

IRS Memo Questions Tax-Exempt Status of NIL Collectives

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In a June memo released by the Office of the Internal Revenue Service (IRS) Chief Counsel, the IRS announced its position that, in most cases, it does not believe name, image, and likeness (NIL) collectives qualify as tax-exempt organizations under the Internal Revenue Code (IRC). Although not legally binding, the decision will likely have a significant impact on existing NIL collectives organized as nonprofits and granted tax-exempt status by the IRS.

NIL Collectives

As we've previously reported, the National Collegiate Athletic Association (NCAA) adopted its Interim NIL Policy, effective July 1, 2021, allowing student-athletes to profit off of their NIL for the first time in NCAA history. For the past two years, college athletes have reaped the benefits through endorsement deals, social media promotions, appearances, autograph signings, camps, and a variety of other means.

NIL collectives were formed to help college athletes maximize their NIL opportunities. These organizations are exclusive of the schools' athletic departments, often formed by boosters, fans, and local businesses to pool contributions and facilitate NIL opportunities for athletes by partnering with local businesses and charities.

Many NIL collectives have organized, at least in part, as nonprofit entities under IRC section 501(c)(3). Once NIL collectives are granted 501(c)(3) status by the IRS, they can accept tax-deductible contributions for donors. The NIL collectives then distribute the funds from these tax-deductible donations to student-athletes, who are typically asked to perform charitable services in exchange for any payment received.

IRS Memo: In Most Cases, NIL Collectives Do Not Serve Exempt Purpose

NIL collectives' tax-exempt status has always stood on somewhat shaky legal grounds. In most cases, these organizations are generally organized to serve some charitable ends, but their predominant purpose is to financially benefit college athletes. Any benefit to charitable institutions or other qualifying exempt purpose is, at least according to the IRS, merely incidental.

To qualify as tax-exempt or maintain tax-exempt status, a nonprofit entity must serve an exempt purpose under section 501(c)(3). There are numerous exempt purposes, but the IRS summarizes the exempt purposes as being limited to "charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals." Importantly, even if a nonprofit does provide some benefit to one or more of these purposes, the entity will likely only receive or maintain tax-exempt status if it does so exclusively. As stated in the memo, "[a]n organization will not be [tax exempt] if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." In other words, any non-exempt purpose served by the nonprofit may only be incidental.

Relatedly, the organization must principally benefit the public rather than any private interest:

[The] organization must establish that it is not organized or operated for the benefit of private interests . . . An occasional benefit to private interests, incidental to an organization pursuing its exempt purpose, will not generally cause an organization to impermissibly serve private interests. However, where an organization serves both public and private interests, the private benefit must be “clearly incidental to the overriding public interest.”

Applying these principles to NIL collectives, the IRS found that, in most cases, NIL collectives likely do not serve an exempt purpose. Instead, the “private benefit [received by student-athletes] is not a byproduct but is rather a fundamental part of a nonprofit NIL collective’s activities.” In support of this conclusion, the IRS also highlighted that the private benefit extends beyond compensation, as NIL collectives often provide a litany of services to student-athletes:

NIL collectives relieve student-athletes of the transaction and compliance costs they would otherwise incur to participate in an NIL deal. These activities include, but are not limited to, identifying and vetting partner charities, negotiating the terms of an NIL deal, and ensuring compliance with state NIL laws and university-specific NIL policies. Some collectives also provide additional services such as financial planning, tax assistance, legal advice, and assistance in personal brand development.

Furthermore, student-athletes are not the only individuals receiving private benefits. NIL collectives also provide tremendous indirect support to the coaches and recruiting staffs of NCAA programs: “Given the role that NIL collectives play in student-athlete retention and recruitment, and the presence of other factors listed above, it is apparent that helping student-athletes monetize their NIL is a substantial nonexempt purpose of many nonprofit NIL collectives.”

Together, the IRS concluded the benefits provided to student-athletes, athletic departments, coaches, and college recruiting staffs override any charitable cause served by NIL collectives.

Conclusion

The true impact of this decision remains to be seen. As noted above, the memo is not binding legal precedent but is, at present, only an interpretation by the IRS’ Office of the Chief Counsel. The ruling should have no impact on NIL collectives already organized as a for-profit entity, but there may be significant consequences for nonprofit NIL collectives.

This article is general in nature and does not constitute legal advice. The authors of this article, Tate Thompson and Curry Sexton are members of Seigfreid Bingham’s Sports and Entertainment Industry Group and routinely represent clients in collegiate athletics. If you or your organization have questions about the impact of these developments, please contact Tate or Curry at 816.421.4460.