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A Riddle Wrapped in a Mystery Inside an Enigma – Perhaps There is a Key: Tax Issues Facing Athletics Departments

Moderator:
Edward J. Jennings, University of Michigan, Ann Arbor, MI

Panelists:
Joseph R. Irvine, The Ohio State University, Columbus, OH
Robert Schirmer, Brigham Young University, Provo, UT
Kyle R. ZumBerge, The University of Texas Sytem Office of General Counsel, Austin, TX

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When I am through learning, I am through. – John Wooden

I. Unrelated Business Income Tax Issues

A. Definition of UBTI.

1. Background. Unrelated business taxable income (UBTI) is defined in Internal Revenue Code Section 512(a)(1) as "gross income derived by any organization from any unrelated trade or business (as defined in Section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b)." Section 512(b) includes a number of types of income that are excluded from UBTI, the most notable of which are: (1) dividends, (2) interest, (3) royalties, (4) rents from real property, (5) capital gains and losses, and (6) income from research.

2. Trade or Business. Section 513(c) states "the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or from the performance of services." It goes on to state that a trade or business does not lose its identity merely because it is carried on as part of a larger activity. Although the IRS maintains that an activity must, at some point, produce a profit to be considered a trade or business, this issue is not settled. The IRS relies on Portland Golf Club v. Commissioner, 110 U.S. 2780 (1990) and West Virginia State Medical Association v Commissioner, 91 T.C. 651(1998), aff'd. 882 F. 2d 123 (4th Cir. 1989).

3. Not Substantially Related. Section 513(a) defines "unrelated trade or business" as "any trade or business the conduct of which is not substantially related.....to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 501...." Section 513(a) excludes the following types of businesses from the definition of unrelated trade or business: (1) those in which substantially all the work is performed by volunteers, (2) those which are carried on primarily for the convenience of the entity's members, students, patients, officers, or employees, and (3) those selling merchandise substantially all of which has been donated to the organization.

   The determination regarding whether a trade or business is substantially related to a university's purpose depends on the facts and circumstances. To be substantially related an activity must contribute importantly to the accomplishment to the university's purposes. Regulation Section 1.513-1(d)(2). There are many rulings discussing "relatedness"; however, most are limited to the facts of the specific ruling and do not provide a lot of helpful information for other circumstances.

4. Regularly Carried On. In addition to being unrelated, a trade or business must be regularly carried on to create UBTI
. Generally, the IRS compares the time span for a comparable commercial activity to that for the activity conducted by the university. Regulation 1.513-1(c) discusses the definition of "regularly carried on."

a. In NCAA v. Commissioner, 92 T.C. 456 (1989), reversed 914 F. 2d 1417 (10th Cir. 1990) the issue was whether an activity was regularly carried on. The 10th Circuit Court of Appeals reversed the Tax Court and held that production of the NCAA's Final Four basketball program was not regularly carried on. The Court indicated that it should consider the business of selling advertising space since that was the business that the Commissioner contended generated unrelated taxable income. The Court stated that since the publication of advertising is generally conducted on a year round basis, that if the NCAA's sale of program advertising was conducted for only a few weeks, that time period alone, could not, standing alone, convert the NCAA's business into one regularly carried on. The Court stated: "the tournament must be considered the actual time span of the business activities sought to be taxed here." The Court rejected the IRS argument that preliminary time spent to solicit advertisements and prepare them for publication should be included in the determination of whether the activity was regularly carried on. The Court mentioned the example in the regulations of a sandwich stand operated at a state fair and that the regulation did not mention time spent in planning the activities, building the stand, or purchasing the supplies.

b. In Suffolk County Patrolmen's Benevolent Association, Inc. v. Commissioner, 77 T.C. 1314 (1981), the Tax Court held that an annual fundraising show and accompanying program guides were not regularly carried on. The Taxpayer held entertainment shows as fundraisers two nights each year. Advertising in the program guides provided substantial revenues to both Taxpayer and the promoter who conducted the shows.

c. In Pirvate Letter Ruling (PLR) 9712001[1] a labor organization held a fundraising event twice a year. It held a concert series over a two or three day weekend at different locations, with a total of eight to ten performances each year. The Service held that the events were regularly carried on because it concluded that the preparation time was about six months. It also held that the royalty exception did not apply because the promoter was an agent of the Taxpayer.

B. Broadcast Rights.

1. Rev. Rul. 80-295. The Service ruled that the sale of exclusive television and radio broadcasting rights to an independent producer by the national governing body for amateur athletics was substantially related to the purpose of the organization's exemption, and therefore did not generate unrelated business taxable income.

2. Rev. Rul. 80-296. The sale of broadcasting rights to an annual intercollegiate athletic event by a regional collegiate athletic conference was related to the educational purposes of the colleges and universities and therefore did not

[1] IRC Section 6110(k)(3) provides that such pronouncements may not be used or cited as precedent, however, technical advice memorandums may give insight to the administration's position on the issue

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