exempt senior citizens center was unrelated).

income."[90]

The flexibility afforded by the combined application of both the fragmentation rule and the convenience exception is evident in the analysis of income derived from other university operations. Thus, the IRS has ruled that revenue from vending machines on campus property generally would be excluded per the convenience exception[91] as would revenue generated by on-campus parking for students, faculty, and staff.[92] Apparently relying on similar logic, the IRS has ruled that concession sales at university athletic events should also be exempt as analogous to a museum operating a cafeteria for the convenience of staff and visitors.[93] Interestingly, this ruling does not make a distinction between sales to university students, staff, and faculty in attendance and sales to members of the general public.

Universities also generate substantial income through the sale of advertising and the solicitation of corporate sponsorships for various university activities. Through the fragmentation rule, the IRS has long taken the position that any activity could be broken up into different components for the purpose of UBIT analysis; this is particularly true with respect to advertising that is sold in connection with an exempt activity. Even so, according to the Supreme Court's holding in the *American College of Physicians* case, the application of the fragmentation rule to advertising does not create a *per se* rule that advertising income was subject to the UBIT.[94] As with any other source of income, the question whether advertising or sponsorship income

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[90] GUIDELINES, *supra* note 90, at 342.(13)(5).

[91] *See* Rev. Rul. 81-19, 1981-1 C.B. 353 (finding that "[t]he goods and services dispensed by the vending machines are necessary for the day-to-day living on the campus of students, faculty, and staff. If the university operated the vending facilities, the income would not be subject to the tax on unrelated business income because the activity would be carried on for the convenience of its students and employees within the meaning of section 513(a)(2) of the Code.").

[92] *See* Rev. Rul. 69-269, 1969-1 C.B. 160 (ruling that parking revenue generated by patients and visitors "substantially related" to mission of exempt hospital).

[93] *See, e.g.*, I.R.S. Priv. Ltr. Rul. 86-23-081(Mar. 17, 1986) (finding that concession sales at related event not subject to UBIT); Rev. Rul. 74-399, 1974-2 C.B. 172 (finding that sales at a museum cafeteria are exempt).

[94] United States v. Am. Coll. of Physicians, 475 U.S. 834 (1986) (holding that the advertising in question was not substantially related).

was taxable would be resolved according to the "substantially related" rule.[95]

In 1991, the IRS applied these rules to corporate sponsorships of college football games. In Technical Advice Memorandum 9147007, the IRS ruled that the UBIT applied to income received from corporations who paid to be "sponsors" of college football bowl games.[96] The Service reasoned that the "sponsorship" arrangement was not simply a way to provide a benefit to an exempt organization associated with education and amateur sports.[97] In the Service's view, the corporation received reciprocal benefits that went well beyond simple "donor recognition."[98] These benefits included the prominent display of the corporate name and logo on the playing field and the scoreboard, on patches placed on the players' uniforms, and in related print materials distributed at the game.[99] The IRS concluded that the "sponsorship" was more like a payment for advertising.[100] When fragmented from the overall trade or business of conducting a football game, the income from these sponsor payments would be subject to the UBIT.[101]

The implications of this ruling for the economic viability of college athletics was significant, prompting concerns about whether and to what extent other revenue associated with the commercialization of college sports would be subject to the UBIT. In 1997, Congress responded to this ruling by enacting Section 513(i), which provided a specific exemption from the

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[95] *Id*.

[96] I.R.S. Tech. Adv. Mem. 91-47-007 (Nov. 22, 1991); *see generally* JAMES J. FISHMAN & STEVEN SCHWARZ, TAXATION OF NONPROFIT ORGANIZATIONS 397 (3d ed. 2010); *see also* Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430 (1980).

[97] I.R.S. Tech. Adv. Mem. 91-47-007 (Nov. 22, 1991).

[98] *Id*.

[99] *Id*.

[100] *Id*.

[101] *Id*.

UBIT for "qualified sponsorship" payments.[102] These can include payments from corporations and other business entities.[103] The IRS finalized regulations for the new statute in 2002 as Treasury Regulation 1.513-4.[104] The statute and the attendant regulations attempt to distinguish between income from sponsorships, which is not taxable, and income from advertising, which could be taxable, depending upon the facts and circumstances.[105] In general, when a corporate sponsorship provides a corporation with nothing more than the right to display the corporation's name, logo, or product lines, the payments will qualify as "sponsorship" payments and not advertising because, at least in theory, the mere display of a logo is not seen as providing a substantial return benefit to the sponsor.[106]

Another source of income for universities that could be subject to the UBIT is royalty income. In general, "royalties" are defined as payments for the use of intangible property, such as a trademark, logo, copyright or patent, or for the exploitation of minerals or natural resources like oil, gas, or minerals.[107] In some situations, royalty payments can be difficult to distinguish from payments for services. The business of college athletics implicates this difficulty in an important way because many of the payments received by colleges for various media rights could be characterized as royalties for the use of intellectual property, including the names and likenesses of the athletes themselves.

The problematic nature of the distinction between service and royalty payments was famously at issue in *Sierra Club v. Commissioner*,[108] a Ninth Circuit case. There, the Ninth Circuit considered whether payments received by the Sierra Club for the use of its mailing list and for an "affinity card" arrangement with a bank credit card issuer constituted

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[102] *See generally* HILL & MANCINO, *supra* note 55, at ¶22.11[7] (discussing additional details on the workings of Section 513(i)); HOPKINS, *supra* note 55, at 714-18.

[103] HILL & MANCINO, *supra* note 55, at ¶22.11[7].

[104] *Id*.

[105] *Id*.

[106] Treas. Reg. § 1.513-4(c)(2)(iv).

[107] *See generally* HILL & MANCINO, *supra* note 55, at ¶23.03; HOPKINS, *supra* note 55, at 697-98; Sierra Club, Inc. v. Comm'r of Internal Revenue, 86 F.3d 1526, 1531 (9th Cir. 1996).

[108] *Sierra Club, Inc*., 86 F.3d 1526.

royalties.[109] The IRS's position was premised on the idea that royalty income is "passive," meaning the recipient pays royalties without any requirement of affirmative conduct.[110] According to the IRS, the payments for use of the mailing list and for the "affinity" credit card required some active conduct by the Sierra Club and therefore did not qualify as royalties.[111] The Ninth Circuit declined to adopt this analytical approach, however, and ruled that the key issue was whether the payments were for the use of property, even intangible property, such as member lists, or for the services that the Sierra Club provided in keeping the mailing list updated and in promoting the affinity card to its members.[112] With respect to the member lists, the Ninth Circuit concluded that the payments the Sierra Club received for use of those lists were royalties because they were solely intended for the exploitation of the Sierra Club's property rights in the lists.[113] The Ninth Circuit found the lower court record inadequate to decide the affinity card issue and, on remand, the Tax Court found in favor of the Sierra Club, noting that it was the bank, not the Sierra Club, that performed the marketing and solicitation services.[114]

As a result of the ruling in *Sierra Club* and subsequent similar cases that followed its reasoning, the "royalty" exception has been expanded so that it applies to almost any payment intended to exploit an underlying property right. In a university context, this means that revenue derived from mailing lists and affinity card arrangements should be exempt. In addition, the *Sierra Club* reasoning demonstrates that income derived from licensing marks for sports-related souvenirs should also be exempt.

IV. THE UBIT AND THE PRESUMPTIVE PURPOSES OF COLLEGIATE ATHLETICS

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[109] *Id*.

[110] *Id*. at 1532.

[111] *Id*. at 1536.

[112] *Sierra Club, Inc*., 86 F.3d 1526.

[113] *Id*. at 1536.

[114] Sierra Club, Inc. v. Comm'r of Internal Revenue, 77 T.C.M. (CCH) 1569 (1999).

Since the enactment of the UBIT, it has always been presumed that the UBIT would not apply to income from collegiate athletics because athletic competitions were "substantially related" to a university's educational mission. However, recent developments surrounding the litigation challenging the legality of the NCAA's amateurism rules make this presumption more difficult to sustain. In particular, the NCAA's own understanding of the nature of collegiate athletics seems to be contradicting the presumption that has long protected collegiate athletics from the UBIT

At the time of the legislation establishing the UBIT, Congress did not seem to regard collegiate athletics as the sort of thing that could be considered an unrelated business. In this respect, the legislation seems to have been drafted with the same presumption that underlies the understanding of collegiate athletics held by the NCAA and its member schools. Neither the House Ways and Means Committee nor the Senate Finance Committee heard any testimony on the issue, but reports of both committees nevertheless asserted, without much reflection or support, that "[a]thletic activities of schools are substantially related to their educational functions."[115] Thus, the committees reflexively concluded that "[o]f course, 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."[116]

Subsequently, rulings by the IRS confirmed that the legislation and regulations associated with the UBIT were designed with the idea that collegiate athletics were unquestionably an aspect of a university's educational mission. In 1977, the Service attempted to make the income from broadcasting college sports events taxable, but this attempt was short-lived. [117] After extensive public protest and political

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[115] H.R. REP. No. 2319, Blat Cong., 2d Sess. (1950), *reprinted* in 1950·2 C.B. 380, 409; S. REP. No. 2375, 81st Cong., 2d Sess. (1950), *reprinted in* 1950-2 C.B. 483, 505.

[116] *Id*.

[117] *See* I.R.S. Tech. Adv. Mem. 78-51-002 (Jan. 1, 1978). The Service tried to take advantage of this gap in the legislative history and notified several universities and the Cotton Bowl Athletic Association, a tax-exempt entity that presents the annual Cotton Bowl football game,

pressure, the Service issued a series of unpublished Technical Advice Memoranda, which ruled that "there is no meaningful distinction between exhibiting the game in person to 100,000 people and exhibiting the game on television to a much larger audience where both groups of people may be made up not only of students." [118] Indeed, the Service even provided a rationalization for its conclusions that had been missing in the legislative history:

> [A]n audience for a game may contribute importantly to the education of the student-athlete in the development of his/her physical and inner strength and to the education of the student body and the community-at-large in heightening interests in and knowledge about the participating schools. In regard to the student-athlete, the knowledge that an event is being observed heightens its significance, which raises the levels of both competitive effort and enjoyment. At- tending the game enhances student interest in education generally and in the institution because such interest is whetted by exposure to a school's athletic activities. Moreover, the games (and the opportunity to observe them) foster those feelings of identification, loyalty, and participation typical of a well-rounded educational experience.[119]

The presumptions that have justified exempting college athletics from the UBIT are at risk due to developments in recent litigation challenging the legality of the NCAA's model for college athletics. This risk arises, of course, from the possibility

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that revenue from the broadcasting rights to the game would constitute unrelated business income.

[118] *Id*. (finding that unrelated business income was not created by university sales of broadcast rights to football and basketball games); *see also* 78-51-005 (Jan. 1, 1978)*; see also* 78-51-006 (Jan. 1, 1978).

[119] I.R.S. Tech. Adv. Mem. 78-51-002 (Jan. 1, 1978)); *see also* 78-51-004 (Aug. 21, 1978); *see also* 78-51-005 (Jan. 1, 1978); *see also* 78-51-006 (Jan. 1, 1978).

that a court may rule that NCAA sports are not truly a part of the educational mission of a university. But, perhaps even more importantly, the risk arises from arguments that the NCAA has made in its own defense. These arguments include some ideas that are in tension with the existing justifications for not taxing college athletic income.

In the *O'Bannon* case, the district court certainly seemed dubious about the idea that the NCAA's model of collegiate athletics and, in particular, its amateurism rules, were really part of a consistent program and policy for accomplishing educational objectives. When the NCAA provided testimony from its current president, Mark Emmert, that it had always made sure that the only resources provided to student athletes were those that were necessary for helping them receive an education, the district court rejected that position.[120] Instead, the district court concluded that a historical review of the NCAA's rules and bylaws demonstrated that the professed relationship between amateurism and education was a relatively recent one and that the NCAA had, over time, taken varying and inconsistent positions on whether athletic scholarships were consistent with a university's educational objectives.[121] Indeed, for many years, the NCAA had taken the position that any kind of scholarship given strictly for athletic purposes was entirely inconsistent with the educational mission of universities.[122] Not surprisingly, then, the district court concluded that the amateurism rules did not significantly advance educational objectives:

> The only evidence that the NCAA has presented that suggests that its challenged rules might be necessary to promote the integration of academics and the testimony of university administrators, who asserted that paying student-athletes large sums of money would potentially "create a wedge" between student-athletes and others on campus . . . . These administrators noted that, depending on how much compensation was ultimately awarded, some student-athletes might receive more money from the school than their professors. Student-athletes

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[120] *O'Bannon*, 7 F. Supp. 3d at 973-75.
[121] *Id*.
[122] *Id*.

> might also be inclined to separate themselves from the broader campus community by living and socializing off campus.
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> It is not clear that any of the potential problems identified by the NCAA's witnesses would be unique to student-athletes. In fact, when the Court asked Dr. Emmert whether other wealthy students — such as those who come from rich families or start successful businesses during school — raise all of the same problems for campus relations, he replied that they did. . . . It is also not clear why paying student-athletes would be any more problematic for campus relations than paying other students who provide services to the university, such as members of the student government or school newspaper.[123]

Despite its skepticism about the educational value of the amateurism rules, the district court concluded that there could be some limited educational value in the attempt to restrict student athlete earnings.[124] Nevertheless, the court ultimately rejected the NCAA's contention that the amateurism rules were essential to preserving the university's educational mission with respect to student athletes; and it ruled that student athletes were entitled to payments for the use of their names and likenesses by their schools, although the extent of those payments would be limited so that they would, in effect, constitute modest supplements to the traditional athletic scholarship.[125] The district court's conclusions, buttressed by the NCAA's own arguments, make it difficult for anyone to take the position that the traditional model of collegiate athletics are necessary to accomplish a university's educational objectives or that collegiate athletics are not a commercial enterprise driven for profit.

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[123] *Id*. at 980 (citations omitted).

[124] *Id*. (finding that "certain limited restrictions on student-athlete compensation may help to integrate student-athletes into the academic communities of their schools, which may in turn improve the schools' college education product").

[125] *Id*. at 1007.

CONCLUSION

Recent litigation suggests that collegiate athletics may not be "substantially related" to the educational mission of a university. There are several reasons for this assumption. First, any finding of a substantial relationship is hard to maintain in light of the NCAA's own description of collegiate athletics as a commercial product, and in light of findings by the *O'Bannon* court concerning the interplay between the amateurism ideal, the business of collegiate athletics, and the realities of day-to-day lives of student athletes.

Second, a new or revised understanding of the nature of collegiate athletics could make it much easier to fragment the income derived from football and men's basketball from the rest of an athletic program. To the extent that football and men's basketball appear to be different kinds of activities than the rest of an athletic program, the IRS could conclude that these activities constitute an unrelated business that is not substantially related to a university's educational mission, even if other sports are considered substantially related. Of course, colleges and universities could respond to such a conclusion by contending that their athletic programs should be viewed as a unified whole, with the gains created by football and men's basketball offset by the losses resulting from the operation of all other sports programs. This would be a fairly compelling argument, given the fact that most athletic programs break even or lose money as a whole. Nevertheless, the power of the fragmentation rule has been demonstrated again and again. Additionally, if the IRS can fragment income from the sale of science books at an art museum gift shop from income derived from the sale of other art-related materials, then there is a very strong possibility that the IRS can fragment a couple of enormously lucrative sports programs from the rest of a collegiate athletic program.

Third, if the current litigation results in payments to student athletes for the use of their names and likenesses, then the fundamental nature of the relationship between student athletes and their universities would change. The relationship could look more commercial than educational because the student athletes would be receiving royalty payments for their intangible property. Although case law has established that the passive receipt of royalty payments does not necessarily create UBIT liability for an exempt organization, it is another thing entirely if an exempt organization is *making* royalty payments so that it can receive a business benefit. In other words, if colleges and universities are paying royalties to some student athletes in

return for the profit-making use of a student athlete's intangible property, then the relationships involved in collegiate athletics could start to look even more commercial.

For all of these reasons, it seems clear that recent developments in collegiate athletics could make it much more difficult for colleges to sustain the long-standing presumption that the revenue derived from their athletic programs should be entirely exempt from taxation. However, there is a great deal of inertia behind the current tax treatment of such revenue and there are powerful political forces that could promote legislation that would preserve the status quo. Things are changing fast and dramatically in collegiate athletics, and it would not be surprising if some of those changes included a substantial revision to the way in which the UBIT was applied to income derived from collegiate athletic programs.