

# Taxing Commercial Sponsorships of College Athletics: A Balanced Proposal

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“[H]igher education’s historical balance between academics and athletics [has] been distorted by all the money sloshing around.”<sup>1</sup>

*What is the proper role of big-time sports in higher education? Expenditures on athletics are rising three to four times faster than expenditures on academics. Climbing coaches’ salaries, suspensions and scandals, and calls for reform all suggest imbalance. Current tax law provides an artificial incentive to expand big-time college athletics by completely exempting advertising revenue generated from the sale of bowl-game sponsorships and similar transactions. This Article introduces developments in the field of sports marketing and proposes an approach for taxing sponsorship payments. The proposal would tax to the extent of the value of the advertising benefits provided. If a corporate sponsor pays more than the value of the advertising benefits received, the excess would be a tax-free charitable gift.*

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<sup>1</sup> Taylor Branch, *The Shame of College Sports*, ATLANTIC MONTHLY, Oct. 2011, at 80, 86.

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## I. INTRODUCTION

Corporations pay millions annually to sponsor college athletic events and name college sports venues.<sup>2</sup> Treating all sponsorship payments exclusively as unrequited charitable contributions on the one hand, or exclusively as arms-length purchases of advertising on the other, will mischaracterize many transactions. Consider:

- (a) Texas Tech University announced that a corporation would need to pay fifty percent of the construction cost to obtain naming rights for its new football stadium.<sup>3</sup> This is at least double (or triple) the price to name a

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<sup>2</sup> CONGR. BUDGET OFFICE, 2 BUDGET OPTIONS 232 (2009) [hereinafter CBO BUDGET OPTIONS], available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/102xx/doc10294/08-06-budgetoptions.pdf> (Option 43, highlighting the NCAA’s estimate for 2004 and 2005).

<sup>3</sup> Alan Schmadtke, *Stadium Naming Is Big Business: Corporate Money Is Dictating the Names of College and Even High School Facilities*, ORLANDO SENTINEL, May 25, 2006, at D1, available at 2006 WLNR 8973720.

professional sports stadium.<sup>4</sup> Data discussed in this Article reveals no situation in which a corporation paid fifty percent or more of the construction cost to name a pro sports arena.<sup>5</sup>

- (b) The University of Virginia requires that a corporation pay a minimum of fifty-one percent of a building's value, or fifty-one percent of a new building's construction cost not covered by the state, to acquire naming rights.<sup>6</sup>
- (c) KFC Yum! Inc. paid \$5 million to name the University of Louisville's basketball practice facility, and a marketing expert calculated that KFC Yum! will acquire roughly the same brand name benefits as if it spent the \$5 million on TV and newspaper advertising.<sup>7</sup>
- (d) A corporation pays approximately \$10 million annually to sponsor a major college football bowl game,<sup>8</sup> and a consultant determined that "Tostitos, Federal Express, Nokia and Citi [Bank] received more than \$106 million worth of in-game signage... during telecasts of the Fiesta, Orange, Sugar and Rose bowls."<sup>9</sup>

The sponsorship payments in examples (a) and (b) contain a substantial charitable gift element, while the payments in examples (c) and (d) are arms-length advertising purchases with no charitable gift involved.

Although the market behavior is diverse and merits a flexible approach, a special tax rule currently treats all these corporate sponsorship payments the

<sup>4</sup> A survey of nineteen naming-rights deals for professional sports venues reported that the corporate sponsor paid from five percent to twenty-five percent of the total construction cost. See William A. Drennan, *Where Generosity and Pride Abide: Charitable Naming Rights*, 80 U. CIN. L. REV. 45, 93–96 app. B (2011). For example, the maker of Heinz ketchup paid approximately sixteen percent of the total construction cost to name Heinz Field, the home of pro football's Pittsburgh Steelers. Pepsi paid approximately twenty-five percent of the total construction cost to name the Pepsi Center where pro basketball's Denver Nuggets play. *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> Andrew Petkofsky, *What's in a Name? Colleges Seek Vanity Donors*, RICH. TIMES-DISPATCH (Richmond, Va.), July 28, 2003, at A1, available at 2003 WLNR 2139899.

<sup>7</sup> Alex Davis, *Yum Puts Its Name on U of L Center*, COURIER J. (Louisville), Sept. 20, 2006, at D1, available at 2006 WLNR 25049364 ("[T]he fee compares favorably to the ongoing costs of 30-second television commercials or quarter-page newspaper ads.").

<sup>8</sup> Brent Schrotenboer, *Bowls Gone Wild!*, SAN DIEGO UNION-TRIB., Dec. 17, 2006, at C11, available at 2006 WLNR 22106232 (quoting Chris Anderson of The Marketing Arm, a national marketing agency).

<sup>9</sup> *Id.* (calculation provided by Image Impact Inc.); see also Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 DEPAUL L. REV. 1, 70 (1994) ("John Hancock [Life Insurance Company] estimated that it received \$5.1 million of advertising services in exchange for its 1990 payment of \$1.6 million to be associated with the college bowl game that now bears its name.").

same, exclusively as unrequited charitable gifts.<sup>10</sup> Current law deems the entire amounts paid by KFC Yum!, Allstate Insurance,<sup>11</sup> Meineke Car Care,<sup>12</sup> and other corporate sponsors as generous, tax-free gifts<sup>13</sup> even when the colleges or their affiliates are contractually obligated to grant naming rights, display the commercial sponsors' logos, broadcast the brand names, describe product features, and furnish other publicity, in exchange for the sponsorship funds.<sup>14</sup> This monolithic portrayal allows these arrangements to completely avoid the unrelated business income tax otherwise applicable to advertising income.

This special tax rule poses (i) tax efficiency, (ii) equity, and (iii) revenue problems. Tax efficiency problems arise when taxes artificially change behavior.<sup>15</sup> In this context, the special tax rule encourages colleges to expand big-time football and basketball programs and aggressively sell advertising. Removing this artificial tax incentive may help address the concern that athletics are overemphasized at some universities.<sup>16</sup> Regarding equity,<sup>17</sup> the current special rule taxes similar transactions in different ways<sup>18</sup> and in a manner contrary to the economic substance. Also, the amount of tax revenue lost with the current rule may be substantial.<sup>19</sup>

This Article proposes a new approach that would more accurately analyze these transactions. The new approach would divide sponsorship payments into a

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<sup>10</sup> See generally I.R.C. § 513(i) (2006). See also *infra* Part II (provided that the payments are not contingent on the level of publicity and there is no comparative advertising).

<sup>11</sup> See Lance Murray, *Ranking the College Bowl Games from 1 to 35*, DALL. BUS. J. BLOG (Dec. 20, 2011, 10:37 AM), <http://www.bizjournals.com/dallas/blog/2011/12/ranking-the-college-bowl-games-from-1.html> (the Allstate BCS National Championship Game was on January 9, 2012).

<sup>12</sup> See *College Football Bowl Glimpse*, BATON ROUGE ADVOC., Jan. 9, 2012, at C9, available at 2012 WLNR 537594 (explaining that the Meineke Car Care Bowl was on December 31, 2011).

<sup>13</sup> See Ethan G. Stone, *Halos, Billboards, and the Taxation of Charitable Sponsorships*, 82 IND. L.J. 213, 215 (2007) ("Underlying . . . the legislation that ended the controversy, was an unexamined assumption that there was an important distinction between providing a charitable donor with public recognition and providing a business with advertising services.").

<sup>14</sup> Treas. Reg. § 1.513-4(e)(1) (2002).

<sup>15</sup> LAURIE MALMAN ET AL., *THE INDIVIDUAL TAX BASE* 9 (2d ed. 2002) ("The more a tax changes behavior, the less efficient it is.").

<sup>16</sup> See *infra* Part III.B.1.

<sup>17</sup> A frequent policy goal in designing tax rules is horizontal equity, described as treating similarly situated taxpayers the same. See Kelly A. Moore, *Previously Taxed Property Credit and the 2035(B) Gross Up*, 34 S. ILL. U. L.J. 275, 285 (2010); Richard J. Wood, *Supreme Court Jurisprudence of Tax Fairness*, 36 SETON HALL L. REV. 421, 435 (2006).

<sup>18</sup> Specifically, tax-exempt colleges generate advertising income and pay no tax, while other providers of advertising services pay income tax. See *infra* Part III.B.2.

<sup>19</sup> See CBO BUDGET OPTIONS, *supra* note 2, at 232 (estimating the foregone tax revenue at \$207.6 million over ten years). But see *infra* Part III.B.3 (arguing that the tax collections would be higher if colleges could only deduct direct costs related to sponsorships).

taxable advertising portion and a tax-free charitable gift portion. It would treat the amount that a hypothetical commercial buyer would pay for similar advertising benefits from a non-charitable sponsorship as taxable advertising revenue, and would treat only the excess paid by the commercial sponsor, if any, as a tax-free charitable gift. This dual-character<sup>20</sup> method would recognize that a corporate sponsor may be making a part purchase and a part gift. For example, if a corporation pays Texas Tech University \$100 million for the new football stadium naming rights,<sup>21</sup> and a corporate sponsor could have acquired similar advertising benefits from purchasing TV, radio, newspaper, and other ads for \$60 million,<sup>22</sup> Texas Tech University would treat \$60 million as taxable advertising revenue and would treat \$40 million as a tax-free charitable gift. Developments in the field of sports marketing enabling more accurate appraisals of advertising benefits based on the number of advertising impressions<sup>23</sup> make this proposal viable. Many consulting firms now specialize in promoting, acquiring, and valuing sponsorship rights.<sup>24</sup>

The scope of the charitable tax exemption,<sup>25</sup> and campus commercialism,<sup>26</sup> are favorite topics for scholars and media commentators, but none have

<sup>20</sup> The U.S. Supreme Court adopted a dual-character approach in a related context. See *United States v. Am. Bar Endowment*, 477 U.S. 105, 117 (1986) (determining the amount of a charitable deduction when the donor receives a benefit from the charity in return for the donation).

<sup>21</sup> See *supra* note 3 and accompanying text.

<sup>22</sup> See *infra* notes 77–90 and accompanying text.

<sup>23</sup> See, e.g., Greg C. Ashley & Michael J. O'Hara, *Valuing Naming Rights* 18 (Aug. 8–11, 2001) (unpublished manuscript) (presented to the 76th annual meeting of the Academy of Legal Studies in Business, Albuquerque, NM), available at <http://cba.unomaha.edu/faculty/mohara/web/ALSB01ValuingNamingRights.pdf>.

<sup>24</sup> See, e.g., Rick Alm, *Racing Puts Products on a Profit Fast Track*, KAN. CITY STAR, Sept. 28, 2006, at C1, available at 2006 WLNR 16799565 (“The televised ad impressions add up fast . . . Last season’s impressions winner . . . was Lowe’s Home Improvements with an estimated 240.3 million impressions absorbed by individual viewers.”); *Nielsen Sports™ Offers Advertisers a Deeper Look into Sports Sponsorship*, PR NEWSWIRE, June 5, 2006 [hereinafter *Nielsen Sports*]; Schmadtke, *supra* note 3, at D1 (“Virtu Development Group . . . specializes in naming rights and enhancing cash flow for athletic facilities.”); Sandy Shore, *Putting Price Tag on Impressions: Firm Measures Value of Exposure from Sports Sponsorships*, HOUS. CHRON., July 31, 1996, [http://www.chron.com/CDA/archives/archive.mpl/1996\\_1356729/putting-price-tag-on-impressions-firm-measures-val.html](http://www.chron.com/CDA/archives/archive.mpl/1996_1356729/putting-price-tag-on-impressions-firm-measures-val.html) (“What we’re going to have to try to determine is what is the value of an impression from a logo on footwear versus apparel, versus a billboard and all the other categories . . .” (quoting the president of The Bonham Group)); Rich Thomaselli, *Nielsen to Measure Sports Sponsorship*, ADVERTISING AGE, May 3, 2004, <http://adage.com/article/news/nielsen-measure-sports-sponsorship/99102>; David Unze, *SCSU Offers Naming Rights*, ST. CLOUD TIMES (Minnesota), Jan. 10, 2010, at 1A, available at 2010 WLNR 515120 (“Front Row Marketing Service has extensive experience in assessing the value of . . . sponsorship and naming rights deals.”).

<sup>25</sup> See generally Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 319 (1976); Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605

considered the ability to measure the value of advertising impressions,<sup>27</sup> and none appear to have proposed a balanced, dual-character approach. A dual-character approach raises challenging implementation issues. For example, how should the parties value naming rights or other sponsor benefits? Who will have the initial responsibility to appraise sponsor benefits? If the commercial sponsor initially appraises, what recourse is available to a charity that disagrees? What information must they report to the IRS? Can new rules incorporate an exception for small transactions or when a college provides a mere incidental acknowledgment of a sponsor? Can new rules permit corporate sponsors to benefit from a “halo effect”<sup>28</sup> to some extent without triggering adverse tax consequences? Is it really beneficial to tax charities in these situations? Will the tax merely shift dollars from charitable causes to government uses? This Article asserts that the tax law confronts similar practical issues in other contexts and maintains that importing selected solutions can achieve reasonable outcomes.

A headline-grabbing trend, the sale of college football stadium naming rights, may provide Congress a golden opportunity to reconsider sponsorship taxation. Big-time college football programs may follow their cross-campus counterparts (the basketball programs) and smaller college football programs in selling stadium naming rights to corporations. The media coverage will be extensive and the dollars will be elephantine. In 1996 the first Division 1A<sup>29</sup>

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(1989); Susan Rose-Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 STAN. L. REV. 1017 (1982); Richard Steinberg, “Unfair” Competition by Nonprofits and Tax Policy, 44 NAT’L TAX J. 351 (1991); Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1475 (2005) (considering the rationale for taxing otherwise tax-exempt entities on their unrelated business income).

<sup>26</sup> See generally John D. Colombo, *The NCAA, Tax Exemption, and College Athletics*, 2010 U. ILL. L. REV. 109 (2010); Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430 (1980); Stone, *supra* note 13. See also Erick Dexheimer, *Does Big-Time College Football Deserve Its Big Tax Breaks?*, STATESMEN.COM (Dec. 27, 2009), <http://www.statesmen.com/news/texas/does-big-time-college-football-deserve-its-big-149737.html>; Gilbert M. Gaul, Op-Ed., *The Department of Lucrative Athletics*, N.Y. TIMES, Nov. 28, 2009, at A19, available at 2009 WLNR 24060256; George F. Will, *Pigskin Piggy Bank*, WASH. POST, Jan. 7, 2010, at A17, available at 2010 WLNR 26706063 (“[T]he universities’ athletic programs are not taxed.”); George F. Will, Op-Ed., *Tax Breaks for Football*, WASH. POST, Oct. 25, 2006, at A17 [hereinafter Will, *Tax*].

<sup>27</sup> See *infra* notes 77–90 and accompanying text.

<sup>28</sup> Knauer, *supra* note 9, at 7 n.27 (“The commensurate benefit that corporations expect to receive is the result of the generally favorable public perception of transfers to charity (and charitable organizations), known as the ‘halo effect.’”); *id.* at 57–58; Elizabeth M. Roberts, Note, *Presented to You by . . . : Corporate Sponsorship and the Unrelated Business Income Tax*, 17 VA. TAX REV. 399, 401 (1997).

<sup>29</sup> See Colombo, *supra* note 26, at 110 n.4 (2010) (explaining that prior to 2006, the NCAA referred to the most serious athletic schools as Division 1A, and thereafter the NCAA uses the title Football Bowl Subdivision to describe this group of 120 schools). For ease of reference, this Article will use the term Division 1A.

school sold football stadium naming rights to a commercial buyer.<sup>30</sup> By mid-2007, only seven of the 120 Division 1A schools had sold football stadium naming rights,<sup>31</sup> but by mid-2010, the count was fourteen.<sup>32</sup> Eventually, intercollegiate competition likely will lead the biggest, most prestigious football programs to seek stadium sponsors.<sup>33</sup> Speculation has begun about commercial names for the football stadiums at Notre Dame, Michigan, Ohio State, and Stanford.<sup>34</sup>

In this Article, Part II succinctly summarizes the current rules that exempt a college's sponsorship income from tax, describes the tax consequences for the corporate sponsors, and mentions the role of the National Collegiate Athletic Association (NCAA), athletic conferences, and other tax-exempt entities that promote collegiate athletics and may be involved with sponsorships.

Part III seeks to establish that sponsorship payments can have a dual character (part sale and part gift) and that advances in sports marketing for estimating the value of advertising impressions allow reasonable approximations of the advertising benefits acquired by commercial sponsors. Based on these features of the market, this Article suggests a viable method for taxing sponsorship payments consistent with economic substance. Part III also addresses several implementation issues.

Part IV concludes with a reflection on the key benefits of the proposal. Proper taxation will encourage charities to focus more keenly on their core educational mission and eliminate an artificial incentive to promote athletics and commercialism. The proposal also will help clarify future debates on college athletics and campus commercialism. The Appendix contains a proposed statute.

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<sup>30</sup> Davis, *supra* note 7, at D1 (discussing Louisville University's arrangement with Papa John's Pizza International and its founder John Schnatter); *see also* Doug Lesmerises, *Louisville Makes Run for Title Game*, PLAIN DEALER (Cleveland, Ohio), Nov. 6, 2006, at C7, available at 2006 WLNR 19284415 (the stadium is nicknamed "The Oven").

<sup>31</sup> Jim Bentubo, *Colleges Forgoing Millions in Naming-Rights Deals*, SPORTS BUS. DAILY, Aug. 31, 2007, available at <http://www.sportsbusinessdaily.com/article/114626>.

<sup>32</sup> Andrea Adelson, *Schools Going Corporate*, ORLANDO SENTINEL, July 5, 2010, at C2, available at 2010 WLNR 13458369.

<sup>33</sup> *See generally* Joseph McCafferty, *The Money Bowl*, CFO MAG., Aug. 2006, available at 2006 WLNR 13792136 ("[P]rograms vie to outspend one another . . ."); Angelique Chengelis, *U-M Scrambles to Upgrade Facilities; University Lags Behind Big Ten Rivals Michigan State, Ohio State*, DETROIT NEWS, July 13, 2003, at 1C, available at 2003 WLNR 18008141 (discussing pressure on the University of Michigan to match the top-notch athletic facilities at perennial Big Ten Conference rival The Ohio State University).

<sup>34</sup> *See* Bentubo, *supra* note 31.

## II. CURRENT LAW: TAXING PRINT ADVERTISING BUT NOT SPONSORSHIPS

Nonprofit colleges and other eleemosynary entities satisfying certain requirements are exempt from income tax<sup>35</sup> except on income from business activities that do not contribute importantly to their exempt purpose.<sup>36</sup> As a result, colleges pay no tax on their tuition revenues or research grants but would pay tax, for example, on profits from the commercial manufacture and sale of pasta.<sup>37</sup> The law taxing a charity's unrelated business activities<sup>38</sup> is the unrelated business income tax, or UBIT.<sup>39</sup> Along with private schools, state colleges are subject to the UBIT notwithstanding concerns about federal taxation of state governmental entities.<sup>40</sup>

Consistent with these general principles, a college or other charity selling commercial advertising in a scholarly magazine or in a program for a sporting event pays tax on the advertising income derived.<sup>41</sup> Generally advertising income only escapes tax if the activity is sporadic<sup>42</sup> or if the activity contributes

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<sup>35</sup> I.R.C. § 501(c)(3) (2006) (providing the basic requirements for tax exemption under this subsection includes that the organization must be organized and operated exclusively for educational, charitable, or other specified purposes; no part of the organization's "net earnings [may] inure[] to the benefit of any private shareholder or individual[]; and] no substantial part of the activities [may be] carrying on propaganda, or otherwise attempting, to influence legislation").

<sup>36</sup> See I.R.C. § 511(a) (2006) (imposing a tax on "unrelated business taxable income"); Treas. Reg. § 1.513-1(d)(2) (1967).

<sup>37</sup> See Stone, *supra* note 13, at 218 (describing New York University's acquisition of the C.F. Mueller Noodle Company as the "poster case" for the unrelated business income tax).

<sup>38</sup> I.R.C. § 513(a) (2006) (defining the term "unrelated trade or business").

<sup>39</sup> See Stone, *supra* note 13, at 218.

<sup>40</sup> I.R.C. § 511(a)(2)(B) (2006).

<sup>41</sup> See *id.* § 513(c) (2006) (including in the section headings the word "advertising" and providing that the income from a trade or business is taxable even if the activity is "carried on within a larger aggregate of . . . activities . . . which may . . . be related to the exempt purposes of the organization[,] but the text of the statutory subsection never uses the word "advertising"); see also *United States v. Am. Coll. of Physicians*, 475 U.S. 834, 836 (1986) (concluding that the American College of Physicians must pay tax on its income from the sale of advertising in its "highly regarded monthly medical journal [The Annals of Internal Medicine] containing scholarly articles . . . [even though the advertisements were for] pharmaceuticals, medical supplies, and equipment useful in the practice of internal medicine"); Stone, *supra* note 13, at 220 n.25 ("Print periodical advertising was the original impetus for [I.R.C.] Section 513(c)(1) . . .").

<sup>42</sup> See *NCAA v. Comm'r*, 914 F.2d 1417, 1425-26 (10th Cir. 1990) (concluding that under the particular facts involved, the NCAA need not pay tax on its income from the advertisements in the program for the semifinal and final games of the Men's Division I Basketball Championship because the sale of the advertising space was not an activity "regularly carried" on by the NCAA for fiscal year 1981-1982). *But see* IRS Tech. Adv. Mem. 91-47-008 (stating that the Tenth Circuit's "analysis is faulty and its legal conclusions



importantly to the organization's exempt function, such as when the students working on a school newspaper arrange for and sell the advertising as part of their education.<sup>43</sup> Following these rules, in 1991 the IRS initially held that when a tax-exempt organization receives payments from a commercial sponsor in exchange for an agreement to advertise the sponsor's brand and logo in connection with a college football bowl game, the tax-exempt organization's advertising income is taxable.<sup>44</sup>

In 1997, Congress reversed the IRS's initial approach and enacted a special rule<sup>45</sup> providing that a college or other tax-exempt organization need not pay tax on income from the sale of commercial sponsorships.<sup>46</sup> Under this current rule sponsorship payments are taxed only if the amount of the payment varies based on the amount of public exposure,<sup>47</sup> or the college advertises the sponsor's prices, or makes comparisons between the sponsor and its competitors.<sup>48</sup> These exceptions are easy to avoid.<sup>49</sup>

As a result, colleges and other tax-exempt organizations promoting collegiate athletics provide commercial sponsors with substantial publicity and pay no tax, unlike other sellers of advertising services. For example, in connection with the Meineke Car Care Bowl Game, Meineke's name and logo could appear on the twenty-yard line on each side of the field.<sup>50</sup> Also, the TV announcers could frequently refer to the contest as the Meineke Car Care Bowl and describe the services Meineke provides. Typically the "cumulative effect . . . is that a spectator . . . is able to see the . . . sponsor's name/logo about 60 times during the [game], and . . . hear the sponsor's name about 50 times during the [game]."<sup>51</sup> Although the college or other exempt organization receives cash in exchange for providing advertising services, it pays no tax on its advertising income because the payments are "qualified sponsorship payments" under the special tax rule.<sup>52</sup>

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erroneous" in *NCAA v. Comm'r*); Colombo, *supra* note 26, at 136 ("The opinion is just flat-out wrong.").

<sup>43</sup> See Treas. Reg. § 1.513-1(d)(4)(iv) ex. 5 (1967); see also IRS Priv. Ltr. Rul. 199914035 (Apr. 9, 1999) (finding there to be no tax even if sale of advertising is conducted in part by students and in part by nonstudent supervisory personnel).

<sup>44</sup> IRS Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991); IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991); see also Stone, *supra* note 13, at 222 (identifying the bowl games involved as the Mobile Cotton Bowl and the John Hancock Bowl).

<sup>45</sup> I.R.C. § 513(i) (2006) (originally enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 965(a), 111 Stat. 893 (codified as amended at I.R.C. § 513(i) (2006))).

<sup>46</sup> I.R.C. § 513(i) (2006) (excluding from the term "unrelated trade or business" the "activity of soliciting and receiving qualified sponsorship payments").

<sup>47</sup> *Id.* § 513(i)(2)(B)(i).

<sup>48</sup> Treas. Reg. § 1.513-4(c)(2)(v) (2002).

<sup>49</sup> See *infra* notes 53–56 and accompanying text.

<sup>50</sup> See Stone, *supra* note 13, at 220 (noting for the Capital One bowl game, Capital One's name was "on both sides of the field at each twenty-yard line").

<sup>51</sup> IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991).

<sup>52</sup> I.R.C. § 513(i) (2006).

Surprisingly, Meineke could even advertise its prices and make comparisons with its competitors<sup>53</sup> during the Meineke Car Care Bowl without violating the qualified sponsorship rules by following a common practice.<sup>54</sup> Meineke could purchase regular commercial time from the TV network during the Meineke Car Care Bowl.<sup>55</sup> The network ads would not taint the qualified sponsorship payments under the applicable Treasury Regulations.<sup>56</sup> Thus, Meineke Car Care could supplement the repetition of its name during the football game telecast with its regular commercials that advertise price and make comparisons with its competitors.

These special tax rules treat advertising revenue from the sale of commercial sponsorships as tax free, just like students' tuition payments, government research grants, and truly unrequited charitable gifts. This treatment applies even if the corporate sponsor and the college or other exempt organization sign a binding contract specifying the advertising benefits for the corporate sponsor.<sup>57</sup>

In these sponsorship arrangements, generally there is no significant tax issue for the corporate sponsor. The corporate sponsor can deduct all sponsorship payments either as business advertising expenses or charitable contributions.<sup>58</sup>

In regards to the flow of sponsorship revenue, the payments initially may not flow directly to the colleges. The NCAA, athletic conferences, and other

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<sup>53</sup> See *id.* § 513(i)(2)(B)(i) (2006) (excluding contingent payments from the definition of “qualified sponsorship payments”); Treas. Reg. § 1.513-4(c)(2)(v) (2002) (excluding amounts paid for price advertising and comparative advertising from the definition of “qualified sponsorship payments”).

<sup>54</sup> Stone, *supra* note 13, at 229 (“It is accepted wisdom among experts that a sponsor should spend several times more on advertising and other efforts to purchase exposure for (and shape the message of) a sponsorship than it spends on the actual sponsorship.” (citing DAVID A. AAKER & ERICH JOACHIMSTHALER, BRAND LEADERSHIP 198, 201 (2001))).

<sup>55</sup> Treas. Reg. § 1.513-4(c)(2)(v) (2002) (providing that the restriction on price advertising and comparative ads does not apply to “activities conducted by a [sponsor] on its own,” and stating that “if a payer purchases broadcast time from a television station to advertise its product during commercial breaks in a sponsored program, the exempt organization’s activities are not thereby [made taxable]”).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* § 1.513-4(e)(1).

<sup>58</sup> I.R.C. § 162(a) (2006) (tax deduction for ordinary and necessary business expenses); *id.* § 170(c)(1) (tax deduction for charitable contributions); see also Stone, *supra* note 13, at 219 (“Businesses can deduct most payments to charity either as charitable contributions . . . or general business expenses . . .”). But see I.R.C. § 170(b)(2)(A), (d)(2)(A) (2006) (stating that a corporation can only deduct charitable contributions in a year to the extent of ten percent of its modified taxable income, although any excess can be carried forward for five years); Treas. Reg. § 1.162-15 (1958) (asserting that if only part of a payment qualifies as a charitable deduction, the corporation cannot deduct the balance as a business expense); *Singer v. United States*, 449 F.2d 413, 421 (Ct. Cl. 1971) (rejecting the rule of Treas. Reg. § 1.162-15 (1958)); *infra* Part III.C.4 (regarding this regulation and the *Singer* case).

organizations promoting collegiate athletics may sell naming rights to specific events,<sup>59</sup> and civic sports authorities may sell naming rights to athletic venues.<sup>60</sup> Funds then may flow from these entities and intermediaries to the college athletic departments. This Article focuses on the tax consequences for the colleges, but the same analysis should apply to these other tax-exempt entities and intermediaries because the sale of advertising services would not contribute importantly to their tax-exempt purpose.<sup>61</sup> For consistency and ease of reference, the balance of this Article will describe a college receiving sponsorship payments, even though it is acknowledged that in practice sometimes the funds initially will flow to other tax-exempt organizations involved in collegiate athletics.

### III. A BALANCED PROPOSAL USING SPORTS-MARKETING ADVANCES

#### A. *Introducing the Balanced Proposal and Its Alternatives*

##### 1. *The Proposal and Its Market Foundations*

Corporate sponsorships are diverse transactions. Attempts to treat them all the same have sparked contentious debates and led to unsatisfactory results.<sup>62</sup> The market for naming college sports venues is especially interesting. After a national study of over 32,000 charitable naming transactions,<sup>63</sup> a leading consultant observed that the general rule of thumb at educational institutions is for the sponsor naming a facility to pay fifty percent of the total construction

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<sup>59</sup> See, e.g., IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (highlighting that the organization receiving cash payments from John Hancock Life Insurance Company (the sponsor) was a nonprofit corporation whose “principal activity is arranging and conducting the play of [an] annual post-season game”); Stone, *supra* note 13, at 220 (“The 2005 Capital One Bowl was organized by Florida Citrus Sports Association, Inc. (FCSA), a tax-exempt nonprofit whose exempt purpose is to ‘promote and foster an interest in amateur athletics.’”).

<sup>60</sup> *KFC Yum! Center Projected to Boost U of L Athletic Profits*, COURIER J., Oct. 10, 2010, available at 2010 WLNR 20246122 (KFC Yum! will pay the Louisville Authority, which has a “deal” with the University).

<sup>61</sup> See *infra* Appendix (proposed § 513(i)(1)) (stating that the proposal applies to direct and indirect sponsorship payments).

<sup>62</sup> The IRS’s initial attempt to tax all the income from all sponsorship arrangements drew sharp criticism from the charitable sector. See Stone, *supra* note 13, at 223. In response, Congress enacted I.R.C. § 513(i) which effectively treats all corporate sponsorship payments as unrequited charitable gifts. Some commentators denounce the I.R.C. § 513(i) approach. See, e.g., Colombo, *supra* note 26, at 150 (“[B]ig-time college athletics revenues clearly . . . fit the normative tax base: payments for . . . advertising . . . are absolutely no different from . . . these same revenues flowing to professional, for-profit sports.”); Stone, *supra* note 13, at 214.

<sup>63</sup> TERRY BURTON, NAMING RIGHTS: LEGACY GIFTS AND CORPORATE MONEY, at xv (2008).

cost.<sup>64</sup> In contrast, in the market for naming professional sports venues, an analysis of nineteen naming-rights deals found that in those non-charitable transactions, corporate sponsors only pay from five percent to twenty-five percent of total construction costs.<sup>65</sup>

Accordingly, this Article proposes a flexible, dual-character approach. Specifically a college would treat a corporate sponsor's payment as taxable advertising revenue, except to the extent the payment exceeds the price that a willing buyer would pay for the advertising impressions in a non-charitable, arms-length transaction. This approach is consistent with the rationales for imposing the unrelated business income tax and with the definition of fair market value for federal tax purposes.<sup>66</sup> Also, it would not disturb the traditional approach allowing corporations charitable deductions when they purchase a "halo effect."<sup>67</sup> Arguably, corporations seldom donate out of pure altruism,<sup>68</sup> and instead normally donate to obtain a halo effect from the public recognition and being associated with the charity. This proposal pegs the tax consequences to the cost of comparable *non-charitable* advertising impressions<sup>69</sup> and thereby treats any charitable premium paid, including the amount paid for the halo effect, as a charitable gift.<sup>70</sup>

For example, presume the University of Virginia will construct a new basketball practice facility for \$10 million, and XYZ Corporation transfers \$6 million to the University and acquires the right to name the facility.<sup>71</sup> If the market price for acquiring comparable advertising impressions from TV or radio commercials would be \$4 million, and the halo effect of being affiliated with a prestigious university would provide additional brand name benefits worth \$1 million (for a total return benefit of \$5 million), the University of Virginia would treat \$4 million as taxable advertising revenue<sup>72</sup> and treat the \$2 million balance as a tax-free charitable gift under this proposal. Purists might argue that the University of Virginia should have \$5 million of taxable advertising revenue,<sup>73</sup> but for decades the tax law has allowed corporations to

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<sup>64</sup> *Id.* at 142–43.

<sup>65</sup> See Drennan, *supra* note 4, at 93–96 app. B.

<sup>66</sup> See Treas. Reg. § 1.170A-1(c)(2) (1972) (providing that fair market value is “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts”).

<sup>67</sup> Knauer, *supra* note 9, at 7 n.27.

<sup>68</sup> See *id.* at 57–59.

<sup>69</sup> See *infra* notes 201–03 and accompanying text.

<sup>70</sup> See *infra* Part III.A.1.

<sup>71</sup> The University of Virginia requires that a corporation naming a campus building pay at least fifty-one percent of the building's value. See *supra* note 6 and accompanying text.

<sup>72</sup> The University would not pay tax on the entire \$4 million of advertising revenue. Rather, it would deduct direct expenses in calculating its unrelated business taxable income. See *infra* Part III.B.3.

<sup>73</sup> The purist might wish to also tax the \$1 million “halo” benefit the sponsor receives. See *infra* notes 196–203 and accompanying text.

deduct transfers to charities when they have benefited from associating with the charity.<sup>74</sup> Disturbing this tax approach would be a radical change and bring into question the validity of many, and perhaps most, corporate charitable deductions.<sup>75</sup> Furthermore, valuing the halo benefit could pose substantial administrative complications.<sup>76</sup>

This proposal would entail new administrative costs associated with valuing the non-charitable advertising benefits, but advances in sports-marketing theory and practice allow practitioners in the field to estimate the commercial value of sponsorship arrangements based on the advertising impressions generated.<sup>77</sup> Sports-marketing consultants can calculate the number of times consumers see or hear a brand name, a logo, and a related message, and based on the type and frequency of impressions, assign a monetary value. In 2001, Professors Ashley and O'Hara detailed the method of analyzing advertising impressions to estimate the value of facility naming rights.<sup>78</sup> By 2006, major sports entities were gathering advertising impression figures to "demonstrate the marketing effectiveness" of sponsorships as an advertising medium.<sup>79</sup> In 2010, one consultant summarized the process stating, "The key to determining [value] is figuring out just how many 'impressions' a sponsorship will create—how many people saw it [and] how many times they saw it . . . ."<sup>80</sup> In 2011, the chairman of a major U.S. corporation said "a sponsorship, whether it's the NBA or the Redskins stadium or the . . . FedEx Orange Bowl, is the total number of impressions."<sup>81</sup>

Consultants analyze advertising impressions to estimate the value of sponsorship arrangements for both buyers and sellers.<sup>82</sup> For example, Nielson Ventures calculates advertising impressions and "evaluate[s] the effectiveness of sponsor-placed media across multiple sports"<sup>83</sup> using a system called Sponsorship Scorecard. In 2006, Nielson Ventures already was comparing the effectiveness of sponsoring college football's Rose Bowl Game with NASCAR

<sup>74</sup> See Knauer, *supra* note 9, at 4 ("[A] corporate transfer to charity is . . . made with the expectation of receiving a commensurate benefit in return.").

<sup>75</sup> See *id.* at 7 n.27; *id.* at 57–59 (noting that corporations usually seek a halo effect when contributing to charity).

<sup>76</sup> See *infra* Part III.C.1.

<sup>77</sup> See, e.g., Ashley & O'Hara, *supra* note 23, at 18.

<sup>78</sup> *Id.* at 19 (discussing the method for valuing naming rights for a convention center).

<sup>79</sup> Nielsen Sports, *supra* note 24; see also Alm, *supra* note 24, at C1 ("The televised ad impressions add up fast . . .").

<sup>80</sup> Jim Harris, *What's in a Name*, ARK. BUS., Oct. 11, 2010, at 28, available at 2010 WLNR 21078353.

<sup>81</sup> John Branston, *Brand Awareness: Fred Smith Says FedEx and the NBA Are All About Making Impressions*, MEMPHIS FLYER, July 18, 2001, at 9, available at 2001 WLNR 9791431.

<sup>82</sup> See, e.g., Nielsen Sports, *supra* note 24; see also Shore, *supra* note 24.

<sup>83</sup> Nielsen Sports, *supra* note 24 ("Sponsorship Scorecard™ enables clients to gauge their return on investment (ROI) by matching impressions across different sports.").

auto races, the U.S. Open tennis tournament, and the NFL Super Bowl.<sup>84</sup> In one study, “[s]ponsors were ranked by average number of television impressions per hour among viewers ages 25–54.”<sup>85</sup> One authority states that an advertising message on radio is the equivalent of four impressions from a roadside billboard.<sup>86</sup>

Marketing experts are proficient in this area for practical reasons. Many entities engage in selling sponsorships, such as professional sports teams offering naming rights to new or renovated stadiums or professional sports leagues selling sponsorships to playoffs or tournaments. These sellers are very interested in maximizing revenue. Likewise, the commercial firms desiring to buy advertising through sponsorships seek the expert counsel of sports marketing consultants to avoid overpaying.<sup>87</sup> The appraisal procedures have become so refined a stadium commission reports that, when multiple consultants appraised a particular sponsorship opportunity, the estimates were almost identical.<sup>88</sup> Colleges and universities ask sports-marketing consultants to estimate the market value of sponsorship rights before considering offers. Rutgers hired two corporate agents to sell the naming rights to its football stadium.<sup>89</sup> The University of Louisville and Boston College have each outsourced the sale of sponsorships to “professional sports-marketing companies.”<sup>90</sup>

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<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> Ashley & O’Hara, *supra* note 23, at 18; *see also* Chris Poynter, *\$40 Million May Be High for Naming of New Arena*, COURIER J., Sept. 11, 2005, at A1, *available at* 2005 WLNR 26774540 (“The industry standard is about a penny per impression.” (quoting the president of Front Row Marketing)).

<sup>87</sup> *See infra* notes 89–90 and accompanying text.

<sup>88</sup> Harris, *supra* note 80, at 28 (“AT&T had a Dallas firm calculate the value [and] the stadium commission asked [Alan] Turner [of Turner Sponsorship Consultants] for his assessment too. The numbers derived between the parties were within \$2,000 of each other, according to a report issued by the stadium commission.”).

<sup>89</sup> Conor Orr & Brendan Prunty, *Scarlet Hoping to See Green by Selling Naming Rights: Stadium, Athletic Center Being Offered as Perneti Seeks Revenue for All Sports*, STAR-LEDGER, July 1, 2010, at 41, *available at* 2010 WLNR 13235553 (hiring Brooklyn Sports & Entertainment and IMG College).

<sup>90</sup> McCafferty, *supra* note 33, at 51.

## 2. Alternatives

There are many ways to tax, or exempt, these transactions. In contrast to this Article's flexible, dual-character proposal, there are rigid, all-or-nothing methods at both extremes. At one end of the spectrum, current law exempts qualified sponsorship payments completely; at the other end, a 2009 Congressional Budget Office white paper would tax all college sponsorship payments. Another possibility for situations posing challenging valuations issues is a fixed-percentage approach.

### a. Characterizing Sponsorship Payments Exclusively as Gifts

In 1997 Congress enacted I.R.C. § 513(i),<sup>91</sup> which allows all qualified sponsorship payments to avoid the unrelated business income tax. This exception is so broad that it practically eliminates the general rule that charities must pay tax on their advertising income.<sup>92</sup> In a 2009 report, the Congressional Budget Office flatly stated “qualified sponsorship payments . . . provide . . . advertising value to the sponsor.”<sup>93</sup>

Under I.R.C. § 513(i), qualified sponsorship payments include all payments in exchange for displaying or publicizing any or all of the following: (i) the payor's services or facilities; (ii) a listing of the payor's locations, telephone numbers, or internet address; (iii) value-neutral descriptions, including displays or visual depictions, of the payor's product lines or services; (iv) the payor's brand or trade names and product or service listings; (v) the sponsor's logos and slogans that do not contain qualitative or comparative descriptions of the payor's products; and (vi) logos and slogans that are an established part of the payor's identity (regardless of whether they contain qualitative or comparative descriptions).<sup>94</sup> As a result of this final item, despite the general rule taxing comparative ad revenues,<sup>95</sup> sponsorship payments for the KFC Yum! Center<sup>96</sup>

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<sup>91</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 965(a), 111 Stat. 893 (codified as amended at I.R.C. § 513(i) (2006)).

<sup>92</sup> Stone, *supra* note 13, at 220 (“On its face, [I.R.C. §] 513(c) appears to set the general rule [that] advertising income is taxable—and Section 513(i) appears to define a limited exception . . . . This appearance is deceptive. Section 513(i) effectively exempts almost all advertising income, if we understand ‘advertising’ colloquially to mean posting a commercial message for pay.”). Current law would tax a commercial sponsorship payment only if the messages contain qualitative language, price information, other indicators of savings or value, or an endorsement. I.R.C. § 513(i)(2)(A) (2006). Also sponsorship payments “contingent upon . . . attendance, . . . broadcast ratings, or [otherwise on] the degree of public exposure” are taxable. I.R.C. § 513(i)(2)(B)(i) (2006).

<sup>93</sup> CBO BUDGET OPTIONS, *supra* note 2, at 232.

<sup>94</sup> Treas. Reg. § 1.513-4(c)(2)(iv) (2002).

<sup>95</sup> I.R.C. § 513(i)(2)(A).

<sup>96</sup> See *supra* note 7 and accompanying text.

at the University of Louisville and the Value City Arena<sup>97</sup> at The Ohio State University can be tax exempt.

When enacted, the government indicated that the current rule would distinguish between taxable advertising and tax-free acknowledgments.<sup>98</sup> But as one commentator asserts, “neither involves any element of gratuitous altruism”<sup>99</sup> and “[i]n each case a business (the advertiser/sponsor) pays a charity to transmit a commercially valuable message (an advertisement or sponsor acknowledgment).”<sup>100</sup>

### b. *Characterizing Sponsorships Exclusively as Taxable Ad Buys*

At the other extreme, in 2009 the Congressional Budget Office prepared a white paper titled *Tax Preferences for Collegiate Sports*<sup>101</sup> and subsequently estimated the tax revenue Congress could raise if it taxed all sponsorship payments to postsecondary sports programs.<sup>102</sup> The CBO states that qualified sponsorship payments “provide . . . advertising value to the sponsor,”<sup>103</sup> and the CBO report “would classify as [taxable] advertising revenue any money given by a corporation to a college or university in exchange for naming rights to postsecondary athletic events and facilities.”<sup>104</sup> The CBO report lists several advantages to this approach.<sup>105</sup>

### c. *Discretionary “Substantial” Benefits Test*

When first considering commercial sponsorships of college football in 1991,<sup>106</sup> the IRS carefully analyzed and relied on existing authorities, but the result was a highly discretionary approach that ignited a hostile response from the charitable world.<sup>107</sup> Several features are noteworthy.

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<sup>97</sup> Schmadtke, *supra* note 3, at D1.

<sup>98</sup> See Treas. Reg. § 1.513-4(c)(2)(iv) (2002) (“[A] substantial return benefit does not include the use or acknowledgment of the name or logo . . .”).

<sup>99</sup> Stone, *supra* note 13, at 225.

<sup>100</sup> *Id.*; see also *id.* at 226 (concluding that true “acknowledgments,” rather than advertisements, are “rare in the real world” and occur only when the sponsor pays to be “connected to the [charity]” but does not benefit from a “commercial communication[]” to consumers).

<sup>101</sup> CONG. BUDGET OFFICE, TAX PREFERENCES FOR COLLEGIATE SPORTS (2009) [hereinafter CBO WHITE PAPER], available at [www.cbo.gov/publication/41172](http://www.cbo.gov/publication/41172).

<sup>102</sup> *Id.* at 232. Consistent with its normal practices the CBO did not officially endorse the proposal. *Id.* at i.

<sup>103</sup> *Id.* at 232.

<sup>104</sup> *Id.*

<sup>105</sup> See *id.*

<sup>106</sup> See IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (John Hancock Bowl); IRS Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991) (Mobile Cotton Bowl); *supra* note 44.

<sup>107</sup> See Stone, *supra* note 13, at 223.



Initially the IRS considered John Hancock Life Insurance Company's payments to sponsor a college football bowl game.<sup>108</sup> The IRS mentioned a series of prior rulings indicating that the IRS would not treat public recognition as a valuable return benefit, but the IRS stressed that in those situations the donors received only limited recognition resulting in only insubstantial benefits not "commensurate with the amount of the payment[s]."<sup>109</sup> In contrast, the IRS stated that "a payment made with an expectation of a *substantial* return benefit will be presumed . . . not to be a contribution or gift."<sup>110</sup>

In applying this test, the IRS stated that it need look no further than the written sponsorship agreement between the parties.<sup>111</sup> The IRS reviewed selected provisions of the John Hancock Life agreement and stated that those provisions alone proved that the commercial sponsor was anticipating substantial future benefits, and the entire amount paid constituted taxable advertising revenue.<sup>112</sup> The ruling stated that all facts and circumstances were relevant, and the approach suggested that IRS auditors and courts would have great latitude in making factual decisions. The ruling contained no discussion of the appropriate valuation techniques or procedures and offered no detailed guidance on how to analyze the facts.

Later in 1991 the IRS employed the same test in a ruling involving the Mobile Cotton Bowl, and again concluded that the written agreement conclusively established that the publicity of the sponsor was a "substantial benefit."<sup>113</sup>

In January 1992 the IRS issued proposed audit guidelines<sup>114</sup> that did little to clarify the application of the test. The guidelines stated that a sponsor receives substantial benefits if the charity "performs valuable advertising, marketing, and similar services," and provided a nonexclusive list of four factors to consider.<sup>115</sup>

<sup>108</sup> IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (considering the 1987 arrangement); *see also* Stone, *supra* note 13, at 222 n.39 (identifying the game as the "John Hancock Bowl").

<sup>109</sup> IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991).

<sup>110</sup> *Id.* (emphasis added); *see also id.* ("The appropriate way to answer this question is to look at all the facts and circumstances to see if the payment was made with an expectation of . . . a *substantial* return benefit." (emphasis added)).

<sup>111</sup> *Id.* ("[T]he agreement clearly shows that the sponsor's payment is commensurate in value with the benefits the sponsor expects to receive . . ."). Apparently the parties involved argued that the IRS's reliance on the contract was excessive.

<sup>112</sup> *Id.* The IRS described the advertising services for John Hancock Life Insurance under the Sponsorship Agreement. John Hancock Life Insurance could "design the game's name and logo," and the logo would appear on promotional materials, the players' uniforms, and on the field. [TV] [v]iewers would see the sponsor's name "about 60 times during . . . the [g]ame . . . and . . . hear the . . . sponsor's name about 50 times during the . . . [g]ame." *Id.*

<sup>113</sup> IRS Tech. Adv. Mem. 91-47-007 (Nov. 22, 1991); *see also* Stone, *supra* note 13, at 222 n.39 (identifying the game as the "Mobile Cotton Bowl").

<sup>114</sup> IRS Ann. 92-15, 1992-5 I.R.B. 51 (Jan. 17, 1992), *available at* 1992 WL 786303.

<sup>115</sup> *Id.* ("A determination of whether a substantial return benefit is present should include an analysis of: the value of the service provided . . . ; the terms . . . ; the amount of control

Perhaps in an attempt to relieve the anxiety for a fraction of the charitable sector, the IRS stated that “[a]s a matter of audit tolerance” volunteer organizations “that are . . . purely local” with “relatively insignificant gross revenue[s] from corporate sponsors” would not be challenged on audit.<sup>116</sup> The IRS anticipated this safe-harbor would exempt “local theatres and youth orchestras,” and “youth athletic organizations such as little league baseball and soccer teams.”<sup>117</sup> The government reneged on this promise of audit leniency for small volunteer organizations in January 1993<sup>118</sup> and made additional modifications in proposed regulations,<sup>119</sup> but apparently the changes were insufficient to assuage the concerns of charitable organizations.

Faced with this vague, discretionary test likely to produce unpredictable results, the charitable sector sought relief. In 1997, Congress adopted I.R.C. § 513(i), which makes sponsorship revenue tax-free as long as the parties comply with certain guidelines.<sup>120</sup> In its defense, in 1991 the IRS was attempting to deal with these complex arrangements before the development of widespread valuation expertise in the sports-marketing field.<sup>121</sup>

#### d. *Fixed-Percentage Approach*

In two situations involving complex valuation issues, the government has adopted a fixed-percentage approach.<sup>122</sup> This approach can avoid the cost of appraisals and valuation disputes, but is problematic when circumstances vary significantly from case to case.

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that the sponsor exercises over the event; and whether the extent of the organization’s exposure of the donor’s name constitutes significant promotion.”).

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> 58 Fed. Reg. 5687-02 (Jan. 22, 1993), *reprinted in* 1993-7 I.R.B. 71 (preamble to Prop. Treas. Reg. § 1.512(a)-1) (“The proposed regulations . . . apply uniformly to all sponsorship activities without regard to the local nature of the organization or activities or the amount of the sponsorship payment.”).

<sup>119</sup> *Id.*

<sup>120</sup> *See supra* Part II.

<sup>121</sup> *See supra* notes 77–90 and accompanying text; *see also* BURTON, *supra* note 63, at 49 (“Since the mid-1990s, there has been a groundswell of naming rights activity.”); ANDREW ZIMBALIST, UNPAID PROFESSIONALS: COMMERCIALISM AND CONFLICT IN BIG-TIME COLLEGE SPORTS 4 (1999) (“[C]orporate sponsorships . . . increased roughly sevenfold in the nineties . . .”).

<sup>122</sup> In one situation, the IRS entered into a settlement agreement with the Church of Scientology allowing the Church members to deduct eighty percent of the fees they pay to the Church for auditing and training services, provided that the Church members do not deduct the remaining twenty percent. *See Sklar v. Comm’r*, 125 T.C. 281, 298–99 (2005), *quoted in* Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1135 n.5 (2008); *see also* *Hernandez v. Comm’r*, 490 U.S. 680 (1989) (illustrating that although the IRS won the *Hernandez* case, the IRS subsequently entered into the settlement agreement allowing Church members to deduct eighty percent).

For example, the government faced potential valuation issues involving college alumni who paid to acquire the rights to purchase tickets to college sporting events. In Revenue Ruling 86-63,<sup>123</sup> multiple universities required alumni to annually contribute at least \$300 to an athletic scholarship program in order to have the right to buy tickets for football or basketball games. Initially, the IRS stated that the results would depend on the facts of each situation. For example, if a college's games always sell out, the IRS concluded that the payments to the scholarship funds are not charitable contributions at all, but instead are disguised payments for tickets, and therefore the alumni cannot deduct any part of the payment as a charitable contribution.<sup>124</sup> The IRS considered another situation in which the college's games never sold out, and there was no benefit gained by making the payments to the scholarship fund. In this situation, the IRS concluded that the payments to the scholarship fund were tax-deductible charitable gifts.<sup>125</sup>

Two years later, however, Congress enacted I.R.C. § 170(l),<sup>126</sup> which replaces this facts-and-circumstances approach with a fixed-percentage approach to avoid valuation disputes with individual taxpayers.<sup>127</sup> The new statute declares that alumni can deduct eighty percent of these payments as charitable contributions, but cannot deduct the remaining twenty percent.

This example demonstrates both the strength and the weakness of a fixed-percentage approach. On the one hand, it is administratively easy for the colleges and the alumni to apply, and disputes are unlikely. As of January 2012, there were no reported cases involving I.R.C. § 170(l).<sup>128</sup> On the other hand, the fixed-percentage approach may allow alumni of colleges with popular athletic programs to deduct eighty percent of disguised payments for entertainment. For example, alumni of football-powerhouse Oklahoma State University paid \$2,500 for the right to purchase football tickets<sup>129</sup> and presumably deducted

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<sup>123</sup> Rev. Rul. 86-63, 1986-1 C.B. 88.

<sup>124</sup> *Id.* at 89 (“Unless the taxpayer can establish that \$300 exceeded the value of the benefit received, no part of the \$300 payment is a charitable contribution.”).

<sup>125</sup> *Id.* (situation 3).

<sup>126</sup> I.R.C. § 170(l) (2006) (originally enacted by the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6001(a), 102 Stat. 3342).

<sup>127</sup> H.R. REP. NO. 100-795, at 523 (1988).

<sup>128</sup> A Westlaw search of the “Federal Taxation-Cases (FTX-CS)” database using “170(l)” found no entries on June 30, 2012. *See also* Barbara L. Kirschten & Carla Neeley Freitag, *Charitable Contributions: Income Tax Aspects*, TAX MGM'T PORTFOLIO (BNA) No. 521-3rd, at A-53 (citing no cases involving I.R.C. § 170(l) and only one IRS Technical Advice Memorandum).

<sup>129</sup> *See* Will, *Tax, supra* note 26, at A17. Although I.R.C. § 170(l) provides in part that “[i]f any portion of a payment is for the purchase of . . . tickets, such portion . . . shall be treated as separate amounts” and would not be tax deductible, there have been no reported cases involving I.R.C. § 170(l). *See supra* note 128 and accompanying text.

eighty percent of those payments. Professor Colombo calls the twenty percent figure “arbitrary.”<sup>130</sup>

Current law arguably employs a fixed-percentage approach to corporate sponsorship payments; the law treats zero percent of the payments as taxable advertising revenue.<sup>131</sup> A fixed-percentage approach treating at least some portion of commercial sponsorship payments as taxable advertising revenue might be closer to the economic substance in some situations, but in light of the factual differences between arrangements,<sup>132</sup> any fixed-percentage approach would fail to match economic reality in many situations.

## B. *The Case for the Balanced Proposal*

### 1. *Balancing Education and Athletics on Campus*

One of Congress’s rationales for enacting the UBIT was that if unrelated activities were not taxed, charities would “allocate an excessive amount of resources” to unrelated activities to the detriment of their core missions.<sup>133</sup> Colleges are multifaceted institutions typically emphasizing education, research, and athletics.<sup>134</sup> The tax law clearly recognizes that the first two endeavors are worthy of tax exemption and donors can deduct contributions;<sup>135</sup> the case for athletics is murky. Generally, recreational activities are neither charitable nor eligible to receive tax-deductible contributions.<sup>136</sup> Nevertheless, historically the

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<sup>130</sup> John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 663 n.23 (2001).

<sup>131</sup> See *supra* Part III.A.2.a.

<sup>132</sup> See *supra* notes 3–9 and accompanying text.

<sup>133</sup> CBO WHITE PAPER, *supra* note 101, at 2 (“Policymakers at that time were . . . concerned that [in the absence of the UBIT, charities would] allocate an excessive amount of resources to those activities rather than to their charitable purpose.”); see also H.R. REP. NO. 81-2319, at 37 (1950).

<sup>134</sup> See, e.g., Kevin Johnson & Kelly Whiteside, *Penn State Rethinks Emphasis on Football*, USA TODAY (Dec. 7, 2011), <http://usatoday30.usatoday.com/sports/college/football/bigten/story/2011-12-06/penn-state-rodney-erickson-interview-football-emphasis/51686080/1>. (“Penn State President Rodney Erickson [said] that he is seeking to transform the university’s public image from a football school to a ‘world class research institution.’”).

<sup>135</sup> See I.R.C. § 170(c)(2)(B) (2006) (contributions to qualified educational or scientific organizations are tax deductible); I.R.C. § 501(c)(3) (2006) (organizations organized and operated exclusively for educational or scientific purposes are eligible for tax exemption); see also BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 288–91 (9th ed. 2007) (fundamental or basic research is “scientific” for these purposes).

<sup>136</sup> See *St. Louis Sci. Fiction Ltd. v. Comm’r*, 49 T.C.M. (CCH) 1126, 1129 (1985) (despite engaging in certain educational activities, the court denied the organization tax exemption under I.R.C. § 501(c)(3) because the “social and recreational purposes constituted a substantial portion of [the organization’s] activities”); *Minn. Kingsmen Chess Ass’n, Inc. v. Comm’r*, 46 T.C.M. (CCH) 1133, 1135 (1983) (chess club was not an “educational”

tax law has treated some nonprofit athletic organizations as tax-exempt educational or charitable organizations under I.R.C. § 501(c)(3),<sup>137</sup> and has treated college athletic programs as an integral part of the tax-exempt college.<sup>138</sup>

An old axiom asserts that if you want less of something, tax it; if you want more of something, refrain from taxing it.<sup>139</sup> Current tax law provides the same economic incentive for a college to play sports as to educate its students. If many believe that colleges should emphasize education over sports,<sup>140</sup> and taxes impact behavior, one would expect controversies over the role of sports on campus. Many current debates confirm these concerns.<sup>141</sup>

For example, numerous commentators complain about the compensation of college football and basketball coaches,<sup>142</sup> particularly when compared to the pay of university presidents and chancellors. Some coaches earn almost ten

organization under I.R.C. § 501(c)(3) because “[t]he presence of a single noneducational purpose, if substantial in nature, will make the organization ineligible . . . regardless of the number or importance of truly educational purposes . . . [and] we find that the [chess] matches were more recreational in nature than educational”). *But see* I.R.C. § 501(c)(7) (2006) (a portion of a country club’s income is tax exempt under certain circumstances).

<sup>137</sup> *See e.g.*, *Hutchinson Baseball Enters., Inc. v. Comm’r*, 73 T.C. 144 (1979) (an adult baseball team competing against semi-pro teams is a charitable organization), *aff’d*, 696 F.2d 757 (10th Cir. 1982); *Lions Assoc. Drag Strip v. United States*, 64-1 U.S.T.C. (CCH) ¶ 9283 (S.D. Cal. 1963) (a drag racing club is an educational organization); Rev. Rul. 64-275, 1964-2 C.B. 142 (the sponsor of multiday seminars for aspiring yachtsmen is an educational organization). Also an organization fostering national or international amateur sports competition will be exempt if it meets various conditions. I.R.C. § 501(c)(3) (2006).

<sup>138</sup> *See e.g.*, Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-296, 1980-2 C.B. 195; *see also* Colombo, *supra* note 26, at 132 (“[T]he IRS has consistently ruled over many decades that college athletics are . . . functionally related to educational programs of universities.”); *id.* at 141–42.

<sup>139</sup> Jeffrey L. Yablon, *As Certain as Death—Quotations About Taxes* (2006 edition), 110 TAX NOTES 103, 108 (2006) (“If you want more of something, subsidize it; if you want less, tax it.”); *see also id.* at 139 (“Every tax exemption constitutes a subsidy.” (quoting Justice William J. Brennan Jr.)).

<sup>140</sup> *See e.g.*, Johnson & Whiteside, *supra* note 134.

<sup>141</sup> *See* RONALD A. SMITH, *PAY FOR PLAY: A HISTORY OF BIG-TIME COLLEGE ATHLETIC REFORM*, at ix (2011) (“The harmony sought by the balance of yin and yang of college athletics has been an elusive feature of big-time athletics.”); Branch, *supra* note 1, at 86 (“[R]eformers fret[] that commercialism [is] hurting college sports . . .”).

<sup>142</sup> *See e.g.*, Steve Berkowitz & Jodi Upton, *College Football’s New Hires in Money*, USA TODAY, Jan. 17, 2012, at 1A (“[A]verage basic compensation . . . will go . . . to a little more than \$1.5 million next season. . . . This just shows . . . the difficulty of bringing [football] into the right proportion, the right balance with the academic mission.” (quoting in part John Nichols, Penn State Professor Emeritus)); James K. Gentry & Raquel Meyer Alexander, *From the Sideline to the Bottom Line*, N.Y. TIMES, Dec. 31, 2011, <http://www.nytimes.com/2012/01/01/sports/ncaafootball/contracts-for-top-college-football-coaches-grow-complicated.html?pagewanted=all>.

times more than the university's top academic officials.<sup>143</sup> Since 1984, the average compensation for head football coaches at public universities has grown 750% (adjusted for inflation), compared to just 32% for college professors over the same time.<sup>144</sup>

Also, commentators describe spending for athletic facilities and equipment as an “arms race.”<sup>145</sup> Elite sports programs feel compelled to match or surpass their rivals in weight room facilities, luxury boxes, and other amenities. For example, the University of Michigan reportedly expanded their 107,000 seat football stadium to keep up with Big Ten rival The Ohio State University.<sup>146</sup> “[A]thletic expenditures are rising three or four times faster than expenditures in academic programs . . . .”<sup>147</sup>

In 2010–2011 alone, high-profile scandals rocked numerous prestigious institutions, including the University of Southern California, The Ohio State University, and the University of North Carolina.<sup>148</sup> A headline proclaimed, “College Football Faces Scandals of Every Stripe.”<sup>149</sup> In each case, “[c]ritics scold[ed] schools for breaking faith with their educational mission.”<sup>150</sup>

In discussing balance on campus, even the NCAA President remarked, “[y]ou shouldn't have the light of the academic side hidden under the bushel

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<sup>143</sup> See George Will, *Modern College Football Is Impervious to Reform*, DESERET NEWS, Nov. 10, 2011, at A17, available at 2011 WLNR 23261384 (illuminating that at the University of Alabama, head football coach Nick Saban's salary is \$4.6 million and the University president's salary is \$487,620; at Louisiana State University, head football coach Les Miles's salary is \$3.75 million and the University chancellor's salary is \$400,000). In 2011, the highest paid football coach was Mac Brown of the University of Texas, receiving \$5,193,500; the highest paid basketball coach was Louisville University's Rick Pitino, receiving \$7,531,378; and the highest paid public-college president in 2009–2010 was Ohio State's Gordon Gee, receiving \$1.3 million. Steve Wieberg, *College Coaches and Power: How Much Is Too Much?*, USA TODAY, Dec. 29, 2011, [http://usatoday30.usatoday.com/NEWS/usaedition/2012-01-17-College-football-coach-compensation-changes\\_ST\\_U.htm](http://usatoday30.usatoday.com/NEWS/usaedition/2012-01-17-College-football-coach-compensation-changes_ST_U.htm).

<sup>144</sup> Branch, *supra* note 1, at 93 (discussing the research of Charles Clotfelter, an economist at Duke University; also noting that the average compensation of a head football coach at a public university is \$2 million); see also Wieberg, *supra* note 143, at 4C (“Whatever restraint is sought in college athletics, it doesn't extend to coaches' salaries.”).

<sup>145</sup> See, e.g., Colombo, *supra* note 26, at 157.

<sup>146</sup> Chengelis, *supra* note 33, at 1C; McCafferty, *supra* note 33, at 48; see also Will, *supra* note 143, at A17 (“A few millennia from now . . . archeologists . . . will wonder why a 109,901-seat entertainment venue was attached to an institution of higher education.”).

<sup>147</sup> Katie Thomas, *A Call to Reduce Universities' Athletic Spending Strikes Some as Unrealistic*, N.Y. TIMES, Oct. 27, 2009, at B16, available at [www.nytimes.com/2009/10/27/sports/ncaaf/27ncaa.html](http://www.nytimes.com/2009/10/27/sports/ncaaf/27ncaa.html) (quoting William E. Kirwan, chancellor of Maryland's university system).

<sup>148</sup> See Branch, *supra* note 1, at 82; Pete Thamel, *College Football's Ugly Season, Facing Scandals of Every Stripe*, N.Y. TIMES, Aug. 21, 2011, at 1 (“[A]t least 10 major college football programs—including those at institutions esteemed for academics, like Michigan, North Carolina and Georgia Tech—have been investigated or punished by the NCAA in recent months.”).

<sup>149</sup> Thamel, *supra* note 148, at 1.

<sup>150</sup> Branch, *supra* note 1, at 82.

basket of football.”<sup>151</sup> In 2010 a “single college athletic league [consisting of twelve schools], the football-crazed Southeastern Conference (SEC), became the first to crack the billion-dollar barrier in athletic receipts.”<sup>152</sup> Unfortunately, contentious issues about balancing athletics and academics cannot be resolved by modeling programs after overseas college athletic departments. “The United States is the only country in the world that hosts big-time sports at institutions of higher learning.”<sup>153</sup>

## 2. Equal Treatment for Similar Activities, and Economic Substance

A bedrock of sound taxation is horizontal equity; the law should tax similarly situated taxpayers the same.<sup>154</sup> Current law on this topic violates the principle because commercial sponsorship of college sports is similar to advertising for professional sports,<sup>155</sup> but the former is tax-free and the latter is taxable. In 1991, the IRS cited with approval the following assertions: “[S]ponsorship . . . has pervaded many sports events including bass fishing, beach volleyball, bowling, college football (bowls), golf (both L.P.G.A. and P.G.A.), marathons, squash, steeplechase, and tennis . . . . Thus, the popularity of . . . [sports] sponsorship is enormous.”<sup>156</sup> At the time, “[s]ports sponsorship [was] a three billion dollar industry, with almost 4,200 companies sponsoring sports events.”<sup>157</sup> By 1999, North American corporations were investing over \$7 billion in sports sponsorships.<sup>158</sup> By 2011, the figure climbed to over \$18 billion.<sup>159</sup>

The Congressional Budget Office makes a disturbing allegation about current law’s inequitable treatment. The CBO states that “[c]orporations that purchase naming rights to college football bowl games . . . effectively pay less

<sup>151</sup> Kelly Whiteside & Kevin Johnson, *NCAA’s Mark Emmert Happy with Penn State’s “Forthrightness,”* USA TODAY, Dec. 7, 2011, [www.usatoday.com/sports/college/football/bigten/story/2011-12-06/ncaa-president-mark-emmert-penn-state-scandal/51686768/1](http://www.usatoday.com/sports/college/football/bigten/story/2011-12-06/ncaa-president-mark-emmert-penn-state-scandal/51686768/1).

<sup>152</sup> Branch, *supra* note 1, at 82.

<sup>153</sup> *Id.*

<sup>154</sup> See *supra* note 17 and accompanying text.

<sup>155</sup> Colombo, *supra* note 26, at 150 (“Big-time college athletics revenues . . . are absolutely no different from . . . [those] same revenues flowing to professional, for-profit sports.”).

<sup>156</sup> IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991); see also N. R. Kleinfield, *Marketers Exploit Second-Tier Sports*, N.Y. TIMES, May 19, 1991, at F-5, col. 1 (examining the impact of sponsorship of steeplechase).

<sup>157</sup> IRS Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991).

<sup>158</sup> Robert Madrigal, *The Influence of Social Alliances with Sports Teams on Intentions to Purchase Corporate Sponsors’ Products*, 29 J. ADVERTISING 13, 13 (2000).

<sup>159</sup> Dave Kovaleski, *Association Sponsorships Grow, but at a Below-Average Rate*, ASS’N MEETINGS, Feb. 2012, at 9, available at 2012 WLNR 2282372 (“Overall, corporations doled out \$18.1 billion in sponsorships last year in North America.”); *id.* (noting that “sports events” is “[t]he largest category . . . get[ting] 69 percent of corporate sponsorships”).

for advertising than they would to purchase similar services from a for-profit organization,”<sup>160</sup> and as a result “a considerable portion of the subsidy the tax code provides . . . [is] passed on to [for-profit] purchasers of advertising.”<sup>161</sup> The CBO’s claim may be correct if commercial sponsors refuse to pay fair-market rates to colleges and demand that colleges charge below-market rates and pass along part of the tax savings to the commercial sponsors. In the absence of empirical evidence, this claim is interesting but subject to potential challenge.<sup>162</sup>

### 3. Revenue Raising and Preventing Accounting Machinations

A cardinal goal of the U.S. tax system is raising revenue for public goods such as national defense.<sup>163</sup> Accordingly, if a new revenue-raising tax satisfies other tax policy goals, it contributes to the welfare of the nation.

In 2009, the Congressional Budget Office stated that qualified sponsorship payments total \$275 million a year,<sup>164</sup> but the CBO concluded that taxing the net income from these arrangements “would be unlikely to . . . garner much tax revenue,”<sup>165</sup> only about \$20 million each year.<sup>166</sup> The CBO report presents no expense calculations, and states “[t]here are no rules or . . . standard practices delineating how schools divide revenue[s and costs] . . . between the athletic department and the [rest of the] university.”<sup>167</sup> The CBO states that colleges “would have a substantial incentive to shift costs from the untaxed portion of the university to the taxable portion and to shift income in the other direction”<sup>168</sup> and notes “increased costs would reduce or eliminate taxable net income for the athletic program.”<sup>169</sup> The CBO acknowledges that the low tax-revenue projection results more from the accounting manipulations than the true economic situation.<sup>170</sup> Perhaps even more pessimistic, the CBO forecasts that a

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<sup>160</sup> CBO BUDGET OPTIONS, *supra* note 2, at 232.

<sup>161</sup> *Id.*

<sup>162</sup> For example, perhaps colleges feel no compulsion to charge cheaper rates than other advertising sellers and are content to compete with other advertising sellers on features other than price. Indeed, actual practice indicates that at least sometimes charities charge premium rates, *see supra* notes 3–6 and accompanying text, perhaps because of the extra cachet from affiliating with a prestigious educational institution. *See* Knauer, *supra* note 9, at 7 n.27 (discussing the “halo effect”).

<sup>163</sup> MALMAN, *supra* note 15, at 8 (“Revenue is the primary goal of taxation.”).

<sup>164</sup> CBO BUDGET OPTIONS, *supra* note 2, at 232.

<sup>165</sup> CBO WHITE PAPER, *supra* note 101, at viii.

<sup>166</sup> CBO BUDGET OPTIONS, *supra* note 2, at 232.

<sup>167</sup> CBO WHITE PAPER, *supra* note 101, at 7.

<sup>168</sup> *Id.* at 12.

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* at 7 (although many schools in the elite Division 1A category report net deficits from their sports programs, this “more likely . . . reflect[s] the conceptual difficulties in measuring income rather than a statement about the true underlying profitability of those programs”).



college anticipating a tax bill for a particular year would pay its sponsorship profits out to the football coach as extra compensation to obtain a tax deduction and thereby evade the tax.<sup>171</sup> This is particularly disturbing because it anticipates that a tax-exempt educational institution would rather pay its football coach an extra dollar than pay thirty-five cents in tax and use the remaining sixty-five cents to educate its students.<sup>172</sup>

Professor Colombo shares the CBO's accounting pessimism. Professor Colombo states, "[I]f the IRS applie[s] the UBIT to individual football or basketball program revenues (either at the NCAA or university level), it would find no net profit from these programs to tax after factoring in depreciation on athletic facilities and a reasonable apportionment of overhead."<sup>173</sup> Professor Colombo observes, "[C]harities in general have shown remarkable ability to 'zero out' any net income [tax] from unrelated business activities."<sup>174</sup>

This accounting pessimism appears based on an assumption that the college can deduct net expenses from playing the sport against the commercial sponsorship revenue. This notion is evident in the 1993 IRS proposed regulations on commercial sponsorships, which concluded that the revenue from selling T-shirts and other apparel featuring the name and logo of a bowl game could be offset by the college's net expenses from playing the bowl game "[b]ecause the unrelated income exploits the bowl game."<sup>175</sup>

In contrast to the CBO Report and the 1993 IRS proposed regulations, under this Article's proposal, colleges could not offset expenses from the exempt activity of playing the game against the unrelated commercial sponsorship payments.<sup>176</sup> Instead, the college would deduct only the expenses directly connected with selling and providing the advertising services to the commercial sponsor. The proposal is consistent with current I.R.C. § 513(c) in fragmenting the unrelated activity from the educational activities, and follows a different example in the proposed treasury regulations in which a college leases its stadium to a professional football team for certain events.<sup>177</sup> This example states the lease is not related to the college's exempt purposes and "does not exploit the bowl game," and therefore "expenses, depreciation, and similar items paid . . . in conducting the bowl game may not be [deducted] in

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<sup>171</sup> *Id.* at 12.

<sup>172</sup> The maximum tax rate on a charity's unrelated business income is thirty-five percent for 2012. *See* I.R.C. § 511(a)(1) (2006) (referring to the tax rates under I.R.C. § 11).

<sup>173</sup> Colombo, *supra* note 26, at 144–45.

<sup>174</sup> *Id.* at 144.

<sup>175</sup> Taxation of Tax-Exempt Organizations' Income from Corporate Sponsorship, 58 Fed. Reg. 5687, 5689 (proposed Jan. 22, 1993) (to be codified at 26 C.F.R. pt. 1) (proposed Treas. Reg. § 1.512(a)-1(e) ex. 2).

<sup>176</sup> *See infra* Appendix (§ 513(i)(2) of the proposed statute).

<sup>177</sup> Taxation of Tax-Exempt Organizations' Income from Corporate Sponsorship, 58 Fed. Reg. 5687, 5689 (proposed Jan. 22, 1993) (to be codified at 26 C.F.R. pt. 1) (proposed Treas. Reg. § 1.512(a)-1(e) ex. 3).

computing unrelated business taxable income attributable to the lease.”<sup>178</sup> The U.S. Supreme Court has held that the calculation of income for tax purposes need not follow generally accepted accounting principles,<sup>179</sup> and this Article’s proposal could raise significant tax revenues.

#### 4. *Shifting Dollars from Campus to Government*

The proposal would shift dollars from campus to government. Theoretically, if both the college and the government spend their dollars on meritorious projects benefiting society generally, the impact of the tax appears to be a wash for society. The tax could even harm society if the government wastes the extra tax revenue, or simply does not use it as wisely as the colleges. But in reality this revenue shifting can have societal benefits. Several commentators assert or imply that large portions of college football and basketball revenues simply are plowed back into the football and basketball programs, escalating the “arms race”<sup>180</sup> between competing colleges resulting in even higher coaches’ salaries and more luxury boxes.<sup>181</sup> Professor Colombo has called for greater information reporting to test the claims of some football and basketball programs that they support minor sports like track and field and rowing.<sup>182</sup> If colleges do not use excess athletic revenues virtuously, taxing that excess may provide net societal benefits.

A related concern is that the tax will reduce the prominence of schools with big-time athletic programs. In support of athletics, some emphasize the “Flutie Factor.”<sup>183</sup> The success of Boston College’s football team with Doug Flutie at quarterback from 1981 to 1984 significantly increased student applications to Boston College,<sup>184</sup> and perhaps the school’s “academic stature.”<sup>185</sup> The Flutie Factor posits that what is good for a school’s sports teams is good for the school. While the Flutie Factor can give an individual college a boost, former

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<sup>178</sup> *Id.*

<sup>179</sup> *Thor Power Tool Co. v. Comm’r.*, 439 U.S. 522, 540 (1979).

<sup>180</sup> Colombo, *supra* note 26, at 157.

<sup>181</sup> *See id.* (discussing the 2001 Knight Commission report’s emphasis on the “arms-race” nature of big-time college athletics).

<sup>182</sup> *See id.* at 156.

<sup>183</sup> *See* William E. Thro, *Review of Murray Sperber’s Beer and Circus: How Big-Time College Sports is Crippling Undergraduate Education*, 28 J.C. & U.L. 233, 237 n.15 (2001).

<sup>184</sup> James J. Hefferan, Jr., *Taking One for the Team: Davidson v. University of North Carolina and the Duty of Care Owed by Universities to Their Student-Athletes*, 37 WAKE FOREST L. REV. 589, 605 (2002) (“[A]dmissions applications [rose] at Boston College from 5000 to 16,000 in the year after Doug Flutie won the Heisman Trophy and completed the now-famous ‘Hail Mary’ pass . . .”).

<sup>185</sup> Timothy Liam Epstein, *Splinters from the Bench: Feasibility of Lawsuits by Athletes Against Coaches and Schools for Lack of Playing Time*, 4 VA. SPORTS & ENT. L.J. 174, 181 n.36 (2005) (citing MURRAY SPERBER, BEER AND CIRCUS: HOW BIG-TIME COLLEGE SPORTS IS CRIPPLING UNDERGRADUATE EDUCATION 60–68 (2000)); *see also* Will, *supra* note 143, at A17 (speculating that “athletic successes [may] cause increased . . . alumni giving”).

Congressman Bill Thomas and others question whether there is any net gain for charities in total.<sup>186</sup> In other words, if more students apply for admission to Boston College because of the success of the football team, are fewer students applying at schools with declining football or basketball programs, resulting in no net increase in students enrolling in college?

### 5. Clarifying the Debates on Athletics and Commercialism

This Article proposes taxing one feature of commercialism on campus, but many ponder commercialism in general.<sup>187</sup> They ask whether the schools are “selling out”<sup>188</sup> and whether “commercialization . . . undermin[es] the academic integrity and educational values at America’s institutions of higher learning.”<sup>189</sup> A Maryland State Senator “introduced a bill that would have forbidden state schools from [entering into] corporate naming-rights deals.”<sup>190</sup>

“In 2001, the Knight Commission on Intercollegiate Athletics, a watchdog group, began railing about the over-commercialization of college athletics . . . [including] increased corporate advertisements and logos . . . .”<sup>191</sup> In a 2009 Knight Commission survey, ninety-five college presidents replied that they “are very worried about the commercialization of intercollegiate athletics.”<sup>192</sup> The co-chair of the Knight Commission remarked, “athletic[] expenditures are rising three or four times faster than expenditures in academic programs.”<sup>193</sup> Despite the concerns of individual college presidents, many were quick to add that they would not be willing to unilaterally reduce commercialism at their home institution for fear of the reaction of alumni and trustees, and the impact on revenues.<sup>194</sup>

<sup>186</sup> See Will, *Tax*, *supra* note 26, at A17 (“[F]ederal taxpayers have no interest in increasing applicant pools at one school opposed to another.” (quoting Congressman Thomas)).

<sup>187</sup> Schmatdke, *supra* note 3, at D1 (“[C]ollege athletics frequently finds itself awash in debates about commercialism . . .”).

<sup>188</sup> *Id.* (“[M]any people are . . . concerned with this notion of ‘selling out.’”).

<sup>189</sup> Frank G. Splitt, *Are Big-Time College Sports Good for America?*, THE DRAKE GROUP (2006), [http://thedrakegroup.org/Splitt\\_Good\\_for\\_America.pdf](http://thedrakegroup.org/Splitt_Good_for_America.pdf).

<sup>190</sup> Schmatdke, *supra* note 3, at D1 (noting that the senator introduced the bill in 1998, but it never passed, and the University of Maryland signed a naming rights deal with Comcast two years later).

<sup>191</sup> *Id.*; see also Alan Schmatdke, *Monied Madness: Too Much Marketing, Too Much Commercialization and Too Much Money Plague College Athletics Today*, ORLANDO SENTINEL, Mar. 10, 2002, at G1, G4, available at 2002 WLNR 12832553 (“We aren’t keeping athletics in their proper role within the institution . . . . Athletics is taking on a life of its own. And the pressure [is] so great that the fundamental integrity of our institutions is being challenged.” (quoting former Florida Board of Regents chairman Adam Herbert)).

<sup>192</sup> Thomas, *supra* note 147, at B16.

<sup>193</sup> *Id.* (quoting William E. Kirwan, chancellor of Maryland’s university system).

<sup>194</sup> *Id.*

The tax issue can obscure these broader controversies;<sup>195</sup> correcting the tax treatment may help clarify the debates.

### *C. Implementing the Balanced Proposal*

#### *1. Valuation with the Focus on Non-Charitable Ad Impressions*

College athletic sponsorships are more complex to appraise than other types of advertising because there are at least four different elements of value. First is the value from the simple appearance and repetition of the name, logo, image or message. This element is present with even the most mundane image or commercial on a highway billboard, on the side of a bus, in a newspaper or magazine, or on radio or TV.<sup>196</sup> “[These] are direct purchases of time and opportunities where [the] exposure and the impressions are reliable and priced accordingly.”<sup>197</sup> Second is the value from affiliation with sports. Some corporations especially desire an association with a sports team or event because the team or event may build a sense of local pride and kinship.<sup>198</sup> This benefit is available from sponsoring a professional team’s stadium as well as a college team’s facility. Third, corporations may particularly value connecting their brand with a winner in order to be associated with success and other traits valued by society.<sup>199</sup> Fourth, affiliation of a sponsor’s brand with a prestigious educational institution could add extra cachet for which a corporation may pay a premium.<sup>200</sup>

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<sup>195</sup> See, e.g., ZIMBALIST, *supra* note 121, at 5 (railing against commercialism, the author notes “the NCAA and its member schools . . . do not pay taxes on their millions from TV deals, [and] sponsorships”); see also Splitt, *supra* note 189 (“[T]he NCAA exploits college athletes while making huge amounts of tax-exempt money under the guise of an institution of higher education.”).

<sup>196</sup> PHIL SCHAFF, *SPORTS, INC.: 100 YEARS OF SPORTS BUSINESS* 173 (2004) (“Several forms of sponsorship manifest in media impressions . . . such as radio, television, and outdoor billboards and print.”).

<sup>197</sup> *Id.*

<sup>198</sup> See Madrigal, *supra* note 158, at 13 (“[F]avorable purchase intentions are more likely to occur (1) as identification with the team increases and (2) when such intentions are perceived as a group norm.”).

<sup>199</sup> See Mike Colias, *Buick Bets Big on March Madness Marketing*, *AUTOMOTIVE NEWS*, Mar. 21, 2011, at 16, available at 2011 WLNR 5787868 (“If [there were] a brand that enables and inspires and celebrates human achievement, boy, that’s March Madness at its core . . . .” (quoting Chris Perry, General Motors head of U.S. marketing)); Branch, *supra* note 1, at 82 (“[C]orporations offer money so they can profit from the glory of college athletes . . . .”); Madrigal, *supra* note 158, at 13 (“[S]ome of the cognitive associations or personal meanings people hold toward the property (e.g., fun, youthful, exciting, excellence) may become linked in memory to the brand . . . . In the case of sports sponsorship, a particularly relevant secondary association is the social alliance existing between a fan and the property.”).

<sup>200</sup> Knauer, *supra* note 9, at 4, 57–59.

This Article's proposal would tax only the amount paid for the first element of value, the simple repetition of the name, logo, image, message, or other identifier.<sup>201</sup> The proposal would treat any excess as a tax-free charitable gift. This streamlined approach has multiple benefits. First, appraisals should be simpler because the appraiser need not consider the extra prestige from associating with sports, winners, or colleges. Second, the traditional rule that corporations may enjoy a halo effect from a charitable contribution without adverse tax consequences would continue.<sup>202</sup> Third, the proposal may avoid the fiery criticism drawn with the all-or-nothing approaches of the past,<sup>203</sup> and the competing factions may view this as a reasonable compromise.

## 2. Procedures for Valuation and Information Reporting to the IRS

In designing and implementing this new approach, procedures from at least three other areas of the tax law may assist. All three address potentially challenging valuation situations.

First, under the rules for noncash charitable contributions,<sup>204</sup> if a donor contributes property such as real estate, art work, gemstones, antiques, or memorabilia, the donor generally may deduct an amount equal to the fair market value of the property.<sup>205</sup> In this scenario, if the deduction exceeds \$5,000,<sup>206</sup> typically the tax law requires that the donor obtain a qualified appraisal<sup>207</sup> from a disinterested appraiser,<sup>208</sup> complete and file a separate tax form with the IRS,<sup>209</sup> attach an appraisal summary to the tax return,<sup>210</sup> and obtain the charity's signature verifying that the charity received the property.<sup>211</sup> The charity need not agree with the claimed valuation of the property.<sup>212</sup> Thus, in the case of noncash charitable contributions, the party having the greatest interest in the value (the donor) obtains the appraisal, the party with less

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<sup>201</sup> See *infra* Appendix (proposed § 513(i)(1)).

<sup>202</sup> See Knauer, *supra* note 9, at 57–59.

<sup>203</sup> See Stone, *supra* note 13, at 223.

<sup>204</sup> See Treas. Reg. § 1.170A-13(c) (1984).

<sup>205</sup> *Id.* § 1.170-1(c)(1) (“If a [charitable] contribution is made in property other than money, the amount of the [contribution] is the fair market value of the property at the time of the contribution.”). *But see* I.R.C. § 170(e)(1) (2006) (limiting the deduction to the taxpayer's basis in the property under certain circumstances).

<sup>206</sup> See IRS Form 8283 (revised Dec. 2006), available at <http://www.irs.gov/pub/irs-pdf/f8283.pdf>.

<sup>207</sup> Treas. Reg. § 1.170A-13(c)(2)(A) (1984).

<sup>208</sup> *Id.* § 1.170A-13(c)(5) (defining “qualified appraiser”).

<sup>209</sup> See IRS Form 8283 (revised Dec. 2006), available at <http://www.irs.gov/pub/irs-pdf/f8283.pdf>.

<sup>210</sup> Treas. Reg. § 1.170A-13(c)(2)(B) (1984).

<sup>211</sup> *Id.* § 1.170A-13(c)(4)(iii).

<sup>212</sup> *Id.* (“The signature of the donee on the appraisal summary does not represent concurrence in the appraised value of the contributed property.”).

concern over the valuation (the charity) need not endorse the valuation, and the donor must disclose detailed information to the IRS.

Second, under the quid pro quo rules, if a donor contributes cash or property and the charity provides goods or services in return, the donor can deduct only the portion of the payment in excess of the fair market value of the goods or services the charity provides.<sup>213</sup> In this situation, although the donor has the greatest interest in the valuation, the tax rules specify that the charity determines the value of the property or other benefits the charity provides to the donor,<sup>214</sup> and the donor must follow the charity's valuation unless it is "unreasonable."<sup>215</sup> The charity must provide the donor with a written statement of the value of the goods or services provided,<sup>216</sup> but the charity need not obtain an appraisal or file an appraisal summary with the IRS.<sup>217</sup>

Third, on the sale of the assets of a business, if the buyer and seller agree in writing on the allocation of the purchase price, or on the fair market value of any asset,<sup>218</sup> they must each attach IRS Form 8594 to their respective tax return.<sup>219</sup> The IRS Form 8594 anticipates setting forth the value of the assets in various classes, and the buyer and seller are bound by the agreed value.<sup>220</sup> The tax rules do not require that either party obtain an appraisal from a qualified appraiser, do not specify whether the buyer or seller should initiate the valuation process, but provide for detailed information reporting to the IRS.

The procedures for this Article's proposal borrow established methods to promote accuracy and minimize administrative burdens. Consistent with the noncash-charitable-donation rules,<sup>221</sup> the proposal would require a qualified appraisal because the situation creates an incentive for abuse,<sup>222</sup> and expertise is needed to accurately value the rights or services. Although either the corporate sponsor or the charity could obtain the appraisal because both might arrange for a professional valuation before actually entering into a binding contract, there may be situations when the college merely relies upon the fifty-percent rule of thumb or a similar approach.<sup>223</sup> Following the rules when a donor receives goods or services in return for a donation,<sup>224</sup> the initial valuation likely should

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<sup>213</sup> *United States v. Am. Bar Endowment*, 477 U.S. 105, 117–18 (1986); Treas. Reg. § 1.170A-13(c)(2)(B) (1984); Rev. Rul. 67-246, 1967-2 C.B. 104, 105.

<sup>214</sup> See I.R.C. § 170(f)(8)(B)(iii) (2006).

<sup>215</sup> Treas. Reg. § 1.170A-1(h)(4)(ii) (1984).

<sup>216</sup> I.R.C. § 170(f)(8)(A) (2006).

<sup>217</sup> See *id.* § 6115 (requiring merely that the charity provide the donor with a "good faith estimate of the value of [the] goods or services" provided).

<sup>218</sup> *Id.* § 1060(a).

<sup>219</sup> *Id.* § 1060(b); Treas. Reg. § 1.1060-1(e)(1)(ii) (2001).

<sup>220</sup> I.R.C. § 1060(a) (2006).

<sup>221</sup> See IRS Form 8283 (revised Dec. 2006), at 2, sec. B (stating that "[a]n appraisal is generally required" for claiming a deduction of more than \$5000).

<sup>222</sup> See Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 23 (2011).

<sup>223</sup> See BURTON, *supra* note 63, at 142.

<sup>224</sup> I.R.C. § 170(f)(8)(B) (2006).

be made by the party with the least interest in the valuation (the corporate sponsor), and the other party (the charity) should be bound to follow the appraised value as long as it is reasonable.<sup>225</sup> Finally, borrowing from the tax rules on the sale of business assets, both the charity and the corporate sponsor should attach an IRS form to their respective tax returns providing detailed information and should treat the transaction consistently with the IRS Form for tax purposes.<sup>226</sup>

### 3. *Permitting Incidental Acknowledgments and a Monetary Threshold*

Corporate charitable giving is a complex phenomenon.<sup>227</sup> Prior to 1935, state law frequently prohibited corporate charitable giving on the theory that a corporation's responsibility was to maximize shareholders' returns, and donations were ultra vires.<sup>228</sup> The tax law did not allow a corporation to claim a tax deduction for charitable contributions before 1935. Attitudes changed, the public expected corporations to become good citizens, and state legislatures repealed the bans on corporate charitable giving.<sup>229</sup> Nevertheless, the federal tax law still reflects a concern. In contrast to individuals who can claim charitable contributions up to fifty percent of their modified adjusted gross income,<sup>230</sup> corporations can only claim charitable deductions up to ten percent of their taxable income.<sup>231</sup>

Part of this lingering concern may reflect that society does not expect corporations to act with pure altruism.<sup>232</sup> Instead, it appears that society always expects donating corporations to seek some halo effect that will promote the corporate brand. It is a customary practice that a corporation is acknowledged with a shout-out if it sponsors a broadcast on public television or national public radio; for example, "This broadcast was made possible by the generous support of the XYZ Corporation."<sup>233</sup>

In recognition of this expectation of some halo benefit, if a charity provides a corporate sponsor with no other advertising impressions, this Article's

<sup>225</sup> See Treas. Reg. § 1.170(A)-1(h)(4)(ii) (1984).

<sup>226</sup> See I.R.C. § 1060(a) (2006).

<sup>227</sup> See Knauer, *supra* note 9, at 4 (reporting that "[l]egal scholarship . . . posits disinterested corporate giving" but arguing that a "corporate transfer to charity is not altruistic; it is intensely self-interested" (internal quotation marks omitted)).

<sup>228</sup> See *id.* at 15 ("When Congress enacted the corporate charitable contribution deduction provisions [in 1935] it was encouraging behavior that was ultra vires under state law.").

<sup>229</sup> *Id.* at 15–16 ("Eventually, all states and the District of Columbia passed legislation permitting corporate contributions.").

<sup>230</sup> I.R.C. § 170(b)(1)(A) (2006) (applicable for cash gifts to public charities). Any excess can be carried forward for up to five tax years. *Id.* § 170(d)(1).

<sup>231</sup> *Id.* § 170(b)(2)(A) (2006).

<sup>232</sup> See Knauer, *supra* note 9, at 4 ("[A] corporate transfer to charity is not altruistic; it is intensely self-interested." (internal quotation marks omitted)).

<sup>233</sup> See, e.g., Stone, *supra* note 13, at 213 (using a similar phrase).

proposal would allow an incidental acknowledgment with no tax consequences.<sup>234</sup> Regulators could prescribe the scope of this limited exception consistent with one-sentence donor acknowledgements consistently employed on public television and national public radio. Perhaps for a thirty-minute telecast or broadcast an announcer could mention the corporation as a sponsor one time, without any comparative advertising and without any description of products or services.

Also, another limited exception would be appropriate to avoid significant administrative burdens on small transactions. The tax rules for charitable contributions employ a variety of dollar thresholds based on various factors. For example, for donations of less than \$250, a contemporaneous written acknowledgment from the charity is not required.<sup>235</sup> For contributions of property worth more than \$500 but less than \$5,000, the donor must provide the IRS with detailed information but need not obtain an appraisal.<sup>236</sup> A taxpayer claiming a deduction of \$5000 or more, but less than \$500,000, must obtain a qualified appraisal of the donated property and file an appraisal summary with IRS Form 8283.<sup>237</sup> A taxpayer claiming a deduction of more than \$500,000 must attach the qualified appraisal to the tax return.<sup>238</sup> Special rules apply to gifts of art work worth \$20,000 or more.<sup>239</sup>

Thus the charitable deduction rules are filled with monetary thresholds. In this situation, the monetary threshold should exclude sponsorship deals from the proposal when the amount involved does not justify the administrative costs. A commercial sponsor likely will need to retain a sports marketing consultant to value the advertising benefits from non-charitable advertising impressions when the proposal applies,<sup>240</sup> in part because these consultants treat their precise valuation techniques as proprietary.<sup>241</sup> Although choosing the specific dollar amount for the threshold likely would not be an exact science, valuations of non-commercial advertising impressions likely will be more costly and time consuming than appraisals of art work with comparable value.<sup>242</sup> Thus, the threshold should significantly exceed the current \$20,000 threshold employed for gifts of art. The Secretary of the Treasury may prescribe regulations or other guidance, aggregating payments from one source to the same recipient or

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<sup>234</sup> See *infra* Appendix (proposed new § 513(i)(4)(B)).

<sup>235</sup> See I.R.C. § 170(f)(8)(A).

<sup>236</sup> Treas. Reg. § 1.170A-13(b)(3) (1984).

<sup>237</sup> See I.R.C. § 170(f)(11)(C) (2006); Treas. Reg. § 1.170A-13(c)(2) (1984). Contributions of publicly traded securities are not subject to the appraisal requirements. I.R.C. § 170(f)(11)(A)(ii) (2006).

<sup>238</sup> I.R.C. § 170(f)(11)(D).

<sup>239</sup> See IRS Form 8283, sec. B, pt. I, item 4 (revised Dec. 2006), available at <http://www.irs.gov/pub/irs-pdf/f8283.pdf>.

<sup>240</sup> See Ashley & O'Hara, *supra* note 23, at 19 (consulting an advertising executive who provided information for the valuation and suggested obtaining "an expert's detailed study . . . to determine the number of ad impressions").

<sup>241</sup> See, e.g., Harris, *supra* note 80, at 28.

<sup>242</sup> See *supra* note 240.



related persons as a single payment during a year for purposes of applying this monetary threshold.

#### 4. *Clarification on Deducting Part-Purchase and Part-Gift Payments*

This Article focuses on the tax consequences to the college or university, but one clarification of the tax consequences for the corporate sponsors is appropriate. As discussed, corporations making a single sponsorship payment to a college may be both buying advertising benefits and making a charitable donation.<sup>243</sup> A Treasury Regulation provides that “[n]o deduction is allowable [as a business expense] . . . for a contribution or gift by an individual or a corporation if any part thereof is deductible under section 170 [as a charitable contribution].”<sup>244</sup> If this Article’s proposal is adopted, the IRS should modify this regulation to allow sponsors to deduct part of a payment as a charitable contribution and part as a business expense in the nature of a purchase of advertising.

#### 5. *Shoe Deals and Other Endorsements*

Although somewhat related, shoe contracts, athletic apparel deals, sports drink arrangements, and similar understandings should be addressed with separate rules designed specifically for endorsements. In these arrangements the corporation makes in-kind transfers of property to the athletic department,<sup>245</sup> and players use the property. Endorsements require special rules because the corporate sponsor can receive a unique benefit that can pay dividends for several decades. Specifically, the players may become accustomed to the gear, equipment, or other supplies they use in school and may tend to buy those items for the rest of their lives. The Court of Claims has completely denied a charitable deduction when a corporation provides its products to students at a discount.<sup>246</sup>

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<sup>243</sup> See *supra* notes 3–9 and accompanying text.

<sup>244</sup> Treas. Reg. § 1.162-15(a) (2006) (referring to I.R.C. § 162(a), which allows a tax deduction for business expenses); see also *Singer Co. v. United States*, 449 F.2d 413, 421–22 (Ct. Cl. 1971) (discussing the history of the regulation).

<sup>245</sup> Athletic apparel giant Under Armour has a \$10.6 million deal with Auburn University, and in 2010 the school’s football quarterback “compliantly wore 15 corporate logos—one on his jersey, four on his helmet visor, one on his wristband, one on his pants, six on his shoes, and one on the headband he wears under his helmet.” Branch, *supra* note 1, at 94.

<sup>246</sup> *Singer Co.*, 449 F.2d at 421–22 (noting that the Singer company contributed sewing machines to high schools for student use).

## IV. CONCLUSION: THE BENEFITS OF BALANCE

Current law is easy to apply. The rules are clear.<sup>247</sup> Colleges and corporations can easily structure their deals to provide valuable brand name promotion to the corporation, while the college athletic department receives big money and pays no tax. When adopted in the mid-1990s perhaps this was a reasonable approach to a contentious issue because at that time valuing the commercial benefits from a sponsorship could have been exorbitantly costly, immensely time consuming, and yet inaccurate.<sup>248</sup>

Times have changed. Corporate sponsorships of college athletics “increased roughly sevenfold in the nineties.”<sup>249</sup> The field of sports marketing is now replete with experienced consulting firms that regularly assist buyers and sellers in the huge market of commercial sponsorships of both college and professional sporting events and facilities.<sup>250</sup> These experts have developed techniques for valuing sponsorships, not as a matter of scholarly curiosity, but rather in response to market demand. Sellers of sponsorships want to maximize revenue,<sup>251</sup> and purchasers want the biggest brand name exposure at the lowest cost possible.<sup>252</sup>

This Article’s balanced proposal will allow the tax consequences to match the economic substance. If a college athletic program provides more than *de minimis* advertising benefits to a sponsor, the college will pay tax on part of the income derived; if the sponsor pays an amount in excess of the value of the basic advertising benefits received, the college will treat that portion as a tax-free charitable contribution.

Current law creates an artificial incentive for colleges to promote athletics and to commercialize their athletic programs. This Article’s proposal seeks to end neither college athletics nor commercialism on campus. Instead, it seeks to properly tax a college’s athletic sponsorship income. Proper taxation will assist colleges in appropriately balancing education and big-time sports, will raise significant tax revenues, and will help clarify the debates about big-time athletics and commercialism on campus.

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<sup>247</sup> See I.R.C. § 513(i) (2006); see also *supra* Part II (discussing that if the commercial sponsorship payments are not contingent on viewership, and the recognition of the sponsor does not refer to price, or make comparisons to competitors, the college receives the sponsorship revenue tax free).

<sup>248</sup> Congress enacted the current rule in 1997, and authors published a leading article discussing the calculation of naming rights based on the advertising impressions in 2001. See *supra* note 23 and accompanying text.

<sup>249</sup> ZIMBALIST, *supra* note 121, at 4; see also BURTON, *supra* note 63, at 49 (naming rights exploded in the 1990s).

<sup>250</sup> See *supra* notes 77–90 and accompanying text.

<sup>251</sup> See *supra* notes 89–90 and accompanying text.

<sup>252</sup> In some situations the commercial sponsor may pay more than the market value of non-charitable advertising impressions to affiliate with a venerable educational institution. See, e.g., *supra* notes 3–6 and accompanying text. The commercial sponsor may pay this excess to enjoy the “halo effect.” See Knauer, *supra* note 9, at 7 n.27.

## APPENDIX: PROPOSED STATUTE

New I.R.C. § 513(i) [replacing current I.R.C. § 513(i)]:

**(i) Treatment of Certain Sponsorship Payments****(1) In General**

The term “trade or business” shall include any activity carried on for the production of sponsorship payments, directly or indirectly, in connection with postsecondary sports programs, even if carried on within a larger aggregate of activities or endeavors which may be related to the exempt purposes of the organization.

**(2) Calculation of Income**

The gross income from sponsorship payments may be calculated based on the fair market value of comparable advertising impressions in a non-charitable context. In calculating the amount of unrelated business taxable income, only expenses directly connected to the sale and furnishing of advertising and related services to the sponsor shall be deducted, and no expenses relating to any athletic program generally, including but not limited to expenses of preparing for and playing the games, or for the sports facilities or equipment, may be deducted.

**(3) Sponsorship Payments**

For purposes of this subsection the term “sponsorship payment” shall mean any payment made by any person engaged in a trade or business under an arrangement or expectation that such person shall receive benefits in the form of naming rights, advertising benefits, or the use or acknowledgment of the name, logo, or product line of such person’s trade or business in connection with a sports activity of one or more postsecondary educational organizations that receive such payment, or any similar benefits.

**(4) Limitations**

The term “sponsorship payment” does not include:

- (A) any payment that does not exceed [a monetary threshold]<sup>253</sup> (the Secretary is authorized to issue regulations treating multiple payments to the same recipient or related persons as a single payment);
- (B) any payment if the only benefit described in paragraph (3) is an incidental acknowledgment as defined by the Secretary in Treasury Regulations or other guidance;
- (C) any payment which entitles the payor to the use or acknowledgment of the name or logo (or product lines) of the payor’s trade or business in regularly scheduled and printed material published by or on behalf of the payee organization;

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<sup>253</sup> See *supra* Part II.C.3 (providing guidance for establishing the monetary threshold).

- (D) any payment made in connection with any qualified convention or trade show activity (as defined in subsection [I.R.C. § 513](d)(3)(B)); or
- (E) any transfer of property (and not money) used directly by players in conducting a postsecondary sports activity, including but not limited to the furnishing of athletic shoes, uniforms or other items, in connection with an endorsement by the postsecondary organization through the use of the shoes, uniforms, or other items by team members.

**(5) Reporting Requirements**

Any party paying or receiving any sponsorship payment, directly or indirectly, shall comply with any reporting requirements prescribed by the Secretary, in Treasury Regulations or in other guidance.

EFFECTIVE DATE

New I.R.C. § 513(i) shall apply to sponsorship payments made under arrangements entered into on or after the date of enactment.

DRAFTING NOTES

The proposed statute borrows from I.R.C. §§ 513(c) and 513(i). New I.R.C. § 513(i)(4) would exclude five types of payments. The first exclusion is for sponsorship payments below the monetary threshold as discussed in *supra* Part III.C.3. The threshold amount should be set to allow relatively small sponsorship arrangements to proceed without excessive administrative burdens. The second exception excludes sponsorship payments when the only advertising benefit provided is an incidental acknowledgment as described in *supra* Part III.C.3. The third and fourth exceptions allow current law to continue to tax print advertising income and exempt income from qualified convention or trade show activities. The fifth exception excludes transactions involving in-kind transfers of property (including athletic shoes) used in athletic activities, and related endorsements of the products. As described in *supra* Part III.C.5, special rules are appropriate for shoe deals and other similar endorsements because of the other benefits provided to the supplier (such as the potential lifelong patronage of the student athletes).