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I.R.C. § 4960'S IMPACT ON COLLEGE SPORTS: IN LIGHT OF IRS GUIDANCE CERTAIN UNIVERSITIES WILL NEED TO ENGAGE IN TAX PLANNING

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INTRODUCTION

The college sports industry is booming to the billions. Fiscal year 2018-2019 was a record-breaking year for the National Collegiate Athletic Association ("NCAA"). The NCAA, for the first time ever, broke $1.1 billion in revenue.[1] Similarly, in Fiscal year 2019, the Power Five college sports conferences had more than $2.9 billion in combined revenue.[2] The expansion of the SEC that includes Texas and Oklahoma could top that revenue by the 2024-2025 fiscal year, with an earth-shattering $1.3 billion in revenue.[3]

As a result of the growing industry, Athletic Directors' and coaches' salaries also continue to rise. More than 240 athletic directors and coaches across the

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1. NCAA 2019 Form 990.

2. Steve Berkwitz, Power Five Conferences Had Over $2.9 Billion in Revenue in Fiscal 2019, New Tax Records Show, USA TODAY (July 10, 2020, 2:00 PM), https://www.usatoday.com/story/sports/college/2020/07/10/power-five-conference-revenue-fiscal-year-2019/5414405002/.

3. Steve Berkowitz, Analysis: If SEC Adds Texas and Oklahoma, the Conference Could Generate as Much Revenue as NCAA, USA TODAY (July 27, 2021, 2:22 PM), https://www.usatoday.com/story/sports/ncaaf/2021/07/26/college-football-if-sec-expands-could-match-ncaa-1-3-billion-revenue/5377990001/.

FBS receive compensation above $1 million.[4] Most athletic departments in the Power Five employ at least two, if not three, individuals whose compensation exceeds $1 million.[5] At least one coach in Football, Men's and Women's Basketball, and Baseball make more than $1 million a year.[6]

Athletic Directors and Coaches are not the only ones that are on their way to being highly compensated. In October 2019, the NCAA's governing board voted unanimously to allow college athletes to be compensated for their name, image, and likeness.[7] The National Bureau of Economic Research conducted a study to attempt to quantify the revenue that college football and basketball stars could make if they were compensated. The study found that high-profile football players could earn up to $2.4 million per season, while a star basketball player could earn up to $1.2 million.[8] Proponents of paying college athletes argued that the players generate more than $14 billion in revenues for college sports programs.[9]

College athletics departments and organizations have historically been granted tax-favorable treatment.[10] Most university and college athletic

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4. Robert Lattinville & Roger Denny, *How The New Excise Tax Impacts Coach Compensation*, ATHLETIC DIR. U, https://athleticdirectoru.com/articles/how-the-new-excise-tax-impacts-coach-compensation/ (last visited Dec. 1, 2021).

5. *Id.*

6. Kurtis Quillin, Here's What Kim Mulkey Will Make as Head Coach of Women's Basketball at LSU, KCEN-TV (Apr. 28, 2021, 8:20 PM), https://www.kcentv.com/article/sports/heres-what-kim-mulkey-will-make-as-head-coach-of-womens-basketball-at-lsu/500-5e28c111-f590-467f-9adf-cae66aa2f060.

7. Board of Governors Starts Process to Enhance Name, Image and Likeness Opportunities, NCAA (Oct. 29, 2019), https://www.ncaa.org/about/resources/media-center/news/board-governors-starts-process-enhance-name-image-and-likeness-opportunities. In June of 2021, the U.S. Supreme Court also ruled on the compensation of student athletes. https://www.supremecourt.gov/opinions/20pdf/20-512_gfbh.pdf. The compensation of athletes is beyond the scope of this article. However, the projected compensation of athletes shows growing revenue within the sports industry.

8. Tom Huddleston Jr., *College Football Stars Could be Earning as Much as $2.4 Million Per Year, Based on NCAA Revenues: Study*, CNBC.COM (Sept. 2, 2020, 3:01 PM), https://www.cnbc.com/2020/09/02/how-much-college-athletes-could-be-earning-study.html.

9. Alan Blinder, *N.C.A.A. Athletes Could Be Paid Under New California Law*, THE N.Y. TIMES (June 21, 2021), https://www.nytimes.com/2019/09/30/sports/college-athletes-paid-california.html.

10. William A. Drennan*, Taxing Commercial Sponsorships of College Athletics: A Balanced Proposal*, 73 OHIO ST. L. J. 1353, 1373 (2012) (documenting that tax law has treated nonprofit athletic organizations and college athletic programs as integral parts of the tax-exempt college); *See also* Kathryn Kisska-Schulze, This is Our House! – The Tax Man Comes to College Sports, 29 MARQ. SPORTS L. REV. 347, 348-49 (2019) (noting that Prior to 2018, college athletics had historically enjoyed favorable federal tax treatment due to their tax-exempt status); *See, e.g.*, John D. Colombo, *The NCAA, Tax Exemption and College Athletics*, 2010 U. ILL. L. REV. 109, 110 (2010) (noting dissenters of the tax-exempt status of the NCAA, including political representative Bill Thomas (R-CA22) and George Will, Op-Ed Columnist for The Washington Post).

departments and the NCAA have been granted tax-exempt status.[11] But in 2017, Congress targeted the increasing executive compensation of tax-exempt organizations by passing a 21% excise tax on certain executive compensation paid by tax-exempt organizations (the "Excess Compensation Excise Tax").[12] The reform targets certain tax-exempt organizations, including U.S. colleges and universities. However, the final legislation contained mistakes and ambiguities that were left to the IRS to clarify. Subsequent IRS clarification has now led to a disparity that could create an inequity between public and private collegiate athletic departments.

The purposes of this article are to (1) provide a summary of the tax-exempt organization of the collegiate sports industry; (2) provide a summary of the Excess Compensation Excise Tax and current IRS guidance and its impact on collegiate supports; and (3) conclude that both private universities and certain public universities should engage in tax planning to avoid the significant impact of the Excess Compensation Excise Tax and prevent an inequity between public and private school athletic departments.

I. The Tax-Exempt Status of College Athletics

The Internal Revenue Code ("IRC") provides different avenues for organizations to receive tax-exempt status. Historically, university and college athletic departments and organizations like the NCAA have qualified for tax-exempt status under one of three avenues: (i) Section 501(a) as a Section 501(c)(3) organization, (ii) Section 115, or (iii) under the doctrine of implied statutory immunity.[13] Generally, universities and colleges and other organizations that receive tax-exempt status under one of these three avenues are not subject to tax on their income, as long as that income is used in furtherance of their exempt purpose.[14] Each of these three avenues for tax-exemption are discussed below.

Section 501(c)(3) provides a tax exemption for charitable organizations.[15] Charitable organizations include corporations that are organized and operated

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11. *See* Drennan, *supra* note 10; *See also* Kissa-Schulze, *supra* note 10 (there are numerous other favorable provisions within the tax code that favor college athletics); (some of these provisions were changed with tax reform in 2017). *Id.* But this article only focuses on compensation.

12. *See* H.R. Res. 1, 115th Cong. (2017-2018) (enacted).

13. Andrew D. Appleby, *For the Love of the Game: The Justification for Tax Exemption in Intercollegiate Athletics*, 44 J. MARSHALL L. REV. 179, 180-181 (2010); *See also* Kissa-Schulze, *supra* note 10, at 348-349.

14. *Id.*: *See also* I.R.C. § 511 (universities and colleges are subject to tax on any unrelated business income); *See also* Appleby, *supra* note 13, at 180-181 (in addition, tax-exempt entities are subject to the private inurement and private benefit doctrines). The private inurement and private benefit doctrines are discussed in more detail in section A *infra* p.180-81.

15. I.R.C. § 501(c)(3) (2021).

exclusively for educational purposes, or to foster national or international amateur sports competition.[16] In 1967, the IRS issued Revenue Ruling 67-291, which provided that university athletic programs are an "integral" part of the educational process and help to further the educational programs of a university, and thus qualify for federal tax exemption.[17] This position was reiterated in 1980 by Revenue Ruling 80-296. Subsequent case law has also supported that college and university athletic departments are generally considered educational in nature and qualify as section 501(c)(3) tax-exempt organizations.[18] Generally, private universities and colleges, including their athletic departments, meet the educational requirements of section 501(c)(3) and qualify for federal tax-exemption.[19] Some public universities are also organized as section 501(c)(3) organizations under the educational requirements.[20]

Similarly, college athletic organizations such as the NCAA are also organized as tax-exempt organizations under section 501(c)(3), but as organizations that foster national or international amateur sports competition. Prior to 1976, fostering national or international amateur sports was not a charitable purpose listed in Section 501(c)(3). But in 1976, Congress amended 501(c)(3) to include the fostering of "national or international amateur sports competition" as a charitable purpose.[21] The fostering of national or international amateur sports was also upheld by subsequent case law.[22] This addition to Section 501(c)(3) has allowed organizations such as the NCAA and Olympic sports organizations to be tax-exempt.[23]

Section 115 provides that income, for tax purposes, does not include "income derived from any public utility or the exercise of any essential governmental function . . ."[24] Section 115 allows public universities that are a function of their state government to exclude most of their income from taxation.[25] While public universities may exclude income based on Section 115,

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16. *Id.*

17. Rev. Rul. 67-291, 1967-2 C.B. 184.

18. Kissa-Schulze, *supra* note 10, at 360-361.

19. *Id.* at 359.

20. *Id.*; *See also* Appleby, *supra* note 13, at 181.

21. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1313(a), 90 Stat. 1520, 1730 (1976) (codified as amended at I.R.C. § 501(c)(3) (2017)).

22. Hutchinson Baseball Enterprises v. Commissioner, 696 F.2d 757 (10th Cir. 1982).

23. I.R.S. Gen. Couns. Mem. 39775 (Oct. 29, 1985); I.R.S. Gen. Couns. Mem. 291825 (Jan, 24, 1985).

24. 26 U.S.C. § 115(1) (2021).

25. Richard Schmalbeck & Lawrence Zelenak, *The NCAA and the IRS: Life at the Intersection of College Sports and the Federal Income Tax*, 92 S. CAL. L. REV. 1087, 1145-1147; Appleby, *supra* note 13, at 181; I.R.C. § 115.

they can also seek tax-exempt status under Section 501(c)(3).[26] In fact, public universities have applied for and received determinations that they are exempt under Section 501(c)(3). For example, the University of California, Los Angeles, University of Michigan, University of Florida, and Florida State University have all applied for and received determination letters.[27] Other universities specifically state that they are exempt under Section 115. For example, the University of Arizona specifically states that it is not a 501(c)(3) organization and provides to its donors and sponsors its determination letter from the IRS indicating that it is a section 115 entity.[28]

Lastly, public universities may also be exempt under doctrine of implied statutory immunity. The IRC does not explicitly exempt states and their political subdivisions from federal income tax. However, the IRS has concluded that states and their political subdivisions are free from federal income tax, under the doctrine of implied statutory immunity – in other words that they are exempt because no provision of the IRC taxes them.[29] The IRS' position is detailed in General Counsel Memorandum 14,407, which concludes that "unless otherwise specified in the Code, states and their political subdivisions are not taxpayers under the code, and their income is not gross income within the meaning of section 61."[30] The General Counsel Memo has been reiterated in a series of revenue rulings issued by the IRS. In Revenue Ruling 87-2, the IRS stated "Income earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision of a state is generally not taxable in the absence of specific statutory authorization for taxing such income."[31] A subsequent Technical Advice Memorandum issued by the IRS concludes that a university system is a political subdivision of the state, and as an integral part of the political subdivision of the state, it is the type of entity to which immunity applies.[32]

Therefore, private universities are generally exempt under Section 501(c)(3), and public universities, while they may be exempt under 501(c)(3), generally are not subject to income tax under Section 115 or

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26. *Id.*

27. Ellen P. Aprill, *Revisiting Federal Tax Treatment of States, Political Subdivisions, and Their Affiliates*, 23 FLA. TAX. REV. 73, FN 146, (2019).

28. *Id.*; *See also* https://www.fso.arizona.edu/sites/fso/files/2019-01/Donors_Sponsors_2019.pdf

29. Aprill, *supra* note 27, 83.

30. *Id.*

31. *Id.* at 85-86; Rev. Rul. 87-2, 1987-1 C.B. 18. The ruling concludes that the Lawyer Trust Fund Account is an integral part of the state. *See also* Revenue Ruling 87-2 also refers I.R.C. § 511(a)(2)(B) (unrelated business income tax) as an example of a specific statutory authorization for taxing the income of a state or political subdivision.

32. Rev. Rule 87-2, *supra* note 31. The doctrine of implied statutory immunity or intergovernmental immunity does not apply to unrelated business income. Public universities are still subject to the unrelated business income tax under section 511.

the doctrine of implied statutory immunity.

II. TAX CUTS AND JOBS ACT OF 2017 AND § 4960.

In 2017, Congress passed the most significant tax reform since 1986.[33] That legislation has come to be known as the Tax Cuts and Jobs Act ("TCJA"). The TCJA contained numerous changes to tax law, including some provisions that could potentially impact the college sports industry.[34] The number of changes and their impact is beyond the scope of this article. This article focuses on a single provision of the TCJA – Excess Compensation Excise Tax.

A. Historical Tax Landscape of Compensation paid by Non-profits

To understand the applicability and impact of the Excess Compensation Excise Tax, it is important to understand the laws that apply to compensation paid by nonprofits. Prior to the Excess Compensation Excise Tax, there were still limitations on compensation paid by Non-profits. Specifically, colleges and universities exempt under 501(c)(3) are subject to the rules on excess benefit transactions and private inurement.[35]

Organizations exempt under 501(c)(3) are required to be organized and operated for the benefit of the public, rather than for private interest.[36] However, "[o]ccasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute private benefits."[37] These rules are known as the private benefit doctrine.

"As part of the prohibition on private benefits, charitable organizations are also prohibited from allowing any part of their net earnings to inure to the benefit of any private individual or shareholder."[38] A private individual or shareholder is defined as a "person having a personal and private interest in the activities of the organization."[39] This is known as the private inurement doctrine. The private inurement doctrine is more limited than the private benefit doctrine because the private inurement focuses only on the beneficiary's relationship to

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33. TAM 7904006 (1979).

34. *See* Kathryn Kisska-Schulze, *This is Our House! – The Tax Man comes to College Sports*, 29 MARQ. SPORTS. L. REV. 347 (2019) (For a broader discussion of all of the changes that impact the college sports industry).

35. I.R.C. § 501(c)(3); I.R.C. § 4958.

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

37. American Campaign Academy, 92 T.C. 1053, 1066 (1989).

38. Rohlfing et. al., *Lessons of the Colleges and Universities Compliance Project*, 25 TAX'N EXEMPTS 08, 12 (2013).

39. 26 C.F.R. § 1.501(a)-1(c).

the organization and types of benefits being received by that individual.[40] The private inurement doctrine requires that dealings between a charitable organization and its insider be reasonable, at arm's length, and in good faith. The primary example is if this is reasonable compensation.

An organization does not violate the private inurement doctrine if the organization pays reasonable compensation for the services actually rendered.[41] However, if the compensation is excessive, as determined partially by Code Section 162, the compensation may result in a private inurement. Whether compensation is reasonable is exclusively a factual determination made on a case-by-case basis.[42] Compensation also includes all economic benefits provided by the tax exempt employer in exchange for the services provided.[43] These include salary, bonuses, deferred compensation, severance, benefit plans, certain insurances, certain fringe benefits, retirement and pension benefits, use of nonprofit assets and resources, tangible goods, and so on.[44]

The IRS has created a safe harbor for tax exempt organizations when setting compensation. The safe harbor requires the organization to take specific steps in setting the compensation. There are three steps required in setting the compensation:

> (1) Approve the terms of the compensation package in advance, with any member having a conflict of interest in abstaining from the vote;
>
> (2) Obtain and relay on appropriate comparability data prior to making a decision; and
>
> (3) Adequately document its basis for its decision on the compensation package concurrently with making the decision.[45]

The safe harbor requires that the organization have sufficient information and data to set the compensation package. This includes reliable information about:

> (1) compensation paid by similarly situated organizations (for-

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40. IRM 4.76.3.11.1(1) from the 2012 Internal Revenue Manual

41. 26 C.F.R. § 71-126; *see* 26 C.F.R. § 1.162-7(b)(3).

42. Brent T. Wilson, *Compensation and Private Inurement in Charitable Organizations: How much is too much?*, ADVOCATE, Sep. 2011, at 23.

43. 26 C.F.R. § 53.4958-4(b)(ii)(B).

44. *Id.*

45. Treas. Reg. § 53.4958-6(a).

> profit and nonprofit) for functionally comparable positions; (2) the availability of similar services in the area where the tax-exempt organization is located;
>
> (3) current compensation surveys prepared by independent consulting firms; and
>
> (4) actual written offers from competing organizations for the services of the disqualified person.[46]

So long as the organization pays reasonable compensation to its officers, directors, trustees, and key employees, no excess benefit transaction occurs.[47]

There are two consequences to violating the private benefit or private inurement doctrine. The first is revocation of the organization's exempt status.[48] The second is a tax on the excess benefits received under IRC section 4958. Section 4958 was created to penalize organizations without taking away their exempt status.[49] Section 4958 imposes on each excess benefit transaction a tax of 25% of the excess benefit.

It is important to note that private organizations, including businesses, are also subject to reasonable compensation rules. Reasonable compensation stems from the deduction under Section 162(a)(1) for "a reasonable allowance for salaries and other compensation for personal services actually rendered.[50] Under these rules, a reasonable salary is the amount that "would ordinarily be paid for like services by like enterprises under like circumstances."[51] This requirement is similar to the exempt safe harbor that requires the exempt organization to have comparable data and ensure the compensation is similar to other similarly situated individuals.

Similarly, Section 162(m) of the code disallows the deduction to publicly held corporations for "applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000."[52] In other words, publicly traded corporations are penalized for excessive compensation by not being permitted to deduct that compensation to offset income – theoretically resulting in a higher tax. Section 162(m) was enacted in 1993 by the Omnibus Budget and Reconciliation Act of 1993, and was targeted at excess

46. Wilson, *supra* note 42, at 24.
47. Rohlfing et. al., *supra* note 38, at 12.
48. John Marshall L. Sch. v. United States, 81-2 USTC 9514 (Ct. Cl. 1981).
49. Rohlfing et. al., *supra* note 38, at 12.
50. I.R.C. § 162(a)(1); Treas. Reg. § 1.162-7(a).
51. Treas. Reg. § 1.162-7(a).
52. I.R.C. § 162(m).

compensation being paid to C-suite executives.[53] The TCJA also made amendments to section 162(m), including expanding the definition of covered employees, and removing a well-used and broad exception to the rules.[54] The purpose of which was to get at the growing compensation being paid to C-Suite executives.[55]

B. Section 4960's Legislative History

The legislative history for the Excess Compensation Excise Tax is relatively silent on its intent.[56] Most commentators seem to agree that the purposes of the Excess Compensation Excise Tax was related to Congress' decision to get serious about excessive compensation, specifically, section 162(m).[57] It seems that Congress decided that if for-profit corporations would be subject to penalties on excess compensation, so should tax-exempt organizations.[58] However, because tax-exempt organizations do not pay tax, they do not take a deduction for compensation, and thus a provision like 162(m) denying a deduction would not work.[59] The solution, then was to impose an excise (or penalty) tax.[60]

The legislative history also does not indicate an intent to target universities – whether public or private – or college athletic salaries.[61] Post enactment of the Excess Compensation Excise Tax, there was significant commentary on whether the tax applied to both public and private universities, and was targeting college athletic salaries.[62] Even the IRS expressed a wide range of views on whether the law applied to both public and private universities.[63] Ultimately, the decision was left to the IRS.

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53. Schmalbeck & Zelenak, *supra* note 25, at 1150-1151.

54. *Id.*

55. *Id.*

56. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054; Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64.

57. Schmalbeck & Zelenak, *supra* note 25, at 1150-1151.

58. *Id.*

59. *Id.*

60. *Id.*

61. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054; Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64.

62. *See* Ellen Aprill, *Congress Fumbles the Ball on Section 4960*, MEDIUM (Dec. 26, 2017), https://medium.com/whatever-source-derived/congress-fumbles-the-ball-on-section-4960-guest-post-by-ellen-aprill-18a2dbf98c5f.; Douglas A. Kahn, *Does Excise Tax on Excessive Comp Apply to State Universities?*, 158 TAX NOTES 397, 398 (2018); Ellen P. Aprill, *Response to Professor Kahn: Tax Status of Public Universities*, 158 TAX NOTES 539, 539-40 (2018).

63. See Schmalbeck & Zelenak, *supra* note 25, at 1146-47 for a discussion of the IRS and public officials discussions.

C. I.R.C. § 4960, Interim Guidance, Proposed and Final Regulations

1. Code Section 4960

The Excess Compensation Excise Tax was codified in the IRC as section 4960.[64] Code section 4960 imposes an excise tax on an exempt organization that pays excess compensation to certain employees. Specifically, Code section 4960 imposes an excise tax equal to the top corporate income tax rate (currently 21%) on an applicable tax-exempt organization ("ATEO") that pays remuneration (*i.e.*, compensation) in excess of $1 million and/or parachute payments to any of the ATEO's five highest-paid covered employees (the "Covered Employees").[65] There are several key definitions under section 4960:

Term	**Definition**
ATEO:	Any organization which for the taxable year: (A) is exempt from taxation under section 501(a) (B) is a farmers' cooperative organization described in 521(b)(1) (C) has income excluded from taxation under section 115(1), or (D) is a political organization described in section 521(e)(1).[66]

64. Wilson, *supra* note 42, at 24.
65. I.R.C. § 4960.
66. I.R.C. § 4960(c)(1).

Covered Employee	Any employee of an applicable tax-exempt organization if the employee (1) is one of the five highest compensated employees of the organization for the taxable year, or (2) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.[67]
Renumeration	Wages (as defined in section 3401(a)), except that such term shall not include any designated Roth contribution (as defined in section 402(c)) and shall include amounts required to be included in gross income under section 457(f).[68] Renumeration does include renumeration paid by a related person or governmental entity.[69]

Section 4960 also applies to any entities that are related to an ATEO.[70] Section 4960 provides that "[a] person or governmental entity shall be treated as related to an applicable tax-exempt organization if such person or governmental entity—

> (1) controls, or is controlled by, the organization
>
> (2) is controlled by one or more person which control the organization
>
> (3) is a supported organization (as defined in section 509(f)(3)) during the taxable year with respect to the organization

67. I.R.C. § 4960(c)(2).
68. I.R.C. § 4960(c)(3).
69. I.R.C. § 4960(c)(4)(A).
70. I.R.C. § 4960(c)(4).

> (4) is a supporting organization described in section 509(a)(3) during the taxable year with respect to the organization, or
>
> (5) in the case of an organization which is a voluntary employees' beneficiary association described in section 501(c)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.[71]

The Statute itself left open numerous questions and ambiguities. One of the major ambiguities surrounded whether governmental entities were included under the definition of ATEO. As such, practitioners and the like called for additional guidance from the IRS. The IRS issued Interim Guidance in Notice 2019-09. Under Notice 2019-09, the IRS determined that "a governmental unit (including a state college or university) that does not have a determination letter recognizing its exemption from taxation under section 501(a) and does not include income from gross income under section 115(1) is not an ATEO described in section 4960(c)(1). However, such a governmental unit may be liable for excise tax under section 4960 if it is a related organization under 4960(c)(4)(B) with respect to an ATEO."[72] The IRS also determined that a governmental entity could voluntarily relinquish its tax-exempt status under 501(c)(3).[73] In other words, a federal instrumentality was not subject to the excise tax.

The IRS reversed course in its proposed regulations, subjecting Federal instrumentalities to the excise tax.[74] In the final regulations issued January 19, 2021, the IRS stated that "these final regulations do not address this issue but reserved 53.4960-1(b)(3) and 53.4960-4(a)(5) for future rules to address these Federal instrumentalities."[75] The IRS further stated that:

> "[u]ntil further guidance is issued, a Federal instrumentality for which an enabling act provides exemption from all current and future Federal taxes may treat itself as not subject tax under section 4960 as an ATEO or related organization. However, if that Federal instrumentality is a related organization of an ATEO, renumeration it pays must be taken into account by that

71. I.R.C. § 4960(c)(4)(B).

72. I.R.S. Notice 2019-09, at 40.

73. *Id.*

74. Tax on Excess Tax-Exempt Organization Executive Compensation, 85 Fed. Reg. 35,746, 35,748 (proposed Jun. 11, 2020) (to be codified at 26 C.F.R. pt. 1).

75. Tax on Excess Tax-Exempt Organization Executive Compensation, 86 Fed. Reg. 6,196, 6,197 (Jan. 19, 2021) (to be codified at 26 C.F.R. pts. 1, 53).

ATEO."[76]

This determination essentially means that tax-exempt entities under 501(c)(3) and section 115(a) are subject to the Excess Compensation Excise Tax, as explicitly stated in the statutory language of § 4960, but tax-exempt entities under statutory immunity are not subject to the tax.

III. APPLICATION OF § 4960 FOR COLLEGE INSTITUTIONS

As previously discussed, college universities and organizations are generally tax-exempt in one of the following three ways: (i) under IRC Section 501(c)(3) as an educational organization or an organization fostering amateur sports and (ii) under IRC Section 115(a) as a governmental entity, or (iii) a federal instrumentality. Two of the three results in the university or organization being subject to the Excess Compensation Excise Tax. In other words, private universities, charitable organizations (*i.e.*, NCAA), and public universities exempt under 501(c)(3) or 115(a) are subject to the Excess Compensation Excise Tax. Whereas universities organized as federal instrumentalities under the doctrine of statutory immunity are not.

The purpose of this article is not to make a conclusion on whether section 4960 or the IRS' current guidance is correct. Rather, the purpose of this article is to show the disparity that arises and encourage both private and certain public universities to seek tax planning to avoid the significant impact of the Excess Compensation Excise Tax. At first glance, the current application of the Excess Compensation Excise Tax may not seem like much of an issue. But when applied to the realities of college athletics, this results in a significant disparity between public and private universities.

A. The Rise in College Athletic Salaries

It is no secret that college football coaches' salaries have been on the rise over the last decade. In 2006, approximately forty-two football coaches earned at least $1 million a year.[77] By 2016, a decade later, twenty football coaches' salaries topped $4 million, and twenty-five basketball coaches earned over $2 million.[78] In all, there are more than 240 NCAA Division I coaches' and athletic directors earning more than $1 million.[79]

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76. *Id.*

77. Erik Brady et. al., *NCAA Football Coaches' Average Salary at 1.64 Million,* USA TODAY (Nov. 20, 2012), https://www.usatoday.com/story/sports/ncaaf/2012/11/19/college-football-coaches-contracts-analysis-pay-increase/1715435/.

78. *Id.*

79. *See also* Robert Lattinville & Roger Denny, *supra* note 4.

As of 2020, there are approximately twenty-two Athletic Directors that make a $1 million or more.[80] With the highest compensated Athletic Director being Jack Swarbrick of Notre Dame with a total compensation of just over $2.5 million.[81] Nick Saban of Alabama remains the highest paid Head Football Coach with a total compensation of $9,300,000.[82] As of 2020, more than ten head football coaches make more than $5 million.[83] Head Basketball coaches' salaries have equally sored. The highest paid basketball coach is John Calipari of Kentucky with a total compensation of over $8 million.[84] On the basketball side, three coaches now make more than $5 million, significantly more are above the $2 million dollar mark.[85] And significantly, as of 2019, at least nine college baseball coaches are now making more than $1 million.[86]

Athletic directors and coaches continue to be some of the highest paid individuals in educational institutions, and the demand for higher salaries continues to grow.

B. Application of the Excise Tax

As currently interpreted by the IRS, the 21% excise tax will apply to private institutions but not public universities that are federal instrumentalities. This has significant cost implications for private institutions and/or public universities that are exempt under 501(c)(3). The best way to illustrate the significance is through an example using football coaches.

On the public university non-ATEO side is Nick Saban, a six-time National Coach of the year and a multi-time BCS National Champion, and the head football coach of the Alabama Crimson Tide.[87] On the private university side is David Shaw a Pac-12 championship coach with multiple bowl appearances, and the head coach of the Stanford Cardinals.[88]

80. *2019-2020 Athletics Directors,* Spencer Fane LLP (2020), http://www.sportsinfo.pro/AthleticDirector2020.html

81. *Id.*

82. Steve Berkowitz et. al., *Top NCAAF Coach Pay,* USA Today, https://sports.usatoday.com/ncaa/salaries/football/coach (last visited Dec. 1, 2021).

83. *Id.*

84. Steve Berkowitz et. al., *Top NCAAB Coach Pay,* USA Today, https://sports.usatoday.com/ncaa/salaries/mens-basketball/coach/ (last visited Dec. 1, 2021).

85. *Id.*

86. Steve Berkowitz & Bob Nightengale, *Top College Baseball Coaches Make Major-League Money; At Least Nine at $1 Million or More,* USA Today, https://www.usatoday.com/story/sports/college/baseball/2019/06/15/coach-salaries-college-baseballs-best-make-more-some-mlb-managers/1455405001/ (last visited Dec. 1, 2021).

87. Nick Saban, Alabama Football, The University of Alabama Athletics, https://rolltide.com/sports/football/roster/coaches/nick-saban/683 (last visited Dec. 1, 2021).

88. David Shaw, Stanford Football, Stanford University Athletics, https://gostanford.com/sports/football/roster/coaches/david-shaw/3786 (last visited Dec. 1, 2021).

	Nick Saban	David Shaw
Compensation	$9,300,000	$4,812,197
Compensation over $1 Million	$8,300,000	$3,812,197
Excise Tax @ 21%	**$1,743,000**	**$800,561**

Under the current guidance, the University of Alabama escapes $1,743,000 in tax, while Stanford pays $800,561 in excise tax. Traditionally, private university salaries are lower than public universities. But now, in addition to being significantly lower, they are also now subject to significantly more tax. In addition to that, the institution is responsible for paying that tax. In other words, the institution must come up with the cash to pay the tax owed.

C. Differences for Public and Private Institutions

The NCAA, the largest collegiate sports organization, currently has 358 Division I member schools.[89] Of those schools, 237 are designated as public and 121 are designated as private.[90] The ability to attract and retain talent often depends on the ability to pay that talent; often, the universities' ability to attract donors to raise funds to pay those coaches. A good conference example of where the tax could make significant impact is the Pac-12. The Pac-12 consists of the following organizations and head football coach salaries:

89. *Division I Institutions*, NCAA, https://web3.ncaa.org/directory/memberList?type=12&division=I (last visited Dec. 1, 2021).

90. *Id.* The designation of private versus public is based on the NCAA designation and is not a reflection of the public university classifications under the internal revenue code. As such, some of these public institutions may be organized as section 501(c)(3) organizations, exempt under section 115(a), or take the position they are exempt under implied statutory immunity.

University Name	**Private/Public**	**Head Football Coach Salary**
Arizona State University-Tempe	Public – appears to take immunity[91]	$3,640,000
University of Arizona	Public – 115(a)[92]	$3,283,333
University of California-Berkeley	Public – 501(c)(3)[93]	$3,276,248
University of California-Los Angeles	Public – 501(c)(3)[94]	$4,300,000
University of Southern California	Private – 501(c)(3)[95]	$4,569,507
University of Colorado Boulder	Public – appears to take immunity[96]	$3,040,000
Oregon State University	Public – 115(a)	$2,288,000
University of Oregon	Public – appears to take immunity[97]	$2,542,500

91. Letter from Susan M. O'Neill, IRS Dep't Manager of Accounts Management Operations, to Ariz. State Univ. (Apr. 30, 2018) https://www.asu.edu/fs/documents/ASU-tax-exempt-letter.pdf.

92. *See* Letter from Shawn Clodfelter, Univ. of Ariz. Senior Tax Compliance Acct., to Univ. of Ariz. Donors and Sponsors (Jan. 2, 2019) https://www.fso.arizona.edu/sites/fso/files/2019-01/Donors_Sponsors_2019.pdf.

93. *Tax Status of the Regents of the University of California*, UNIV. OF CAL., https://www.ucop.edu/research-policy-analysis-coordination/resources-tools/about-uc/tax-status-of-the-regents-of-the-university-of-california.html (last visited Dec. 1, 2021).

94. *Id*. *See also* Aprill, *supra* note 27 at 110 n.146.

95. *Exempt Organizations Business Master File Extract (EO BMF)*, IRS, https://www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-eo-bmf (last updated Oct. 11, 2021).

96. *Tax-Exempt Status*, UNIV. OF CO., https://www.cu.edu/psc/tax-exempt-status-0 (last visited Dec. 1, 2021).

97. Letter from Lucinda J. Comegys, IRS Field Dir. of Accounts Mgmt., to Univ. of Or. (Nov. 2, 2020) https://pages.uoregon.edu/baoforms/bao_drupal_6/sites/ba.uoregon.edu/files/TaxExemptLetter.pdf.

University of Utah	Public - 501(c)(3)[98]	$4,634,178
Washington State University	Public – 501(c)(3)[99]	$2,870,000
University of Washington-Seattle Campus	Public – 501(c)(3)[100]	$2,912,500
Stanford University	Private – 501(c)(3)[101]	$4,812,197

The Pac-12 illustrates the concern. Three institutions – Arizona State, University of Colorado Boulder and University of Oregon – all take the position that they are exempt from tax under statutory immunity, and thus under current guidance are not subject to the Excess Compensation Excise Tax. The remaining nine institutions, as currently structured, are subject to the Excess Compensation Excise Tax. This provides a substantial benefit to the institutions that are not subject to the Excess Compensation Excise Tax. To illustrate, let's use Arizona State University-Tempe Head Football Coach, Herm Edwards:

	Herm Edwards	David Shaw
Compensation	3,640,000	4,812,197
Compensation over $1 Million	2,640,000	3,812,197
Excise Tax @ 21%	**554,400**	**800,561**

If Arizona State were subject to the Excess Compensation Excise Tax, it would be required to pay $554,000 in tax. To put this in perspective, the amount of tax

98. *Exempt Organizations Business Master File Extract (EO BMF)*, *supra* note 95.

99. *Id.*

100. *Id.*

101. *Id.* (Tax Identification Number 94-1156335). *See also*, *Frequently Asked Questions*, STANFORD GIVING, https://giving.stanford.edu/faqs/ (last visited Dec. 1, 2021).

is roughly the equivalent of ASU's defensive coordinator salary.[102] But, currently, Arizona State does not have to pay that tax. Instead, theoretically, ASU receives an indirect benefit allowing it to reinvest that money into its own program, or rather, perhaps not have to eliminate lower-level positions. Whereas Stanford, for example, will need to come up with the cash to pay the tax owed. This could result in lower salaries for coaches or elimination of positions.

Most conferences have a mix of these three types of tax-exempt institutions because the NCAA is made up of both private and public universities. The law as it currently exists could lead to significant disparities between public and private universities given the significant amount of tax. These disparities include the need to raise money to pay the tax, decrease salaries, failure to attract and retain top talent, and/or eliminate positions.

IV. SOLUTIONS

Given that the Excess Compensation Excise Tax is fairly new, a direct impact on college athletics has not been seen or felt. The disparity will likely take years to play out and show an impact. However, there are tax planning solutions that can be utilized to address the disparity.

A. Legislators Should Ask What Really is the Intent of the Excess Compensation Excise Tax

While the purpose of this article is not to make a conclusion on whether section 4960 or the IRS' current guidance is correct, it would be remiss not to mention that legislators should consider what the true intent of the Excess Compensation Excise Tax is. Is it truly to level the playing field between for-profits and non-profits?

It is undeniable that executive salaries continue to grow. But when compared, are non-profit executive compensation rates out of control such that they should be subject to a 21% tax? Let's compare the top three salaries for publicly traded for-profit salaries to non-profit salaries:

102. *Arizona, ASU Football and Basketball Coaches' 2019 Salaries Unveiled*, ARIZ. SPORTS (Oct. 22, 2019, 12:09 PM), https://arizonasports.com/story/2128071/arizona-asu-football-and-basketball-coaches-2019-salaries-unveiled/.

For-Profit[103]

Company Name	**Salary**
Tesla	6,658,803,818.00
Oak Street Health	568,442,024.00
Good RX	497,838,903.00

Non-profit[104]

Organization Name	**Salary**
Kaiser Foundation Health Plan Inc.	15,709,853.00
Delta Dental Plan of Michigan	14,842,204.00
United States Steel and Carnegie Pension Fund	13,423,001.00

Admittedly, compensation of executives is complicated, and as such this is not a perfect comparison. However, it illustrates that non-profit executive compensation is a fraction of large publicly traded company executive salaries. The top three head football coaches' salaries are even lower, ranging from 9-8 million.[105] And unlike the private company, who may use other tax deductions to offset the recognition of income, non-profits are forced to pay a pure 21% tax on the compensation above $1 million. To put that in perspective, Tesla paid approximately $292 million in U.S. taxes in 2020.[106] Had Tesla paid the 21% tax on Elon Musk's salary, it would have paid $1.3 billion in taxes alone. Yet, the Kaiser Foundation will pay $3 million in excise tax on Bernard Tyson's salary.

In the broad scheme of things, does the 21% tax seem fair? Should public and private universities be subject or not subject to the tax? These are broader questions I will leave to the policy-makers to address. But it is fair to put this question back on policy-makers, and for them to consider the broader impacts of the Excess Compensation Excise Tax.

As for public and private universities there are a number of tax-planning solutions that can be utilized.

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103. Anders Melin, *Elon Musk's Outrageous Moonshot Award Catches on Across America*, BLOOMBERG WEALTH (Aug. 4, 2021), https://www.bloomberg.com/graphics/2021-highest-paid-ceos/.

104. Jason Urbaniec, *Top 10 Highest Paid CEOs at Nonprofits 2021*, ECON. RSCH INST. (June 15, 2020), https://www.erieri.com/blog/post/top-10-highest-paid-ceos-at-nonprofits-2021.

105. *See* Berkowitz et. al., *supra* note 82.

106. *Tesla Income Taxes 2009-2021*, MACROTRENDS, https://www.macrotrends.net/stocks/charts/TSLA/tesla/total-provision-income-taxes (last visited Dec. 1, 2021).

B. Relinquish 501(c)(3) Status

The first planning option that public universities, who may be subject to the Excess Compensation Excise Tax, can consider is relinquishing their 501(c)(3) status as indicated by IRS Notice 2019-09.[107] In order to relinquish 501(c)(3) status, an organization must follow the procedures described in section 3.01(12) of Revenue Procedure 2018-5.[108] Public universities must weigh all the consequences of relinquishing their 501(c)(3) status before utilizing this option.

However, in order to utilize this option, the organization will need to have another basis for exemption other than 115(a) or Section 501(a) otherwise it will still be subject to the tax.[109] In other words, this option is really only viable for public universities that can take the position that they are exempt from tax under statutory immunity. Public universities that can utilize this option should also consider whether they should seek a Form 6166 providing them with an IRS determination letter indicating that they are exempt from tax under statutory immunity.[110]

C. Compensation Planning

Another option to keep coaches of certain public universities (those that chose not to relinquish their 501(c)(3) status or are 115(a) organizations) and private universities competitively compensated is to consider other ways of providing income. An option is to supplement the base contract salary with more impressive employee compensation and benefits packages that may include items like life insurance options, retirement plan contributions, and deferred compensation. These arrangements are increasingly common in the business and sports world.[111]

One primary example of an alternative structure is that which exists for the University of Michigan ("UM") and Jim Harbaugh. The contract between UM and Harbaugh includes below-market split-dollar term loan advances in the amount of $2 million per year.[112] This allowed Harbaugh to obtain a sizeable life insurance policy. Under the policy's terms, Harbaugh can recognize the cash value of the life insurance policy by borrowing directly from it.[113] Upon death, the proceeds of the life insurance policy will be used to repay UM for the loans

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107. I.R.S. Notice 2019-09, 2019-04 I.R.B. 403.

108. *Id.* Rev. Proc. 2018–5, 2018–1 I.R.B. 233, 239.

109. *See* 26 U.S.C. § 4960.

110. *See Letter from Susan M. O'Neill, IRS Dep't Manager of Accounts Management Operations, to Ariz. State Univ.*, *supra* note 91.

111. *See also* Lattinville & Denny, *supra* note 4.

112. *Id.*

113. *Id.*

under the coaching contract, and any remainder will go to Harbaugh's estate.[114] All tax free.[115] Proceeds from the loans are not taxable, and they are not considered renumeration under section 4960.[116]

Another example is deferred compensation. Section 4960 applies to all renumeration. Renumeration is treated as paid when there is no substantial risk of forfeiture of rights to such renumeration. Substantial risk of forfeiture exists when the person's right to compensation is conditioned upon his or her future performance of substantial services.[117] In order to avoid the Excess Compensation Excise Tax, universities could structure contracts such that a substantial risk of forfeiture lapses pursuant to a schedule that reduces the amount to be included in renumeration each year. For example, a university might offer a contract that pays $1 million, which vests $200,000 per year over five years subject to the recipient maintaining employment through the end of each year. This approach would treat $200,000 as renumeration each year. Contrast this with a contract where the $1 million payment vests only at the end of the five-year period subject to the recipient maintaining employment through such date. In that case, the $1 million is included as remuneration all in one year.

There are complex tax code provisions that govern these types of compensation agreements. Institutions should carefully consider these options and the legal and tax ramifications associated with them.

D. Third Party Supplement University Pay

Another option is to maximize that amount of compensation that can come from unrelated third parties. Prior to section 4960, it was common for universities to utilize foundation accounts to pay portions of a coaches' salary or to purchase benefits on behalf of the coach.[118] For example, in 2013, the Crimson Tide Foundation purchased housing for University of Alabama Head Football Coach Nick Saban.[119] However, section 4960 contains related party rules that include in the definition of renumeration, amounts paid by a related party.[120] Most university foundations will be treated as related to the ATEO because they are organized as a supporting organization or have similar

114. *Id.*

115. *Id.*

116. I.R.C. § 4960(c)(3) (note there are other considerations such as cancelation of indebtedness income and income from forgiven or below market interest rates.).

117. I.R.C. § 457(f)(3)(B).

118. *2020 NCAA Football Head Coach Salaries Methodology*, USA TODAY SPORTS (Aug. 4, 2021, 11:12 AM), https://www.usatoday.com/story/sports/ncaaf/2021/08/04/college-football-2020-ncaa-head-coach-salaries-methodology/5482805001/.

119. *Id.*

120. I.R.C § 4960(c)(4).

control.[121] As such, universities will need to look to other unrelated third-parties to creatively structure coaching agreements that will not be subject to the Excess Compensation Excise Tax.

These alternative structures can include: renegotiating sponsorship agreements; additional compensation from outside groups; allowing coaches to run and profit from summer camps and clinics; income from endorsements; and game or venue revenue sharing. These ideas are not necessarily new to college athletics, rather a greater emphasis may be placed on them to avoid the 21% excise tax.[122]

Using summer camps as an example, the university can allow the coach to own the rights to the summer camps and to operate the camp on school property. Generally, two conditions must be met in order for the coach to retain the profits of the summer camp: (1) the camp must be advertised in the coaches name alone, and (2) the coach must pay all fees to conduct the camp (even if it is at discounted rates).[123] Summer camps have traditionally been lucrative making thousands of dollars.[124] There are also additional ways to capitalize on summer camps including merchandise, and perhaps broadcasting rights. Therefore, summer camps along with clinics could be one alternative to shifting income to coaches and avoiding the Excess Compensation Excise Tax.

Another alternative proposed is allowing coaches to capitalize on their name, image, and likeness by universities renegotiating sponsorship deals to allow coaches to receive or maximize income.[125] The king of this method in recent years was Roy Williams, the former University of North Carolina Basketball coach. A significant portion of Williams' income was earned from outside sources, as disclosed by his 2015 "[n]otice of intent to earn outside income."[126] This disclosure revealed outside compensation agreements with Sirona Dental Systems, Nike Championship Clinics, Raleigh Sports Club, Learfield Sports – Tar Heel Sports Properties, Nike, and RWW Enterprises.[127] Jumping off this model, universities could work with interested parties to increase outside compensation. One interesting proposal by Robert Lattinville and Roger Denny of Spence Fane, LLP was for universities to renegotiate sponsor contracts to offload coaches' compensation. They provide the following example:

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121. *Id.*

122. *See* Martin J. Greenberg, *College Coaching Contracts Revisited: A Practical Perspective*, 12 MARQ. SPORTS L. REV. 127 (2001) (for a discussion of college coaching contracts and special provisions.).

123. *Id.* at 206.

124. *Id.* at 205.

125. *See also* Lattinville & Denny, *supra* note 4.

126. *Id.*

127. *Id.*

> Virginia Tech's current Nike Contract provides for $275,000 of Base (Cash) Compensation and a Supplied Product Limit of $1,625,000. A more efficient structure, in light of §4960, may be to (1) allow current coaches to contract directly with Nike, using university marks and other university property, and in exchange therefor, (2) agree to a lower Supplied Product Limit. Virginia Tech would then be able to use the increased cash available (from the offloaded coach compensation) to purchase additional product (presumably at an increase of less than 21%).[128]

The Nike example applies to other vendors such as Learfield Sports (TV Broadcasting) and other independent sponsors. Essentially, the coach is profiting off of his or her name, image, and likeness without it being governed by his or her university contract. This will likely be similar to what we see play out with college athletes.

The one caveat to this solution is that universities will likely need to work with coaches to assist with self-employment taxes. Under the previous model, the compensation came from the university as W-2 wages that were required to have federal and state tax withheld and are not subject to self-employment tax.[129] Under the proposal, coaches would be contracting directly with sponsors and would be considered independent contractors. As such, coaches will receive 1099 income which is subject to self-employment tax. Along with self-employment tax, there are also additional compliance issues related with being an independent contractor that coaches will need to be aware of (*i.e.*, insurance and estimated payments). Sophisticated coaches with representation will likely attempt to negotiate for a portion of the Excess Compensation Excise Tax savings to help with their self-employment obligations.[130]

CONCLUSION

The IRC has generally provided public and private universities with favorable tax-exempt status. Under the IRC, public universities are exempt from tax either as 501(c)(3) organizations, the provisions of section 115(a), or under the doctrine of statutory immunity. Similarly, private universities are exempt from tax as 501(c)(3) organizations.

Compensation paid by both private and public universities is subject to

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128. *Id.*

129. *See* I.R.C. § 3401.

130. *Id.*

certain limitations and restrictions, such as private benefit and private inurement doctrines. However, generally, if the compensation paid is reasonable, these institutions pay no tax. However, the TCJA took a significant step in imposing an excise tax on these institutions. The new Excess Compensation Excise Tax imposes a 21% tax on ATEO for renumeration in excess of $1 million. The Excess Compensation Excise Tax does not exclude reasonable compensation and, under current guidance, applies to all ATEOs except for those exempt under statutory immunity.

The current guidance and applicability of the Excess Compensation Excise Tax leads to a disparity between public universities that are statutorily immune, and public universities that are organized under 501(c)(3), public universities organized under 115(a), along with private universities exempt under 501(c)(3). This has significant impacts on college athletics and coaches' and athletic director's salaries.

The significance of the tax could lead to striking disparities within college athletic conferences, and college athletics as a whole. As such, public universities that are organized under 501(c)(3), or 115(a), and private universities exempt under 501(c)(3) need to engage in tax planning and restructuring of coaches and athletic director salaries in order to limit or avoid exposure to the Excess Compensation Excise Tax. There are several methods that universities can employ such as relinquishing exempt status, engaging in compensation planning, and utilizing unrelated third parties to provide compensation.